Fair and Progressive Taxation

Introduction

Successive tax cuts largely for the benefit of corporations and the affluent have reduced the federal government's tax revenues to the lowest share of the economy they have been in 70 years.[1] As a result, Canada has an increasingly regressive tax system and shrinking revenues that are being used to justify spending cuts, wage suppression, and inadequate support for public services.

There is now broad recognition that these types of regressive tax cuts have failed to stimulate the economy. The federal government's halving of its corporate tax rates and reduced tax rates on investment income were supposed to boost the economy through increased business investment. Instead, these tax cuts have been associated with lower rates of business investment, slower productivity growth, and stagnant wages.[2] Instead of trickling down for the benefit of all, they have resulted in a greater concentration of economic and political power in the hands of a select few, promulgating even more regressive economic policies.

The growth of citizen-based organizations advocating for fairer taxation around the world and in Canada — including Canadians for Tax Fairness, Doctors for Fair Taxation and Attac-Québec — have helped turn the tide towards more progressive taxation. Traditionally fiscally conservative organizations such as the International Monetary Fund have suggested governments increase taxes on top incomes and on wealth.[3] Even some of the world's most renowned investors — including Warren Buffett and Bill Gross, manager of the largest mutual fund in the world — have urged governments to increase taxes on top incomes and eliminate the tax breaks that allow investors to pay much lower tax rates than working people.[4]

Other governments have taken steps to reverse the regressive tax trends of recent decades, by increasing top income rates, closing tax loopholes, hiking corporate tax rates, eliminating subsidies for fossil fuels, and introducing taxes on the financial sector.

In Canada, a number of provinces have reversed corporate tax cuts and increased rates on top incomes. The Business Council of New Brunswick successfully urged that province to increase corporate income taxes, stating that previous reductions did not help stimulate the economy, so they didn't see that raising them would hurt much either.[5] However, provinces are limited in what they can achieve alone as differential provincial taxes rates can cause leakages of business to other provinces when their rates are significantly higher.

Unfortunately, the federal government remains far behind the times. Research has found Canada's tax system to be one of the worst in the developed world when it comes to reducing inequality, but already the federal government is planning additional tax measures that will make it even more regressive, including income splitting and increasing the amounts that can be sheltered in tax-free savings accounts (TFSAs).[6] The benefits of both these measures will overwhelmingly go to top incomes and the wealthy.

The federal government's plan for income splitting of up to $50,000 for families with children under 18 will cost an estimated $3 billion in tax revenues annually and an additional $1.9 billion annually for provinces, according to analysis by the Canadian Centre for Policy Alternatives.[7] If income splitting were extended to all families, the federal government would lose $7.5 billion and provinces would lose an additional $4.3 billion.

Doubling annual limits for Tax Free Savings Accounts will accelerate the sheltering of capital assets from taxation, and could lead to a loss of over 5% of federal tax revenues (equivalent to over $10 billion annually for the current year).

There has been a major expansion in the cost of federal tax expenditures, with a large share of the benefits going to higher incomes. One of the major reasons why the top 1% are able to pay an overall lower rate of tax than middle- and low-income taxpayers is because of tax loopholes or tax expenditures, such as the stock option deduction and lower rates of tax on investment income such as capital gains, all of which primarily benefit high-income earners. There is no evidence that these tax policies have been effective or beneficial for the economy, instead they appear to have been detrimental and destabilizing. The existence of these tax loopholes and the ability to evade taxes through tax havens or tax shifting also makes it much more difficult to maintain progressive tax rates. The Parliamentary Budget Office and the Institute for Competitiveness and Prosperity have called for a comprehensive review of all tax expenditures and credits.[8]

Tax measures proposed in the Alternative Federal Budget are based on fundamental principles of good tax policy:

- *Equity:* More revenues should be raised from those with the greatest ability to pay and income from different sources should be subject to relatively similar rates of tax. The tax system should be designed as an integrated system, with relatively more regressive taxes balanced with much more progressive income tax rates and tax credits to make the overall system fair and progressive, and to promote intergenerational equity.

- *Efficiency*: The tax system should be relatively simple, with limited administrative costs for the government with effective enforcement. To minimize economic distortions, taxes should be broadly based, with limited tax exemptions, expenditures or loopholes, except where justified for reasons of equity or effectiveness. It should be simple enough for the public to fill out their tax return without having to pay a high-priced accountant or for tax-filing programs.

- *Effective:* Tax rates should be sufficient to raise revenues to pay for quality public services over the longer term. The tax system can be used to promote economic, social or environmental objectives with varying rates, exemptions, deductions and credits, but these should be limited to instances where they are proven to be more effective and less costly than alternatives.

Major Initiatives

Restore corporate tax rates

The federal government has slashed the general corporate income tax rate down from 29.1% in 2000 to 15% in 2011. This has led to an escalation of corporate profits, but no increase in rates of business investment, productivity or economic growth. Instead, corporations — which have also benefited significantly from other tax cuts — have over $500 billion in cash surpluses.[9] With much of this excess cash going into speculative and other financial investments, these tax rate reductions have contributed to economic instability, slower overall economic growth, and increases in the use of tax havens.

Claims that cuts in corporate and business taxes stimulate growth are based on analyses and data from before the financial crisis, when countries such as Ireland, Iceland and Greece helped lead the race to the bottom by cutting corporate taxes. The result has been devastating.

It would be better for the economy if governments restored corporate income tax rates so they are closer to tax rates on personal income and put the excess cash to work with increased infrastructure investments and improved public services. Every dollar spent on public services or invested in public infrastructure generates an average of five times the number of jobs and amount of immediate economic activity as a dollar spent on corporate tax cuts.

Finance Canada calculated that the federal government would lose $6.1 billion in annual revenues when the federal government announced it was cutting the corporate income tax rate from a planned 18.5% in 2011 to 15% — or $1.75 billion per percentage point.[10] More recently, the Parliamentary Budget Officer (PBO) calculated that a one percentage point increase in the general corporate tax rate would generate $1.85 billion while a percentage point increase in the small business rate would generate $0.59 billion.[11]

The AFB is more cautious in its calculations and estimates that each percentage point increase of the general corporate tax rate would generate $1.4 billion (or 25% less than the PBO estimates) in order to account for tax shifting and economic and behavioural responses. The AFB will restore the general federal corporate income tax rate to 22%, just slightly below its 2006 rate of 22.1%. This will generate an estimated $9.8 billion annually in additional revenues.

As the Canadian Federation of Independent Business has argued, it makes sense to preserve proportionality between the small business rate and the general corporate tax rate, so the small business rate should be increased proportionately with the general rate.[12] Small businesses are less productive than larger businesses and the lower small business tax rate is distortionary, discourages growth and should be phased out.[13] Accordingly, the AFB will increase the small business tax rate from 11% to 15%. This will generate an additional $1.75 billion annually, assuming 25% lower revenues than the PBO estimates.

The additional revenue from restoring corporate tax rates totals $11.5 billion.

As outlined in the Sectoral Development chapter, the corporate income tax rate on the oil, gas and minerals sector will be restored to 28%, the same rate that applied until 2002. These sectors benefit from large direct and indirect subsidies — including tax preferences and low royalty rates — with a large share of the profits going to foreign owners. Canada's wealth of non-renewable resources should be shared, and not exploited and exported at the expense of the environment and future generations. Profit levels in the industry can be highly variable, but the revenues from this higher industry tax rate are expected to average $1 billion annually.

Close regressive tax loopholes and simplify the tax system

Canada's tax system has become riddled with an array of ineffective, regressive, and expensive tax preferences and loopholes. While some tax credits and deductions make sense and are effective and progressive, others do little more than benefit the wealthy and distort the tax system.

The most regressive and outrageous tax loopholes are:

- **The stock option deduction,** which allows CEOs and executives to pay tax on their compensation in stock options at half the rate the rest of us pay on our hard-earned employment income.[14] This loophole is expensive and unfair, costing the federal government $800 million, with 90% of the benefits going to the top 1%. It is also bad for the economy because it creates a big incentive for CEOs to use a company's cash to inflate short-term stock prices through share buybacks, instead of putting it into long-term productive investments.[15] Stock options are so bad for the economy that one of Canada's top business experts, Roger Martin, wrote a book calling for them to be eliminated. Yet still federal and provincial governments continue to provide tax preferences for them.

- **The capital gains deduction** enables individuals and corporations with income from capital investments, such as stocks and real estate, to pay tax on the increase in their value when sold at half the tax rate others pay on income from doing something productive, such as working. This is a very expensive loophole, costing the federal government approximately $9 billion annually, with most of the benefits going to corporations and the wealthiest Canadians.[16] It is also bad for the economy: renown investor Bill Gross, who runs the largest mutual fund in the world recently emphatically stated: "The era of taxing 'capital' at lower rates than 'labour' should end."[17] The AFB would do just this: tax income from capital at the same rate as employment income, after adjusting for inflation. Other existing capital gains exemptions, such as for principal residences, family farming, fishing, small business and personal use property, would be maintained. Net revenues after adjusting for inflation, behavioural and other factors would amount to $8.4 billion.[18]

- **The corporate meals and entertainment expense** allows businesses to deduct half the cost of meals and entertainment expenses, including the cost of private boxes at sports events. This loophole is widely abused, can be used for inappropriate lobbying, and inflates ticket prices, and makes some sports events inaccessible for ordinary Canadians. Eliminating this loophole would save the federal government $400 million annually.[19] It could also make it possible for ordinary fans, without the right corporate connections or oodles of cash, to obtain and afford tickets to sporting events.

- **Tax-free savings accounts** (TFSAs) now provide Canadians with $5,000 each in tax-sheltered investment income every year. That is more than enough: most Canadians don't have any extra money to put into RRSPs, let alone TFSAs. Yet the federal government is increasing this amount by $5,000 per year and plans to increase it by $10,000 a year. This will only benefit the very affluent and will further erode federal revenues, costing over $6 billion annually.[20] The AFB will cap TFSAs at a total lifetime rate of $25,000. The savings from this may be relatively low in initial years, but they escalate in future years.

- **Fossil fuel and mining subsidies**: the federal government still provides significant tax preferences and other subsidies to the fossil fuel and mining industries, including accelerated depreciation, exploration, and development expenses, flow-through shares and mineral exploration tax credits — called one of the dumbest tax expenditures on the books by University of Victoria public administration professor Lindsey Tedds.[21] We don't need to keep subsidizing the rapid exploitation and export of our natural resources at the expense of the environment, future generations and the creation of good sustainable jobs. See the Environment and Climate Change chapter for costing.

The AFB will also eliminate or limit a number of other tax credits and significantly increase funding for public programs — such as for public transit, post-secondary education, child care, post-secondary education, public pensions, recreation programs, research and development, and services for the disabled — where direct funding is more effective and equitable.

The federal government has multiplied the number of boutique tax credits in our tax system. While providing the appearance of doing something, these have achieved little except to complicate our tax system and create work for tax accountants. In addition to eliminating ineffective and regressive tax preferences to simplify the tax system, the AFB will make filing taxes much easier and less expensive by providing online software for free filing of all tax returns through the Canada Revenue Agency. Canadians shouldn't have to spend money—or any more time than is necessary—to file their taxes.

In total, closing these loopholes will save the government $9.6 billion a year.

Increase enforcement and tackle tax havens to reduce tax evasion

An estimated $280 billion is lost from public revenues worldwide from the $20-$30 trillion sheltered in tax havens.[22] Those in low-income countries are harmed most, while banks, big corporations, and the wealthy benefit the most. Canadians for Tax Fairness estimates that Canada loses up to $10 billion annually as a result of the use of tax havens. Estimates of revenue lost just through the operations of Canada's big six banks amounts to between $1 billion and $2 billion annually.

Canadians for Tax Fairness has urged the federal government to reduce the use of tax havens by requiring automatic information sharing between tax authorities, a public registry of ultimate beneficial owners of companies and trusts, increasing compliance and enforcement activities, imposing stronger penalties, and, if necessary, introducing withholding taxes on assets held in tax havens. Unfortunately, the federal government has done little to achieve this goal and has even cut funding for enforcement activities. The federal government has promised repeatedly to crack down on tax avoidance through tax havens, but the problem is growing rapidly worse.

The officially reported assets that Canadian corporations have sheltered in tax havens has grown from $13 billion in 1981 to $74 billion in 2001 and to $165 billion in 2011.[23] At 8% annual average rates of growth, the amount sheltered will increase to an estimated $190 billion in 2013 and over $200 billion in 2014.

Together with much stricter enforcement and international cooperation, the AFB will apply a modest 1% withholding tax on the assets held in tax havens. This is equivalent to or less than what many asset managers charge in management fees and is also equivalent to what they would pay in tax, assuming modest rates of return. It is also consistent with IMF proposals for a 1% net wealth tax. This would generate approximately $2 billion annually and encourage those sheltering their assets offshore to bring their money back home.

Introduce a new top income federal tax bracket of 35% on incomes over $250,000

Canada's most affluent 1% have kept much of the country's income growth for themselves over the past three decades, but pay a lower overall rate of tax than all other income groups, including the poorest 10%.[24]

Because sales, property and other taxes are regressive, we need progressive income taxes (as well as higher taxes on capital, corporate and investment income) to keep the whole tax system fair and progressive.

In 1981, Canada's top federal personal income tax rate was 43% for taxable income over $119,000 (equal to about $295,000 today); now it is only 29% for taxable income over $136,270.[25] This applies whether your income is $150,000 or $15 million. Canada's top rate is far below high income rates in many other countries, including the United States, where income over $400,000 is taxed at a federal rate of almost 40%. Combined with provincial tax rates, Canada's top rate is also considerably below optimal rates of up to 80% as identified by leading economists.[26]

About two thirds of the revenue from an increase in the top rate would come from incomes over $250,000, so after accounting for behavioural responses, tax shifting, and other factors, a new tax bracket of 35% for income over $250,000 would generate revenue of $2.5 billion in 2015.[27]

Inheritance and wealth taxes

Unlike the United States and most European countries, Canada has no wealth, inheritance or estate tax. Property taxes function as a form of wealth tax, but they are ultimately a regressive form of wealth tax because they only apply to gross real estate values, not to net wealth and not to other forms of wealth such as financial and other assets that are more concentrated at the top. Capital gains taxes may be levied on some portion of inheritances, but they don't apply to the base amounts and are often avoided.

The International Monetary Fund recently suggested countries increase high income tax rates and/or also taxes on wealth to generate more revenues.[28] The IMF estimates Canada could generate 0.6% of GDP (or $11 billion for 2014) from a 1% tax on the net wealth of the wealthiest 10% of households and 1.1% of GDP (or over $20 billion) for a progressive net wealth tax of 1% on the top 10 wealthiest and another 1% on the top 5% wealthiest. These are general estimates, but give some indication of the potential revenue that could be generated.

The AFB proposes a minimum inheritance tax of 45% on estates of $5 million or more. It would apply in a similar way as the Estate Tax in the United States, integrated with capital gains taxes, and at similar rates. This inheritance tax would only apply to amounts in excess of $5 million (e.g., after a $5 million deduction). Capital gains taxes would continue to apply for inheritances below $5 million, but at the full rate and indexed for inflation. This means for inheritances of cottages or other property that have been held in the family for decades, taxes would likely be lower than under the existing system.

It is not clear exactly how much this tax would generate, but given that Estate and Gift Taxes have generated between $20 billion and $30 billion in revenue annually in the United States, we estimate a similarly designed estate tax in Canada would generate approximately $2 billion a year in revenues.

Increase taxes on banks and finance

Not only did Canadian banks and other financial institutions benefit more than any other industry from corporate tax cuts, but they also benefit from the exemption of financial services from value-added taxes such as the GST and related provincial sales taxes.

Following the financial crisis, there has been a strong revival of interest around the world in financial transactions taxes (FTTs) not only to help pay for the costs of the crisis, but also to reduce excessive financial speculation and activity, steer resources into more productive activities, and reduce the risk of further financial crises. Taxes on finance are also highly progressive, since they are paid almost entirely by the financial sector and by wealthier individuals.

A number of European countries have introduced financial transaction taxes during the past two years, with another eleven agreeing to introduce a harmonized FTT through the European Union's process of "enhanced cooperation." In the United States, Senator Tom Harkin and Congressman Pete DeFazio introduced legislation on 28 February 2013 to tax financial transactions of stocks, bonds and derivatives at 0.03% or three basis points, which is expected to generate $40 billion annually. The European Commission estimates a Europe-wide FTT at a rate of 0.1% on stocks and at lower rates on bonds and derivatives could generate $85 billion annually.

Financial transactions taxes are more effective if they are implemented through international agreements at a global level, but that hasn't stopped many countries — including Switzerland, the U.K. and China — from having effective financial transactions taxes in places for decades.

The AFB would seek an agreement with the provinces to introduce a broad-based financial transactions tax at a rate of 0.5% on transactions of stocks — similar to the rate in the U.K. — and at lower rates on bonds and financial derivatives. This would generate over $4 billion annually, assuming a 50% reduction in trading volumes.[29]

If there are obstacles to this, the AFB will instead proceed with a Financial Activities Tax, as proposed by the IMF, at a rate of 5% on profits and remuneration in the financial sector to compensate for the exemption of financial services from value-added taxes, such as the GST. This would generate an estimated $5 billion annually.[30]

Green taxes

The Kyoto Accord to reduce greenhouse gas emissions ultimately failed not only because of the political opposition of countries such as Canada, but also because the process and methods for achieving the Accord's goals were flawed.

There has been little progress in reaching international agreement on the proposed international cap and trade scheme. Even operational regional cap and trade schemes, such as Europe's Emission Trading System, have been plagued by problems.[31] Despite costing close to $300 billion, the ETS and other cap and trade schemes appear to have had no effect in reducing emissions and at the same time have provided funding to projects that have often had perverse and negative consequences for Indigenous and impoverished people.[32]

With worldwide greenhouse gas emissions now more than 50% higher than they were in 1990 and not 5% lower as they were supposed to be, it is time to move forward with a new approach — and one that most economists prefer — a carbon tax.

The AFB will introduce a national harmonized carbon tax integrated with existing provincial carbon taxes, with a large share of the revenues going towards a strongly progressive green tax refund. This will ensure that a majority of Canadian households will be better off after accounting for their increased costs as a result of the carbon tax. Cap and trade schemes increase costs for consumers but they do so indirectly, without transparency and without compensation to households.

Carbon taxes are more efficient, transparent and less corruptible mechanisms for putting a price on carbon than cap-and-trade quantity quotas. Carbon taxes also provide a clear price signal for business, organizations and consumers, and avoid the speculation, uncertainty and unfair windfall gains associated with cap-and-trade systems. Many European countries have had effective carbon taxes in place for decades.

A national carbon tax would also include border tax adjustments to ensure Canadian industry is not put at a competitive disadvantage. Imports from countries that don't have similar measures would be taxed at appropriate rates to reflect emissions associated with their production, processing and transport, with specific exemptions for highly impoverished nations. Exporters to countries without comparable provisions could receive rebates. These border tax adjustments would put pressure on other countries to enact climate change measures while also benefiting Canadian industry.

The AFB would introduce a $30/tonne national carbon tax on July 1st, 2016. The national harmonized carbon tax would apply where provincial carbon taxes are not in effect or are at a lower rate. It would generate approximately $10 billion from the 350 megatonnes emitted annually from transportation, heating and other smaller sources and another $7.5 billion from the approximately 500 large industrial facilities responsible for more than a third of Canada's total GHG emissions. Gross revenues net of provincial and border tax adjustments would be approximately $15 billion annually.

As with all forms of carbon pricing or regulations, carbon taxes are regressive. They most hurt those on low incomes who also have the least ability to adapt and invest in more efficient measures. Accordingly, a large share of the revenues raised would be devoted to a progressive green tax refund, which would provide a majority of Canadians with a larger annual credit than they actually pay out in carbon taxes. Cheques of $300 would be sent out at the beginning of the year to all Canadians where the national carbon tax is in effect, with amounts gradually clawed back for family incomes above $100,000. This amount is higher than the quarterly GST credit payments and would be available at more than twice the income thresholds. Additional credits would be provided for those living in northern and rural communities where fuel and energy use is higher.

The carbon tax would be increased as required to meet Canada's greenhouse gas reduction targets and the credit would be increased together with it at a rate of $10 per

$1/tonne increase in the carbon tax. This would ensure that a majority of Canadian households would always be better off.

Carbon Tax Revenues will total $15 billion. A Green Tax Refund will cost $7.5 billion, leaving a net revenue of $7.5 billion.

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