

TAXATION IN THE SOCIETY OF TOMORROW

ARTHUR B. C. DRACHE*

Kingston, Ontario

Introduction

Traditionally, when one is asked to consider legal problems, one usually is caught up in the "is and ought to be" type of analysis. However, the editor of this special issue is concerned with still a third aspect of law . . . the future development.

For the writer, this poses a difficult problem, because he is not asked what should be the course of development, the traditional "ought to be" situation, but is, in effect, asked to predict the future role of law in a society of which he can, by definition, know little about.

The first step, therefore, must be to determine how society is going to develop. Once one makes that determination, some assessment can be made about the forms of law which will be necessary in that projected society.

Therefore, unlike the case of the "normal" law review article, there is little opportunity for the making of value judgments.

In this article, I have predicated the society towards which I believe we are moving. It is a society of under-employment, of non-employment, a society wherein bigness and efficiency become all important.

Many of the aspects of such a society can be easily seen today. Many take the view that anything which is bigger and faster and more efficient is better. As far as attitudinal changes are concerned, we can see around us a marked difference in viewpoint about traditional values between those born before World War II and those born afterward. The so-called generation gap probably is just the start of a change in the attitudes of society which will eventually touch us all.

To some, the world which I describe in this article and the development which I term inevitable in the area of taxation will be an anathema. To others it will simply be a logical and desirable development.

* Arthur B. C. Drache, of the Faculty of Law, Queen's University, Kingston, Ontario.

However, to a legal futurist, there is no need to make moral judgments. The world is changing and unless there is a reversal of the current trends, the society described will be upon us by the turn of the century. If there is no reversal, our legislators will have to cope with the problems posed, and I suggest that the most effective resolution of those problems will take substantially the form which I suggest in this article.

A Tax-Transfer System for the Society of the Future

It has been said that there is nothing new under the sun. Taxation has been with us from pre-Biblical times and in one form or another has survived to the present day. If there is one thing we can count on, it is that in the super industrial society of the future we will continue to have a system of taxation. The irony, however, is that in all likelihood, in its essence, taxation will more closely resemble Biblical taxation than the system we presently have.

Joseph, when he came to power in Egypt, imposed heavy taxation in the fruitful years in order that there be enough food to feed the populace in the years of famine. The system could be termed a tax-transfer system, not dissimilar to proposed guaranteed annual wage which will undoubtedly be the rule in North American societies within two generations. Joseph, however, was ahead of many of the current theorists in that he saw from the outset that no transfer system could be feasible without a co-ordinated tax system to finance it. Any contemplation of a tax system in the society of the future must be inextricably linked to and capable of financing some form of massive transfer system which the technological era demands.

The super industrial society of tomorrow will bring with it many problems analagous to the classic depression situation . . . large pools of labour willing and able to work and still unable to find jobs, yet having to support families. As Joseph foresaw, some governmental action on a vast scale will have to be undertaken to meet the challenge.

Modern taxation in Western societies has passed through two main phases and is now groping toward the inevitable third phase.

Phase one starts with the implementation of a tax system, often in response to government's need for unusual revenues to meet some crisis, usually a war. In this phase, the system is comparatively primitive in its operation, and this often manifests itself in a very short and seemingly comprehensive taxing statute. There is little in the way of tax planning done in this phase. The populace at large responds to the system by the most direct means available to it . . . tax evasion. That is, a large percentage of the citizens simply do not report their income. Given a decade or so,

the legal and accounting professions respond to the challenge and begin devising techniques to avoid taxation through legal means. In this endeavour, they are usually aided and abetted by the courts which take an extremely legalistic approach, couching their judgments in terms of "strict construction".

The legislature must then respond to avoidance techniques heralding the advent of phase two. The response takes the form of amendments to the statute which are designed to "plug up loopholes". The character of the statute undergoes a radical change, becoming increasingly bulky and very technical. In this phase, substantial government tampering also takes place in order to "recognize special situations" and to stimulate the economy. Soon, a cadre of "tax experts" grows up, people who spend almost all their time dealing with the tax statute, and non-experts are gradually foreclosed from the field. Eliminating the non-expert in turn deprives the vast majority of citizens of even basic tax planning thus producing the effect that the wealthy can avoid taxes to a considerable degree while the less well-off carry a disproportionate tax burden. This, in turn, leads to so-called taxpayer revolts.

The taxpayer revolt makes taxation once again a political issue and the elected representatives must meet the challenge. Usually what happens is that a Royal Commission or its equivalent is appointed. It brings in recommendations which would restore equity to the system, but usually these recommendations are rejected by the government for "political reasons". The government then attempts to reform the tax system on its own, and succeeds only in making the statute even more complex, exacerbating the very problem it was trying to alleviate. It must then resort, in order to protect revenue, to a series of arbitrary administrative acts, usually embodied in the tax statute, designed to deem certain types of receipts as income notwithstanding the legal form of the transactions which gave rise to the receipts. This type of legislation, an anathema to lawyer and taxpayer alike, can only be utilized for a relatively short period of time. At some point, the whole structure must fall of its own weight, because the system is moving towards a point where the taxing authority will simply impose an arbitrary tax based on a "gut reaction" as to what the taxpayer should be paying.

In this eighth decade of the twentieth century, a number of developments are taking place in society which must inevitably be reflected in the tax system. Technology is displacing large numbers from the work force and even more importantly, jobs which in the past would have been opened as a result of economic expansion do not arise. In the private sector we have now large numbers of "working poor", people who hold down full-time jobs at what used to be considered decent salaries, who cannot afford

the essentials of modern life. Very often, these people could be replaced by machines. In the public sector, usually politics rules out mass dismissals of people whose jobs are redundant. Further, government cannot afford to pay "starvation wages" and as a result large numbers are being paid wages which are far out of line in terms of the services performed.

In this eighth decade, we have not as yet accepted the inevitable . . . that efficiency and finances require ever-increasing mechanization and that the mechanization must in turn mean that large numbers who are gainfully employed will lose their jobs. In some areas, a phasing out is occurring where retiring workers simply are not replaced, but in many other areas, men are being paid for doing nothing though they formally have a job.

What must inevitably occur is that being unemployed will carry no stigma in the future. The very term "unemployment" will disappear and be replaced by the non-pejorative term, non-employment. This will require us to meet two major challenges, equally vital. The first will be to educate society that it is no sin not to work, and that in many instances non-employment may be the greatest contribution a man can make to society. This will probably come about slowly, first through a shorter and shorter work week where, in effect, two or more men hold down a job now occupied by one man, each working perhaps fifteen hours a week so that there is no social stigma attached to an individual because he does not have a job. The concomitant of this, of course, is that the individual must receive adequate compensation. This cannot come directly from his employment, for more pay for less work must only make our present fiscal position inestimably worse. Rather, every individual, or family unit, will receive a government payment, automatically, to bring him to an acceptable financial level. What he earns at his job will represent merely a taxable increment over this level.

In other words, we shall move not only to a system in which there is a guaranteed annual wage, but to a system wherein the fact that a person is non-employed carries with it no social stigma.

In contemplating such a plan, we should be aware of the fact that we have been moving towards it since 1945, albeit in a shockingly inefficient manner. The notion of an acceptable level of four per cent unemployment carries with it the realization that we will never again see "full employment" in the lay sense of the phrase. There will always be with us able-bodied people who wish to work and cannot find jobs. This, to a great extent, is an acceptance of the fact that the technological era is upon us. What we have not been able to deal with is the social stigma which has been attached to these unemployed.

To some extent, this is because of the nature of the "aid" we

give them . . . welfare, unemployment insurance and the like which are inadequate to keep them even at the poverty level and which create pockets of poverty all over the country. An adequate transfer scheme which would allow such people to live a decent life would go a long way to remove the pejorative labels which have been attached. Further, we must recognize that the removal of a substantial portion of the population from the work force may well be a benefit to society.

Since the end of World War II, Canadian governments have been committed to transfer systems without means tests. The baby bonus and the old age pension are just two such programmes which spring to mind. With such an attitude embodied in existing statutes and national consciousness as to the young and the old, it is not irrational to take the same approach vis-à-vis payments to all. The welfare system, which is the classic example of a system which demands a means test, is undoubtedly the most inefficient and inhumane of all our transfer systems, with "midnight raids", often officious and insulting bureaucrats and the most terrible connotations involved in "being on welfare".

Why should there be a stigma attached to getting welfare if one is able-bodied and unable to find work while no such stigma attaches to the elderly who draw an automatic pension or a newborn child who gets the same? Technology has prevented these people being employed just as age has mitigated against the very young and the very old.

Once society recognizes that the work ethic is not all-important and that more and more able-bodied people will be unable to find jobs in a super industrial society, and indeed that it may be to society's benefit that these people do not work, we will be ready to move into the third phase of tax development, which will co-ordinate the logical development of the tax system and the needs of the technological society.

Phase three of tax development is to some degree a return to phase one. In phase three, the tax system is returned to simplicity. In this case, however, the simplicity is one of comprehensiveness of the tax base. That is, the tax system is rewritten to include in income virtually all receipts. Such a system does not distinguish between capital gain and income, the profits of a corporation and those of its shareholders, the receipt of a gift, an inheritance or a salary. Such a scheme may sound familiar to many readers as indeed it should. Such was the plan proposed by the Carter Royal Commission on Taxation which was deemed by the governments to be politically impossible. In fact, Canadians have been given the plan for the future and have rejected it. But nobody who understands taxation can doubt that this is the position to which we are moving.

The Carter proposal also envisaged such things as taxing the family as a unit, surely the most logical unit in the modern world. It planned to do away with Ministerial discretion. It planned to do away with sales taxes, the most regressive of all our myriad taxes. In fact, though the *Carter Report* did not consider the transfer side of the equation, it did in fact propose the tax system which is a pre-requisite for the implementation of a transfer system of the future.

It cannot be seriously doubted that Carter outlined the tax system of phase three. All over the world, the *Report* is accepted as being the blueprint of the "ideal" tax system, one against which all other systems and proposals are measured. Probably no single "law" document ever produced in Canada has had such an international effect.

The importance of Carter is that it recognized that most of the complaints about the tax system were justified, and that most of these complaints could be alleviated by the relatively simple expedient of not distinguishing between types of income. It came to be known derisively in Canada as the "buck is a buck" system, but in point of fact, the truth in taxation is as simple as that.

Just as the penal system has been ineffective because nobody is certain as to the proper role of the penitentiary, so the tax system has been undermined by trying to use it in too many ways. The tax system should raise revenue, pure and simple, and it should raise it in the most equitable way. The powers that are in this country and in others have not as yet grasped this simple notion but sociological and technological developments must inevitably bring them to the point of understanding. And the most important use to which the revenue raised must be put is the maintenance of a decent life style for citizens in the face of technological change which the individual cannot cope with.

Only three things probably will be added to the Carter proposal. Firstly, the inclusion of imputed income for owner occupied housing, which is a necessity from both the equity point of view and the revenue point of view. Secondly, a proportional rate of tax at a relatively low figure (probably forty per cent) doing away with all personal exemptions. And finally, perhaps more from a political than a fiscal point of view, a wealth tax, to replace various death duties in order to keep wealth from accumulating to an inordinate degree.

The taxation of corporations in the super industrial society of the future will reflect the major changes which will take place on the personal side. To put none too fine a point on it, corporations will not be taxed, they will simply serve as a source from which tax is withheld while profits are en route to the shareholder. The

introduction of a proportional rather than a progressive tax system makes this the logical extension.

Once again, we have to look only to the Carter proposal for full integration. The Carter view reflected the view that the corporation is simply a legal fiction agglomerating individual shareholders. One of the primary roles of the corporation today from a tax point of view is the accumulation and retention of income. That is, as long as it is possible to retain earned income in a corporation at true tax rates which are lower than those of the corporation's shareholders, income will be retained. Much of our tax jurisprudence revolves around attempts of taxpayers to postpone taxation in this manner and governmental response to prevent it.

The logical technique, once one has a proportional tax, is to simply impose the tax at the corporate level, and allow the distribution of dividends free of tax. This, after all, is simply a variation of Carter's corporate integration scheme.

The technique works equally well for multi-national corporations. Withholding taxes ostensibly would be at the same level as ordinary internal taxes, so that the residence of the owners of the corporation would make no difference. Thus, those corporations which benefit by carrying on business in Canada (and of course their shareholders) will have to pay their fair share of society's upkeep.

In this super technological, super efficient world, there will be an ever diminishing role for the small corporation. This diminishing role should be recognized by the elimination of the various "small business preferences" which have riddled our tax structure for the past three decades. There is no rational reason to encourage small business through the tax system. If businesses are successful, they will grow. And if the nature of the business (such as the corner grocery store) is such that society wishes it to be small, society can and will pay the price in purchasing from that business directly, not through the tax system. Even today, many women will pay higher prices at a small corner grocery store in order to get personal service and convenient shopping, rather than go to one of the huge supermarket chains. This is as it should be. Smallness may be a virtue in some instances, and if this is the case, the consumer, not the taxpayer, should pay the price.

For those industries which wish to grow, direct government aid should be available, not the indirect and inefficient system which we now have burdening the tax system.

The reaction of business to the Carter proposals is particularly instructive in that it typifies the reaction of the public at large when faced with change, no matter how beneficial. For years it has been axiomatic that business has wanted lower taxes on corporations. When taxes are cut by ten per cent, the government is

given praise in the most generous fashion. But when the government proposed to go all the way and *de facto* eliminate corporate taxes completely, the business community rose as one to protest. Even the most sophisticated businessmen apparently were unable to grasp what was being offered. All they were able to see was something new and "radical" which would force them to change their traditional patterns, and they rejected this.

It is true, of course, that such a plan would in fact make it unattractive to retain earnings and finance growth in that manner. Under the present system, growth to a great extent is financed by low tax dollars and therefore subsidized by the taxpayers at large while the shareholders get a deferral. Under the new system, it would remain open to corporations to retain earnings, but in this case, the growth is financed by fully taxed dollars and the burden of expansion is borne by the shareholders of the corporation, not the populace at large.

In the more socially aware tax system of the future, the present situation could not be allowed to continue.

The advent of the computer, available not only to corporate giants, but to smaller concerns through their accountants, makes the "paperwork" involved almost negligible, and allows for fast and efficient reckoning at each year end.

The fear has often been voiced that such a system would drive many businesses out of the country. But in the day of the multinational corporation, this cannot be so. Corporations are in Canada usually for one of two reasons; either to serve the domestic needs of Canadians (and make a profit doing so) or by exploiting the natural resources of the country. In either case, physical and tax presence is a necessity. Those corporations which have been held up as an example as having "fled the country" are usually, on close examination, holding corporations which do little or nothing for the country, and are present in Canada because of an accident of geography or because of favourable tax laws.

Of course, it should be pointed out that the changes being considered in this article, though discussed primarily in the context of Canadian society, will not take place in a vacuum. In referring to three phases of tax development I referred to developments in Western society. The phenomena which I have been discussing are occurring in the United States and in other industrialized societies. The development will take place in other countries as well, and the day is rapidly approaching when there will be no hiding place. Even today we have passed the point where a large multi-national corporation can operate from some remote island or from the top of an Alp. The heads of such corporations have

already learned that they must be where the action is, and damn the taxes.

Even without a transfer system, such a scheme will be adopted in the future because only such a plan responds to all the criticism of the tax system which is mounting at the present time. Such a scheme eliminates very high rates, eliminates the loopholes which are available only to the wealthy, creates both vertical and horizontal equity and at the same time does not impair governmental revenue. But it does one more thing in the world to which we are moving: it allows government to raise the revenue necessary to finance the transfer system which will be the *sine qua non* of Canadian society fifty years hence.

The transfer system itself must have two crucial characteristics. The payments will have to be universal with no means test and the payments must be adequate to at least the so-called "poverty level". In the literature of transfer schemes this is known as the "social dividend" approach.

The universality is important for two reasons. First the major benefit which we are attempting to get is equivalent to every resident being on a salary, guaranteed as long as he lives in Canada. Secondly, and more importantly, universality will remove the stigma of receiving a handout. If every family unit from the Prime Minister's on down receives a cheque each month, the mere fact of reception carries with it no negative connotations. This is the case at present with the baby bonus and the old age pension. **The removal of negative connotations will herald a major step to public acceptance of non-employment and under-employment. At the same time, the proposed forty per cent tax rate on other earnings is low enough to ensure that those jobs which must be filled by humans will not go begging, for such a rate does not discourage incentive.** As a technical matter, the payments themselves will not be subject to tax, which makes the elimination of personal deductions, themselves inherently regressive under our present tax system, possible.

The second major characteristic mentioned was adequacy. At the present time, those working in the area have come up with the notion of a "poverty level". Such a level is, of course, entirely artificial, but it purports to denote some level of income which is minimal to decent survival. In the *Senate Report on Poverty*, \$5,000.00 was said to be the poverty level for a family of four in Canada in 1969. It is obvious that the selection of the level is important only at the bottom end, that is, it must be a figure which allows the unit to live decently. The upper end simply is a matter of finances: how much can the country carry in the way of direct transfer payment?

This raises the inevitable question of the cost of the plan. While it is outside the scope of this article to cost out such a scheme, it has already been done in a number of places and the conclusions are uniform¹ . . . we could at the present time, given an overhaul of the tax system along the lines suggested in Carter, with some modifications, afford such a tax transfer scheme today. The problem, of course, is not a fiscal one. The problem is that most citizens are living in the past, the past of the Protestant work ethic, the past in which it is a shameful thing to be unemployed (notwithstanding the fact that your employment might be socially useless) and the past in which government should step in to help a citizen only if he could not, because of physical or mental disability, help himself. Members of this society have not as yet realized that society has changed and will change even faster and that no individual can cope with the changes. The ethic of the past is hampering the development of future change. If we are to have the full benefits which flow from improved technology we must recognize that we must change our attitudes.

Conclusion

What are the alternatives? If we continue along the path we have been following up to the present time we will be faced with a society in which larger and larger numbers of people are unemployed or under-employed because of technological advances. It is obvious even today that we are talking here not only of the under-educated, but equally of those who have had many years of post-secondary training.

It will become increasingly important to have a transfer system which is both adequate and efficient. Changes such as have been recently contemplated in Canada which eliminate universal benefits and make increased transfers to those who are in need are inadequate because the day is coming in which huge numbers will be in need, unless an overall programme is introduced.

The current system of taxation is inadequate for it is backward looking, born in a day where full employment was not of necessity a myth. The notion of personal deductions to allow for living expenses, for instance, contemplates that everyone is able to earn enough to benefit from the exemptions. The benefits for farmers reflects the myth of bucolic paradise which should be encouraged. Tax benefits for non-residents reflects the already outmoded view

¹ The best work to date outlining a plan for a tax-transfer system for Canada is an unpublished LL. M. Thesis by Richard Green done at Queen's University, 1972. Two other attempts to cost out such a scheme are: Crowley and Dodge, *Cost of the Guaranteed Annual Income* (1969), 17 Can. Tax J. 395; and Drache, *A Positive Approach to a Negative Income Tax* (1972), 18 McGill L. J. 105.

that we should encourage foreign investment in Canada. This is the statute of the past, which we have spent the past ten years modifying in the name of reform, without any substantive reform whatsoever.

The primary role of the tax statute of the future will be the raising of revenue to finance an adequate life style for the citizens who become victims of technology. In a future society, one-half the present work force may produce double or treble the current gross national product. It will be desirable to get the benefits of scale, not only in industry but in agriculture as well. The income tax statute of the future must encourage scale, not smallness.

Perhaps the ultimate irony is that the proposal which came forth in this country in 1966 can, for the most part, meet all these criteria. In addition, it also meets the current criticisms which are rightfully levelled at the present statute. The most charitable conclusion one can come to is that the authors of the *Report* were ahead of their time.

The changes are inevitable. The sole question is whether we will drift towards them in a piecemeal fashion or whether those who are charged with making the decisions will have the vision to take the great leap forward into the future. Historically, it would seem that legislators never anticipate the changes. It is to be hoped that for the sake of the next generation, this pattern will be broken, for if it is not, hundreds of thousands will pay the price of their lack of foresight.
