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The ARNOLD REPORT

Brian J. Arnold

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The Grand Old Man of Canadian Tax

You may have seen him at a Canadian Tax Foundation conference or an IFA Congress. He walks slowly, recently with a cane, and he always sits in the front row, often with his son. He is portly and reminds me a little of Peter Ustinov, the distinguished British actor (without the beard). His eyes are bright and intelligent and his smile is kindly. He is still working at the age of 84 and, although he may be slow of foot, his mind is sharp and active.

Arnold Sherman has been a pillar of the Canadian tax community for as long as I can remember. When I first started in tax, Arnold was the head of tax at Massey-Ferguson, at that time a Canadian corporate icon – the Blackberry of its day – engaged in manufacturing farm and industrial equipment. And I first met him in the early 1980s when I became involved in the activities of the International Fiscal Association. Even at that time Arnold was a fixture at CTF conferences and IFA Congresses and a long-time member of the Council of the Canadian Branch of IFA (from 1973 to the present, which must be a record). If you check the list of registered participants for each year's annual CTF conference, you will see that he is usually the first one to register.

The basic details of Arnold Sherman's life and career make fascinating reading. He was born in Northampton, England in 1931. He qualified as a chartered accountant in 1954 and began doing audit work for an accounting firm in London, associated with Arthur Andersen. After a few years, in 1956 he decided to emigrate to Canada (Why Canada? Because Australia and New Zealand were too far away and he didn't fancy the US) He started working in audit in Toronto with Clarkson Gordon, a prominent Canadian firm that got gobbled up by Ernst & Young. While working for Clarkson Gordon he met Kerr Gibson, the sole tax partner, who, according to Arnold, was brilliant and probably the last person who knew everything there was to know about the Canadian income tax system.

Arnold spent over 2 years auditing with Clarkson Gordon, but he knew there was no future for him in audit. He had always been interested in tax ever since winning the tax prize in his CA course (he had even bought and read a couple of books on Canadian tax before emigrating). Clarkson Gordon tried to get him a position but anti-Semitism was widespread in those days and Arnold found it difficult to get a suitable position. After a year with Rio Tinto, he joined Massey-Ferguson and spent 17 years (1960-77) with the company, the last 15 years running the head office tax department. In the early years he was forced to teach himself tax and then to convince the company to treat international tax planning as a proactive exercise. He recounted to me an incident in which he saved $5,000 (a substantial sum at the time) in personal tax for the CEO and learned the valuable lesson that saving a small amount of personal tax for the CEO was as good as saving millions for the company.

While with Massey-Ferguson, Arnold became interested in Brazil and spent 2 ½ years living and working in Sao Paulo, where he learned to speak, and still speaks, fluent Portuguese (a remarkable achievement). As his replacement in Toronto during his stay in Brazil, Arnold picked a bright young man from the Netherlands – Maarten Ellis. Maarten went on to international tax prominence as the managing partner with Loyens & Volkmaars in Amsterdam, then as secretary-general of the International Fiscal Association, and finally as a senior adviser to the Dutch government.

After leaving Massey-Ferguson in 1977, Arnold moved to Monaco to straighten out the somewhat misguided tax affairs of a major diversified multinational company. He left in 1981 to return to Canada as head of the tax department of Dome Petroleum in Calgary. Dome went into bankruptcy in 1982 but Arnold remained in Calgary and established his international tax consulting firm.

Canadian multinationals and Canadian tax practitioners working in international tax owe Arnold Sherman more than they know. Paragraph 95(2)(a) of the Income Tax Act is a provision in the foreign affiliate property income (FAPI) and foreign affiliate rules that deems interest, royalties and other amounts paid by one foreign affiliate to another foreign affiliate to be income from an active business as long as the payments are deductible in computing the active business income of the payer affiliate. The result is that the income is not FAPI and is included in the exempt surplus of the recipient affiliate. In effect, paragraph 95(2)(a) allows Canadian multinationals to shift amounts from an affiliate in a high-tax treaty country to another affiliate in a low-tax treaty country and convert the character of the amounts from interest, royalties, etc., into a tax-free dividend out of exempt surplus. Paragraph 95(2)(a) is so important that many taxpayers would prefer restrictions on interest deductibility rather than give up paragraph 95(2)(a).

When the FAPI rules were introduced in the early 1970s, Massey-Ferguson had a tax haven company that received huge royalties from Massey-Ferguson subsidiaries in the United Kingdom and the United States. The royalties would have been FAPI, resulting in a substantial Canadian tax bill. According to Arnold's calculations, it would have been much cheaper for the company to leave Canada than to pay the tax. Arnold made submissions to the Department of Finance on behalf of Massey-Ferguson, in particular to Alan Short (for whom Arnold expressed great admiration and respect) and the unthinkable was avoided through the introduction of paragraph 95(2)(a).

I asked Arnold how the tax profession has changed over the years. He replied that one of the major changes is that tax avoidance is now widely considered to be bad – a result he blames on the media. Some tax professionals have always engaged in inappropriate behaviour but these few bad apples should not taint the entire profession. Arnold considers the idea of a special designation for Canadian tax professionals – an idea currently being debated by the Chartered Professional Accountants of Canada and the Canadian Tax Foundation – to be an excellent one. He is a Chartered Tax Adviser, the designation provided by the UK Chartered Institution of Taxation, and until recently was a member of its international committee. According to Arnold, there is a need for some institutional mechanism for tax professionals to provide input to government (both Finance and the CRA) on tax matters. The Joint Committee and the Tax Executives Institute do a good job but more focused input from an organization of tax professionals is necessary. He expressed enormous respect for the senior people in the Department of Finance but thought that the legislation could benefit from increased consultation with tax professionals during the drafting phase.

Arnold expressed an interesting perspective on the evolution of the Canadian tax system over the course of his career. The Carter Commission Report and 1972 tax reform were the major defining events and what has taken place since then represents ongoing attempts to refine the rules to broaden the base, close loopholes and reduce rates. He laments the unnecessary complexity of the system. Some complexity, he acknowledges, is necessary "because of people like me." But the complexity caused by the proliferation of tax expenditures – especially the trivial personal ones, which do not belong in an income tax – is avoidable.

I asked him how the Canadian system compared to other tax systems he was familiar with. He suggested that all of the systems were too complex but cautioned that all attempts at simplification that he was aware of had failed miserably. Arnold expressed concern about the extent of tax evasion and corruption in developing countries, although he noted that, as a result of recent developments, there were fewer places to hide illegal funds.

As for tax avoidance, Arnold acknowledged that the general anti-avoidance rule was necessary for Canada and also, more recently, for the UK, once again because of "people like me." A GAAR introduces a lot of uncertainty for taxpayers but that uncertainty must be balanced against the need for the government to counter what it perceives to be abusive tax avoidance schemes. Without any prompting from me, Arnold also pointed out that in his view the *MIL (Investments)* case was clearly wrongly decided. I asked Arnold if he had any advice for young people embarking on careers in tax. He suggested that after getting an accounting or law degree – and a double qualification would be even better – young people should try to get broad experience in tax rather than specializing too early. Thus, he thought it might be better for young professionals to avoid the large law and accounting firms and seek out boutique tax firms doing a wide range of tax work.

Finally, I asked Arnold if he had to do it all over again, would he do something other than tax. He didn't hesitate in telling me that he would never consider doing anything else and that he was still enjoying it. As an afterthought, he said he might do some law in order to complement his accounting background.

Arnold has many publications on tax matters to his credit, including many articles for the Canadian Tax Foundation (including an article about the FAPI rules in the 1972, vol. XX, no. 5 Canadian Tax Journal, with the catchy title "How to Kill a Mouse with an Elephant Gun, or Foreign Accrual Property Income: Some Problem Areas") and a major book on the tax aspects of immigration to and emigration from Canada (*Migration Canada*, published by Kluwer in 1985). He was the Canadian representative on the Business and Industry Advisory Committee (BIAC) for 9 years; that Committee provides advice to the OECD on behalf of the business community. He was also a member of the Tax committee of the Canadian Chamber of Commerce from 1977 to 2000, and has been a quality control consultant to the IBFD from 1994 to the present.

Arnold is still based in Calgary and actively advising clients on international tax issues through his professional consulting firm, which is part of an international network of tax advisers. He has 3 children: David, who is a well-known tax lawyer, editor of the popular *Practitioner's Income Tax Act*; Jeffrey, who is a chartered accountant and the author of many finance and accounting publications; and Angela, who is an engineer. He has 7 grandchildren and 6 great-grandsons, none of whom has shown any interest in tax … yet. In addition to visits to and from family during the good weather, Arnold spends his spare time reading (science fiction – I would never have guessed) and watching movies. He doesn't have an all-time favourite movie, but The Sopranos is his favourite TV series. Every year he takes a cruise with one of his grandchildren.

Arnold Sherman – a fascinating man, a treasure for the Canadian tax community, and a remarkable career worth celebrating! Thank you, Arnold.