

Taxation

If taxes are the price we pay to live in a civil society, then Canada has become much less civilized in recent years. Tax cuts have been the top political priority for the federal government. Irrespective of the issue, the answer is almost always a tax cut.

While Canadians would not object to having some extra dollars in their pockets, few are asking for tax cuts. Given the challenges facing Canada as a nation, most Canadians would rather keep that money in the public sector to invest in programs and infrastructure that sustain our society and environment, and that contribute to our shared international obligations.

After a decade of solid economic growth those challenges are as acute as ever. It is clear that tax cuts cannot build more affordable housing or end homelessness. Tax cuts will not improve conditions for Canada's Aboriginal people. Tax cuts will not solve the challenges posed by global warming and will not clean up our environment. Tax cuts will not expand early learning and child care programs. Tax cuts will not make it easier to get to work in the morning, nor will they create healthy communities.

In short, tax cuts fail to deliver on what Canadians really want for their families. Moreover, tax cuts have eroded tax fairness in Canada and have contributed to growing economic inequality. The tax measures have made Canada's tax system less progressive: the major beneficiaries of the various tax cuts have been upper income taxpayers.

The Alternative Federal Budget raises the revenue needed for strategic investments, but also to make the tax system fairer and more sustainable. Only by pooling our money together can we make progress on the challenges facing us as a nation.

Tax Fairness

In 1990, the overall tax system was progressive (meaning higher tax rates as incomes rose) up to the middle of the distribution, then it was relatively flat. By 2005, the system had become less progressive for Canadians in the bottom of the income distribution, and regressive at the top. The shocker is that tax rates are slightly higher for Canadians in the bottom 10% than those in the top 1%. The peak tax rates are in the middle,

and are about six percentage points of income higher than the top and the bottom.¹

A key reason why the most affluent pay less of their income in taxes is that they tend to receive a greater share of that income from sources that are not taxed (such as inheritances and bequests) or lightly taxed (such as the capital gain from selling stocks). But tax cuts were the major factor behind the erosion of Canada's tax fairness, with personal income tax cuts leading the reduction in rates at the top. Tax cuts have reinforced the growing gap arising out of the labour market, being implemented precisely when inequality in pre-tax incomes surged.

The AFB provides several initiatives that generate additional revenue and curtail the growth in the income gap. New tax measures increase the federal government's capacity to provide programs and services that benefit all citizens by increasing taxes on taxpayers with the greatest capacity to pay. The AFB restores tax fairness to Canada's tax system, and would return us to a system that reduces, rather than reinforces, inequality trends.

This means reversing the tax cuts announced last October that have so depleted Canada's fiscal capacity.

Restore the GST to 6%

The AFB restores the GST to 6%. This will reverse the 2008 GST cut on July 1 2008, redirecting billions of dollars into improving our infrastructure — also taking the pressure off local property taxes and user fees.

Restoring the GST raises \$4.5 billion in 2008–09, rising to \$6.6 billion in 2010–11.

New tax bracket for incomes over \$250,000

Incomes have exploded at the very top of the pay scale. Recent income tax cuts have disproportionately benefited the highest income earners and have contributed to rising income inequality.

The AFB increases the tax rate for incomes over \$250,000 from the current rate of 29% to 31.5%. This measure will raise \$1.1 billion in new revenue from Canadians who have seen their income grow at the fastest pace and it will be used for programs that will benefit all Canadians regardless of income.

Full inclusion of capital gains income

The AFB would tax capital gains at their full value, adjusted for inflation, on the principle that a buck is a buck, and the tax system should not tax labour income more heavily than income from the appreciation of assets. This will also encourage longer-term productive investments in the economy and discourage short-term speculation.

Employee stock options

Eliminate special treatment of employee stock options. One of the most superfluous benefits for high-income executives involves the special treatment of employee stock options. Not only are employee stock options taxed at the lower rate applied to capital gains, but tax on the shares can also be deferred until they are sold. The AFB will tax the proceeds of stock options, when realized, at the same rate applicable to earnings from employment. We estimate that the elimination of this tax expenditure will save the government \$438 million in 2008–09.

RRSP contribution limits

While many taxpayers may allocate some income to RRSP/RPPs, few are able to come close to the maximum contributions. Maximum contributions have been increasing over the past few years, and are set to continue to increase until 2010. Raising this ceiling amounts to an additional tax break for upper income Canadians, as

TABLE 5 AFB Tax Measures (\$millions)

	2008-09	2009-10	2010-11	Total
Greater Equity				
Increase Canada Child Tax Benefit to \$5,000	(2,000)	(3,200)	(4,200)	(9,400)
31.5% tax rate on income above \$250,000	1,071	1,124	1,180	3,375
Maintain maximum RRSP/RPP deduction at 2007 level (\$19,000)	121	243	364	728
Education tax savings changes	796	1,470	1,650	3,916
Tax Fairness & Simplification				
Increase the inclusion rate for capital gains, personal	594	2,495	2,619	5,708
Increase the inclusion rate for capital gains, corporate	624	2,595	2,699	5,918
Employee stock options	438	459	482	1,379
Meals and entertainment expense deduction	111	456	468	1,035
Environmental Tax Initiatives				
Carbon tax on non-industrial emitters at \$30/tonne CO ₂ e	5,250	7,000	7,000	19,250
Emissions permitting and trading system revenues	250	1,300	2,500	4,050
Green Tax Refund	(3,750)	(5,063)	(5,316)	(14,128)
Investment				
Restore GST to 6%	4,515	6,285	6,580	17,380
Maintain federal corporate income tax rate at 2007 levels	2,845	4,007	5,856	12,708
Corporate tax rate restored to 28% for oil & gas sector	1,750	1,750	1,750	5,250
Strategic investments fund (funded from 2007-08 surplus)	2,500	3,500	5,000	11,000
Equity tax credit Community Economic Development Investment funds	(15)	(45)	(75)	(135)
Total	15,099	24,377	28,558	68,034

most Canadians do not come close to maximizing their contributions.

The AFB freezes the maximum annual RRSP contribution rate at the 2007 rate of \$19,000. This will save \$121 million in 2008-09, \$243 million in 2009-10 and \$364 million in 2010-11. This will only affect individuals with incomes above \$100,000 who contribute the maximum.

Proceeds of capping RRSP contributions at 2007 levels will help partially fund an increase in the GIS and provide additional income to retirees that need it most.

Increase Child Tax Benefit to \$5,000

As part of its anti-poverty strategy the AFB increases the Canada Child Tax Benefit (CCTB)

to \$5,000 annually. The benefit has become an important means of providing financial support to low-income households with children. But the child poverty rate remains stubbornly high. The AFB supports the maximum refundable child tax benefit based on proposals from the Caledon institute and Campaign 2000. The program will be partially funded by folding the two new Conservative government's child income benefits into the CCTB and investing additional funds to support the program.

The program will be phased in and will reach the \$5,000 maximum in 2010-11. These changes are stated as being net of revenues for each year, although the CCTB is in practice an income transfer and could also be stated as an increase in

expenditures. The cost is \$2 billion in 2008–09, rising to \$4.2 billion in 2010–11.

Education tax savings changes

Tuition fees continue to increase across Canada, providing an obstacle and a burden for all students but especially for low-income households. AFB 2008 increases the accessibility of post-secondary education by funding a national system of needs-based grants to be administered by the Canada Student Loans Program.

The program will be funded by ending the Registered Education Savings Plan, the Education Savings Grant, the Millennium Scholarship Foundation, the tuition fee credit, education credit and the newly introduced textbook tax credit. It is expected that these changes will, when fully implemented, make approximately \$2 billion available annually to fund the new grant program (phase-in period is beyond the three-year AFB framework).

CED fund equity tax credit

The AFB provides an equity tax credit for community economic development investment funds. This proposal is modeled on a successful program that has been in place in Nova Scotia for a number of years, which provides a 30% equity tax credit for investments in community economic development funds (many of which are also RRSP eligible).

Meals and entertainment expense deduction

The AFB will eliminate the corporate meals and entertainment expense deduction, as of January 1, 2009. Fully phased in, this will save the government more than \$400 million a year.

Corporate taxes

The AFB maintains for 2008 and subsequent years the 2007 corporate income tax rate (a base rate of 21% plus a surtax of 1.12%). This move increases available revenues by \$2.8 billion in 2008–09, \$4 billion in 2009–10 and \$5.9 billion in 2010–11. The AFB, however, does not cancel tax cuts for small business.

Corporate tax cuts, in particular, are poorly attuned to the specific challenges facing the nation. Corporate tax cuts are justified on the grounds that they will increase investment in Canada. This is a dubious claim, as corporations invest for so many other reasons: access to resources (think oil patch), access to markets, availability of skilled labour, and energy costs are the main ones. If Canadian rates were way out of line, and all of these other factors were the same as comparator countries, there might be some justification for cutting corporate rates, but this is not the case.

Prior to the current tax-cut exercise, Canadian corporate income tax rates were already lower than in the U.S., and back in the heyday of high investment and productivity growth in the 1960s, the federal rate was 40%, or close to double the 2007 rate. It is often pointed out that the Nordic countries tax capital relatively lightly and make up their revenues elsewhere. While this real-world example that must be kept in mind, there is little evidence that Canadian rates are high in comparative terms.

A related claim is that Canada's rates on the margin for new investment are too high. This is the marginal effective tax rate (METR) claim, advanced by the CD Howe Institute and the Department of Finance. There are some questionable methodological issues in how these rates are calculated and how comparable they really are across countries.² Even on its own terms, recent targeted measures (e.g. accelerated depreciation for manufacturers) have greatly reduced Canada's METR so that we are no longer "uncompetitive".

Finally, the subsidiaries of U.S.-based corporations are taxed in the U.S. based on their global profits. Increasing those profits by lowering Canadian taxes will simply lead them to pay the tax to the U.S. treasury instead of the Canadian treasury.

Corporate income tax on oil and gas sector industry

The AFB restores the federal corporate income tax rate to 28% (the initial level that prevailed before deep federal CIT cuts beginning in 2003) for the oil and gas industry (*see Sectoral Development Strategy chapter for more information*). This raises approximately \$1.75 billion per year in new federal revenue in support of a value added development strategy. The application of differential corporate tax rates for particular sectors has been a feature of federal tax policy at many times in the past, motivated by the desire to stimulate particular sectors (such as secondary manufacturing and processing) or tax others (such as energy or finance).

Greening the tax system

In addition to making the tax system fairer, the AFB also makes it more ecologically friendly in order to reduce greenhouse gases (GHGs). A major part of this is to begin to put a price on GHG emissions to end the treatment of the atmosphere as a free dumping ground. This will provide better signals to consumers and businesses to do the right thing, although the AFB also ensures that the people who did the least to cause the problem are not punished. The load must be shared in an equitable manner.

Carbon tax on non-industrial emitters at \$30/tonne CO₂e

The AFB calls for an initial charge of \$30 per tonne of carbon dioxide equivalent (CO₂e) emit-

ted, consistent with the proposals in the Green Budget Coalition recommendations for Budget 2008. Similar to last year's AFB, this involves a hybrid system: a carbon tax at a rate of \$30 per tonne of CO₂e emitted on most sources of CO₂ emissions (such as transportation, residential, commercial) that would not be covered by an emissions permitting and trading system, and an emissions permitting and trading system for large final emitters of greenhouse gas emission (*see below*).

A carbon tax at this rate that applied to fuel used by most forms of road and rail transportation (excluding aviation and international marine) and to fuel used by residential, commercial, institutional, public administration, construction and agriculture sectors would raise slightly more than \$7 billion a year fully phased in, based on both 2005 emission figures and 2005 energy supply-demand fuel use figures.

Together with a carbon tax, there needs to be complementary measures to both compensate for the additional costs, particularly on lower- and middle-income households, and, from an environmental policy perspective, to help households and others of lesser means reduce their carbon emissions.

The carbon tax would come into effect on July 1, 2008. Adjusting to a fiscal year basis, this leads to an initial \$5.25 billion that would be collected in 2008–09. This revenue will be recycled into the Green Tax Refund/Credit (valued at \$3.75 billion in 2008–09) and other measures to address climate change.

More details on this are provided in the Environment chapter.

Green Tax Refund/Credit

A carbon tax, as well as emissions permitting systems which put a price on carbon, will have a larger proportional impact on lower- and middle-income households which spend a higher proportion of their income on fuel, other forms of energy, and energy intensive goods and services.

To offset these adverse distributional impacts the AFB includes a green energy tax refund: a refundable tax credit that completely compensates lower- and middle-income households for the direct impacts of higher carbon taxes. This would be in the form of a progressive tax refund modeled on the format of the GST tax credit, but for a larger amount that would also reach more households.

The green energy tax refund would provide an after-tax refund of \$300 per adult and \$150 per child. The full refund would be provided to all families with a family income of up to \$70,000. Above this, it would phase out at a rate of 5% of income above \$70,000.

Further details of this measure are outlined in the Environment chapter.

Emissions permitting and trading system revenues

The AFB includes an emission permitting and trading system to apply to all large final emitters of GHGs in Canada. It will raise about \$1 billion in revenues in the first year, rising rapidly as more permits are sold off, instead of granted for free.

The AFB sets an absolute domestic cap of 350 Mt in 2009 for heavy industry/large final emitters, declining by 5% a year to reach 200 Mt by 2020. More details are provided in the Environment chapter.

Notes

¹ See recent CCPA study by Marc Lee, *Eroding Tax Fairness: Tax incidence in Canada, 1990 to 2005*.

² See Ruggeri and McMullin (2004) for a good critique of the METR concept.