

A taxing question

IF YOU ASK SOMEONE, “Would you like to go to the dentist less often?” they will probably say “yes.” But if you ask, “Would you like to fill your own cavities?” the answer will likely be “no”.

The same should go for taxes. Ask a Canadian if they want to pay lower taxes, and you might expect a resounding “yes”. Now ask if they want to hand over cash every time they drive down a road or visit the doctor. The answer would be no. Nothing strange here.

But there is something strange here. Because time and again, polls show that most Canadians are very reluctant to say “yes” to the first question — to jump on the tax-cutting band wagon.

Maybe it’s a common-sense Canadian thing. We somehow know that big tax cuts mean fewer public services, lower quality services, and higher personal costs.

And we’re right.

Sex and taxes are inevitable

Well, not really. But rather than linking taxes with death (as in the familiar saying), taxes could be seen as both essential and much nicer when shared (rather like sex).

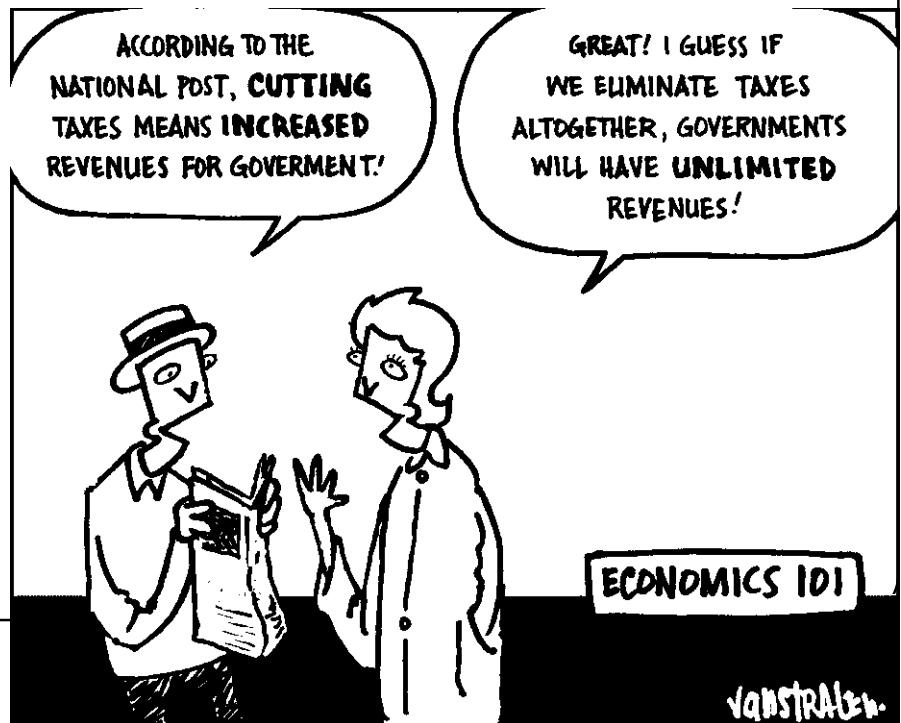
Simply put, taxes are a payment you make in exchange for something you need. You don’t expect to walk out of a supermarket without paying

for your groceries. Similarly, you can’t expect to go to school, visit a health clinic, drink tap water, or stroll through your neighbourhood without paying for their construction, upkeep, and staff.

Taxes play three broad roles in our society (you could say they do three types of work):

1. Providing: Tax dollars create and maintain our public services and infrastructure. Everything from roads, meat inspectors, hospitals, garbage collection, schools, library books, orchestras, parks, law courts — all the people, programs, and places that keep us ticking. Taxes allow

CONTINUED ON NEXT PAGE...



REAL the bottom line

Taxes allow us to care for one another when facing sickness, poverty, unemployment, and old age.

us to pay for these vital services together, rather than individually.

2. Restraining: Taxes discourage negative behaviour by individuals or groups (such as corporations). Examples are the consumption taxes — “sin taxes” — on tobacco and alcohol, or pollution taxes.

3. Spreading: To promote social equality, tax revenues are redistributed among individuals and families based on need. The money is spread through transfer payments, such as welfare cheques or pension supplements, and through public services, as in (1) above.

This third tax role — of redistribution and reducing disparities in income among people — is rarely acknowledged by mainstream media. Yet it is a central function of our taxation system that should be widely discussed.

Indeed, taxes help to build and nurture our common ground as citizens — enabling us to care for one another when facing sickness, poverty, unemployment, and old age. This modern-day commons is financed by taking different percentages of tax money from people based on their ability to pay.

Taxes are a tool that helps communities to foster a profound result: social cohesion. With services and culture supported by tax dollars, Canadians enjoy a less isolated, less unequal, and more civil society. It's the difference between dog-eat-dog and sharing the load. Not only is sharing nicer, it's more stable and efficient.

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DEFICIT DUELLERS AND TAX CUTTERS

In the 1980s and 90s, government deficits were touted as Public Enemy #1: out-of-control debt that blighted prosperity and hexed the future. With vocal back-up from business interests, many governments used deficit-lowering as an excuse to slash social programs, even though those programs bore little responsibility for high public debt. Today, neoliberal and right-wing politicians are only too willing to run up whopping deficits while buying off the public with tax breaks.

Tax Cutters At Work

IMAGINE WAKING UP in the morning and feeling glad that your taxes were buying really neat stuff like public schools and health care for this relatively harmonious country of 30-odd million people.

Okay, maybe that's asking too much. Or is it? Why, exactly, do we never hear what taxes actually do — let alone hear anything good?

Could it be that Tax Cutters own the airwaves?

Yup, most of the airwaves. And their messages are blasted with gale-force strength: Taxes are outta control. Taxes are slavery. Taxes are legalized robbery, with government in the role of robber, and taxpayer as ravaged victim.

But wait, there's a way out. Tax cutting will bring freedom. Salvation. A miracle cure. The Promised Land. Indeed, Tax Cutters have an evangelical tone reminiscent of the Deficit Duellers of the 1980s and 1990s. No surprise. They're the same people.

Consider two prime players:

- Since 1995, the Mike Harris Conservatives have significantly cut income tax in Ontario. That province is heading into a tax-cut-induced deficit for each of the next two years (2002 and 2003).

The fiscal squeeze now facing Ontario is the direct result of the Harris Government's seven year long attack on the province's revenue base. Tax cuts have reduced annual personal income tax revenue by \$9.5 billion. Corporate tax cuts have cost the revenue base an additional \$2.6 billion.

Meanwhile, Ontarians paid for these tax cuts with a big whack to their public services and safety. Altogether, Ontario's public services have declined by 20% under Mr. Harris.

(See the CCPA publication Ontario's "Made By The Harris Government" Fiscal Crisis, by Hugh Mackenzie, published in November 2001.)

- Since their election in May 2001, the Gordon Campbell Liberals have briskly torn a few pages from Ontario's play book. Without bothering to study the province's finances, Mr. Campbell delivered a 25% personal income tax cut to British Columbians. The bulk of the cut goes to high income earners. For example, the

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wealthiest 1% of income earners will get 20% of the tax-break cake. Business was treated a few months later to a host of lower taxes. After less than six months in office, Mr. Campbell spawned a \$2 billion deficit and — drum roll — launched an unprecedented program of cuts to public services.

Mr. Campbell and Mr. Harris are not isolated Tax Cutters; they are merely outstanding in their field. Given the punishing impact of their actions, how do Tax Cutters sell their ideas? They rely on two highly emotional messages:

1. Canadians are overtaxed and desperately need a break.
2. Canadians will reap great prosperity through lower taxes.

Overtaxed: Oh really?

Yes. No. Sort of. Definitely. Nah. Are. Aren't.

Truth be told, it's not a simple question. And you should be suspicious of anyone with a simple answer. Author Murray Dobbin tackled the matter in the 1999 CCPA report *Ten Tax Myths*. He crunched a lot of numbers and ideas, and came to this conclusion:

“Are Canadians overtaxed? It depends. On what we want taxes to pay for, on how fair we want our society to be ...”

In other words, you can't talk about taxes without talking about what-you-get and whether-it's-fair. It's like talking about the price of pizza without ever tasting the pie — or inspecting the kitchen.

Dobbin found that taxes are not as evenly collected as they used to be. So you can safely say that, yes, some Canadians are overtaxed. The bottom quintile of income taxpayers is giving more than their share. The top quintile is giving less. (For an explanation of “quintile” and other economics-speak, see the “Plain Talk” section on page 7). Dobbin says:

“In part because of the tax system, wealthy Canadians have gained an ever-increasing share of the total national income since the early 1970s ... Canada's unbal-

anced [tax] system has allowed the high-income earners to become extremely wealthy, and the gap keeps growing.”

Comparing Canada's overall tax rates to other countries is also not simple. What does a Swede get for her/his tax dollar? An American? Dobbin wrestled with this complex question, too. For readers interested in a percentage snapshot, he offers this:

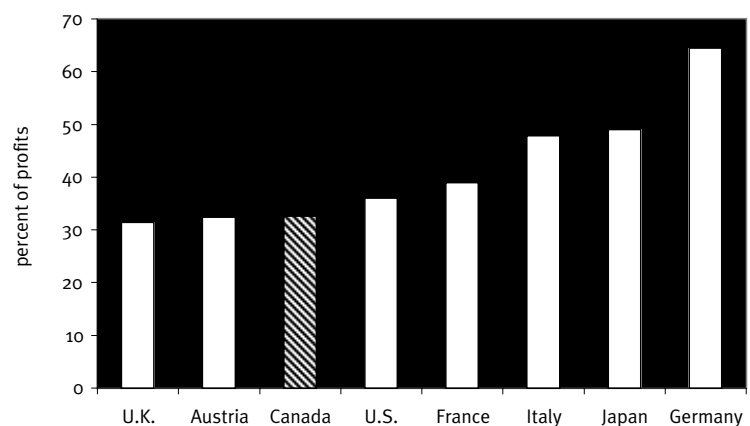
“Are we overtaxed with respect to ... other developed countries? ... International tax comparisons raise countless problems ... Consequently, many researchers measure effective tax rates, most commonly by calculating total tax revenue as a share of GDP. By this approach, Canada [at 36.8% in 1996] comes right in the middle of the [Organization for Economic Co-operation and Development] pack — higher than some, but lower than others [European Union at 42.4%].”

South of the border

How often do you hear that Canadians are mercilessly taxed in comparison to our southern neighbours?

How often are you told that doing business in Canada is murder due to our skyscraper corporate and payroll taxes?

EFFECTIVE CORPORATE INCOME TAX RATES



Source: KPMG Canada, "The Competitive Alternatives: A Comparison of Business Costs in North America, Europe and Japan, 1999"

Taxes aren't **grabbed** by government any more than schools and hospitals are **shoved** down our throats.

Well, think again. Here are some quick facts that may surprise you:

- Canadian businesses enjoy lower effective corporate income tax rates: 32.6% here, 36% in the U.S. according to a 1999 study by accounting firm KPMG.
- Payroll taxes are the main reason for our corporate advantage. Average Canadian payroll taxes (for things like public pensions and employment insurance) are dramatically lower than in the U.S.
- Not surprisingly, American employers tend to pay much more for health insurance than Canadian employers.

Lower taxes: A miracle cure?

Do lower taxes and economic revival go hand-in-hand, as Tax Cutters claim? Listen to Gary Collins, B.C.'s Minister of Finance, as he announced massive tax cuts for business in July 2001: "Our government intends to deliver on our promise of a new era of hope and prosperity for all of us in the best province in the best country in the world."

Such euphoria seems odd, if only because his government's tax cuts were saddling British Columbians with a huge deficit. Yet Mr. Collins is in good company — Ronald Reagan, Margaret Thatcher, and George W. Bush,

among others. Their big idea is that lower taxes incite oodles of economic activity. With some extra dollars, companies will produce more widgets, people will buy more widgets, and investors will invest in more widgets. All this joyful producing and buying and investing will fatten the tax base. In fact, Tax Cutters say, lower taxes actually lead to higher tax revenues — or at least mop up any deficit caused by the tax cut.

There's even more good news: The benefits will spread like wildfire. When corporations are freed from the yoke of high taxes, they'll be eager to create more jobs, exploit new resources, test new technologies. The same goes for individuals. With a few extra dollars in your pocket, you'll seriously consider buying that new dream house, won't you?

You won't?

And therein lies the problem. There is little evidence that these economic theories are valid. Tax cuts can be modestly stimulating to the economy, but "There is no proof that a net reduction in tax levels will necessarily result in added growth," said economist Pierre Fortin in 1999. (See the CCPA publication *Tall Tales About Taxes in BC*, by Marc Lee, page 28.) What is true is that human beings make economic decisions — as simple as buying

a coat or as elaborate as relocating a business — within a web of perceptions, conditions, and feelings. Even profit-hungry corporations "care" about whether a community has nice parks, decent schools, and good water. And most people don't decide to buy a house or a widget just because their income tax fell by a few hundred dollars — especially if their other living expenses are soaring.

The evidence is clear. Tax cuts lower what government revenues would otherwise be.

Smoke & mirrors

Hidden taxes are one of the guaranteed downsides of tax cuts and imbalanced tax systems. And



You pay hidden taxes whenever you buy goods and services that used to be fully or better covered by tax dollars.

hidden taxes are extremely unfair.

You pay these hidden taxes whenever you buy goods and services that used to be fully or better covered by tax dollars. Perhaps it's a higher fee for daycare or swimming lessons. Perhaps it's more expensive bus fares, garbage pick-up, building permits, or home care nursing. Things get pricier because they're no longer adequately supported by public revenues. Sure, your income tax bill might be a tad lower, but your overall living expenses are heading up.

Taxes enable us to create and deliver services as a community — collectively and publicly. Fair taxation means sharing both the pleasure and the pinch: the pleasure of public goods and services, the pinch of taxes. With widespread tax cuts, you may get a little less pinch but a lot less pleasure.

Deep tax cuts lead to many hidden taxes. What are some examples?

- User fees (e.g., health care)
- Co-payments (e.g., pharmacare payments)
- Fee hikes (e.g., tuition, permits)
- Escalating local rates (e.g., municipal taxes)
- Brand new fees (e.g., school supplies)
- Tolls (e.g., roads, bridges)
- What else?

The Flat Tax Fiddle

Tax Cutters don't just cut taxes, they like to fiddle with them too. One of their favourite fiddles is to flatten the tax structure.

Today, our income taxes are called "progressive." The more money you make, the higher percentage of tax you pay (i.e., the tax rate gets progressively higher). In contrast, our sales taxes are called "regressive." Everyone pays the same 7% GST.

Progressive taxes are much fairer than regressive taxes. Why? The principle behind progressivity is that people need a basic amount of money for their core human needs (food, shelter ...). If their income rises above that amount, then they can contribute more to the collective pot. It's quite simple: You pay based on your ability to pay. A family earning \$25,000 a year spends most of their money on basic necessities, so they pay the lowest percentage of income tax. A family earning

\$125,000 a year has money to spare, so they pay a higher percent. The second family still has a lot more money, including the extra they get from the stock market, property sales, or tax shelters like RRSPs.

Regressive sales taxes aren't fair. Why? It's quite simple, too. Take the GST: on the surface, everyone pays the same percentage. But because poorer people spend more of their money on taxable goods and services, a greater portion of their income goes to taxes than does the income of wealthier people. In fact, wealthier people have money left over for investments, savings — money that "grows." If you ever wondered why the rich get richer ...

Some Tax Cutters want everyone to pay the same (low) percentage of income tax, or very close to the same. This is the Flat Tax Fiddle. Since the 1980s, governments in Canada have done their share of flattening by narrowing the tax rate between high- and middle-income earners. The Canadian Alliance Party is a very keen advocate of a flat tax. The flat tax schemes are promoted as really fair and really uncomplicated. But it's clear who gets helped by flat taxes: wealthy people, whose tax bills

LEAKY BUSINESS

Why don't tax cuts lead to robust economic growth, as Tax Cutters boast?

In part you can blame "leakages" — the tax-break money that people sock into their savings accounts and foreign investments, or spend on French wines and holidays in Monaco. Rather than being injected into the Canadian economy, these dollars "leak" out of the country or into bank accounts. Leakages are especially high when tax cuts favour the wealthy, because that's who can afford to save, and to spend abroad.

This isn't a radical idea. In 1999, the B.C. Business Summit agreed that a tax cut of \$1.5 billion would only recover a third of its value through revenues from economic growth. The rest, they said, would have to be paid for by curtailing government spending.

Even profit-hungry corporations “care” about whether a community has nice parks, decent schools and good water.

fall dramatically. It’s also clear who gets hurt: the rest of us, from loss of revenue for the public programs we need.

All’s not fair: Why you should complain

THERE ARE VERY good reasons to complain about Canada’s taxation system. It isn’t as fair and balanced as it used to be, and certainly not as fair as it could be.

- People at the top of the pile are paying less than they used to pay. Why? When all taxes are rolled together, and tax breaks taken into account, Canadians face a more-or-less flat tax system. In other words, even though our income taxes are progressive, when you calculate all the taxes people really pay — sales, payroll, income, etc. — the tax rate is about the same for almost everyone.

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- High-income people benefit from more tax loopholes than other people. For instance, they have the advantage of tax deductions for RRSPs and low tax rates on capital gains.
- Low-income people shouldn’t have to pay income tax at all. They already pay a higher proportion of their income on regressive sales and consumption taxes than other folks.
- You do have less money to spend than before, even though taxes may not be the culprit. The culprit could be your earning power, which has shrunk for many middle- and low-income Canadians. The problem is too-low wages, not too-high taxes.
- You are getting fewer public services and fewer completely free services, due to cutbacks.

Ways to go: Beyond tax cutting

Taxes are a powerful way to move a political agenda. For example, blunt tax cutting represents a pro-business, anti-government agenda. But there are other ways to revise our tax system — to redistribute the tax burden and to further an agenda that respects social, environmental, and cultural values too. Here’s a brief snapshot of some fair-minded options:

- Make the system more progressive. Today, there are only four federal income tax brackets, ranging from 16% to 29%. Before the mid-1980s, there were ten tax brackets. How about adding some higher income brackets, as in the U.S.?
- Broaden the tax base, and close some loopholes. Today, corporations enjoy a slew of loopholes and tax breaks, along with a fairly low income tax rate. The result? They pay far less than the statutory rate.
- Create a financial transaction tax. Valuable stocks, bonds, and currencies are traded around the world every day — why not tax this economic activity? After all, you get taxed when you buy a book. For example, a very small tax on currency exchanges would be helpful in two ways: by creating a new revenue source, and by restraining some of the reckless behaviour of financial marketeers. This idea was originally proposed by James Tobin, and has become known as “the Tobin Tax.”
- Bring in an inheritance tax (also called a wealth-transfer tax). American families pay this one, as do

GREAT MOMENTS IN HISTORY

Taxes are a product of history, just like every other part of our social and political landscape.

Canada had a very different approach to taxation in our early years. Neither personal nor corporate income taxes existed until World War One, when they were introduced to finance the war (1917). Until that time, customs and excise duties provided the vast bulk of federal revenues: 90% in 1913.

Sales taxes and the now defunct Manufacturers Sales Tax (MST) were introduced in 1920. The Depression of the 1930s brought other major changes. Notably, provinces gained the power to levy income taxes on individuals and corporations.

Naturally, the growth of taxes in the 20th century reflected the growth of public services and infrastructure. We do well to remember that taxes aren’t grabbed by government any more than hospitals and sewers are shoved down our throats. They are choices we make as a society.

Canada's taxation system isn't as fair and balanced as it used to be, and certainly not as fair as it could be.

families in almost all industrialized countries. Why not in Canada?

- Raise taxes on capital gains. Today, investors pay taxes on a mere half of their investment income — why not on 100%?
- Introduce “green” alternatives. Offer tax incentives to individuals and companies that use environmentally sensitive products or processes. At the same time, levy higher taxes on activities that hurt the environment.

Plain Talk

Quintile (or fifth): A word only an economist could love. What does it mean? Take everyone who pays income tax and divide them in five. The “bottom quintile of taxpayers” means the 20% of taxpayers with the lowest income.

Progressive tax: People pay a higher percentage of their income as their income (their ability to pay) rises. This is done through tax brackets that tax income above a certain threshold at a higher rate. Example: federal income tax.

Regressive tax: Everyone pays the same tax rate (percentage), regardless of their ability to pay. Example: the GST. This tax is regressive because high-income people spend less of their money on taxable goods and services, and therefore spend a smaller portion of their income on taxes than low-income people.

Flat tax: Everyone pays the same percentage of income tax.

Statutory tax rate: The percentage of tax before deductions, exemptions, etc.

Effective tax rate: The percentage of tax you really pay after deductions, exemptions, tax breaks, deferments, and the like. The effective tax rate for businesses and high-income earners is much lower than their statutory tax rate.

Capital gains: The money you make on the stock market or when you sell property or a business. The capital gains tax applies to only 50% of the profit.

Tax bracket: Tax rates. Today, people paying federal income tax fit into four tax brackets: 16%, 22%, 26%, and

29%. For example, a person who makes \$35,000 this year will pay nothing on their first \$8,000 of income, 16% on the income between \$8,000 and \$30,000, and 22% on the last \$5,000.

Tax expenditure: The revenues that government does not collect due to tax credits, exemptions, deductions, incentives, loopholes, etc. For example: a tax credit for being a student; a tax deduction for an RRSP; a tax loophole for business lunches and box seats at the hockey game. Governments “spend” huge amounts on tax expenditures, using them for social and economic goals. Some tax expenditures are necessary, but most are not necessarily fair.

Revenue neutral: A tax change that affects where money comes from, not how much is collected. For example: shifting the tax bite from low and middle-income earners to high-income earners.

WHEN A BUCK AIN'T A BUCK

Kenneth Carter was the head of the Royal Commission on Taxation in the 1960s. He was a Bay Street accountant, hardly a revolutionary. Yet Carter ended up advocating for progressive changes to the taxation system. In particular, he proposed that any increase in personal wealth should be taxed regardless of its source — whether from a job, investment, inheritance, or speculation.

“A buck is a buck,” Carter famously said. Yet the fairness approach of his 1967 report was largely ignored.

Today, some bucks are a helluva lot buckier than others. In general, money from stock-market investments — known as capital gains — are taxed at a much lower rate than wages and salaries. A full 50% of income from capital gains isn't taxed at all. To tilt the fairness scale even further, the interest paid on money borrowed for investment purposes is tax deductible.

Sometimes more is better

FOR MORE INFORMATION and analysis about taxation and social justice, check out the following resources.

Resources From the CCPA

Have a look at the CCPA website. There's lots of free materials available, including studies, reports, fact sheets and opinion pieces. www.policyalternatives.ca

Tall Tales about Taxes in B.C., by Marc Lee (2000)

Ten Tax Myths, by Murray Dobbin (1999)

Left vs. Right: Why the Left Is Right and the Right Is Wrong, by Neil Brooks (1995)

Healthy Families: First Things First (The Alternative Federal Budget), by CCPA and CHOICES (2000)

In Search of the Good Life: "Competitiveness and Well-being in B.C. and Washington State," by Donna Vogel (2001)

The Great Tax Cut Giveaway, an analysis of the BC tax cuts announced in June 2001, in BC Commentary, Volume 4, Number 3 (Summer 2001)

Rethinking the Tax Cut Experiment, a brief submitted to the BC government on the provincial budget (2001)

Print resources

Behind Closed Doors, by Linda McQuaig (Toronto, Penguin Books: 1987)

The Rhetoric of Tax Politics: The Attack on Citizenship, by Neil Brooks, in "Tax Conversations," R. Krever (ed.). (Great Britain, Kluwer Law International: 1997)

Websites

- The Canadian Tax Foundation is an independent organization that does research on tax policy and its impacts on Canadians. www.ctf.ca
- The Centre for Social Justice is an advocacy organization based in Toronto that works on issues like fair taxation and the growing gap between rich and poor. www.socialjustice.org

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CANADIAN CENTRE FOR POLICY ALTERNATIVES. THINK AGAIN.



The Canadian Centre for Policy Alternatives offers an alternative to the message that we have no choice about the policies that affect our lives.

The CCPA produces and promotes research on issues of social and economic justice. We publish research reports, books, opinion pieces, fact sheets and other publications, including *The Monitor*, a monthly magazine.

The CCPA is a non-partisan, non-profit national organization. We have offices in Ontario, British Columbia, Manitoba and Nova Scotia. The BC Office is producing "The Real Bottom Line" series. Please feel free to copy and distribute this material.

Visit our website for more info and tons of free materials:
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