Taxes and the Common Good

A CPJ backgrounder on taxation

by Chandra Pasma

May, 2011

CITIZENS *for* PUBLIC JUSTICE

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- CPJ is committed to seek human flourishing and the integrity of creation as our faithful response to God's call for love, justice and stewardship.
- We envision a world in which individuals, communities, societal institutions and governments all contribute to and benefit from the common good.

Our Mission

- CPJ's mission is to promote *public justice* in Canada by shaping key public policy debates through research and analysis, publishing and public dialogue. CPJ encourages citizens, leaders in society, and governments to support policies and practices which reflect God's call for love, justice and stewardship.

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- Public Justice is the *political* dimension of loving one's neighbour, caring for creation and achieving the common good, and is particularly the responsibility of government and citizens.

CPJ addresses a range of public justice issues, from eliminating poverty to creating a climate of welcome for newcomers to fostering hopeful citizenship. CPJ's professional staff actively engage in a number of activities to realize CPJ's mission and keep public justice front and centre in policy debates.

Our members, who come from a wide variety of faith communities, are committed to public justice and its contributions to public dialogue. They participate in CPJ's work through campaigns, dialogue and financial support. CPJ's 13-member board of directors includes representation from across Canada and meets regularly two times per year.

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Taxes and the Common Good: A CPJ Backgrounder on Taxation

By: Chandra Pasma
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Executive Summary

Taxes raise the revenues used to pay for democratic institutions and to provide government programs and services. Taxes can also be used to promote other economic and social policy goals through the use of tax expenditures.

Over the past decade, significant changes have been made to Canada's tax system, including deep cuts to tax rates. The impact of these changes is cause for concern: there has been a significant loss or erosion of public services that benefit Canadians, a loss of progressivity in the tax system, and growing income inequality between the rich and the poor. At the same time, there has been an erosion of democratic control and accountability for taxation and public spending. The context for debate has also been very hostile to an open and honest conversation about taxes and the services they pay for.

Currently, there are a number of policy options being advocated which would change Canada's tax mix. These include lowering or raising the rates of corporate income tax, raising the GST or increasing reliance on consumption rather than income taxes, replacing Canada's progressive income tax system with a flat tax on income, raising income tax rates on the richest Canadians, expanding the tax base by redefining taxable income and closing tax loopholes, introducing a Financial Transactions Tax, introducing a carbon tax or other forms of green taxation, and implementing tax cuts.

These proposals are molded by different perspectives on taxes. Some view taxes as theft of individual property by government, or as an onerous burden that always needs to be diminished. A more positive perspective on taxes views them as an important part of citizenship and democratic representation and a contribution to the common good. A related perspective views taxes as dues paid in recognition of the common wealth each citizen benefits from, passed on by earlier generations. Taxes can also represent a form of income redistribution over the course of an individual lifetime, as well as an efficient and effective way for individuals to procure services by doing so collectively. Taxes are also an important form of income redistribution in society.

CPJ has worked on issues of taxation for over twenty-five years. Three themes consistently emerge from CPJ's work on taxation. First, CPJ has constantly called for the integration of social, environmental and economic policy in a way that supports justice. Second, CPJ has promoted an understanding of taxes as an investment in our shared prosperity and a reflection of our shared responsibility, the other half of public services and spending. Third, CPJ has argued for a progressive, equitable and fair distribution of taxes, appealing to the public justice guidelines of mutual responsibility and fiscal fairness.

CPJ's public justice framework supports the notion that taxes are an important contribution to the common good. Taxes are one way in which we as citizens fulfill our obligation to promote justice and to respect the right of all people to live in dignity. For governments, tax policy can be used to foster justice, in addition to tax revenues paying for infrastructure and public services that benefit all and promote an equitable society. Public justice also supports a progressive distribution of taxes, and transparent and accountable decisions from governments on taxation and spending.

Introduction

Taxes raise revenues for government programs and services. They can also be used to achieve other economic and social goals. For this reason, taxes have an important role to play in the government's pursuit of public justice. They also represent an important contribution from citizens to the common good. However, tax cuts over the past decade have created considerable cause for concern about the fairness and sufficiency of Canada's tax policy. This has led to a number of policy options that would change Canada's tax mix. These policy options represent a variety of different perspectives and core beliefs on taxation. Citizens for Public Justice has worked on issues of taxation for over twenty-five years. CPJ has consistently called for a perspective of taxes as an investment in public services, and hence a shared benefit and responsibility. CPJ has also supported a fair and equitable distribution of taxes.

1. Policy Analysis

Current Situation

In the 2008-2009 fiscal year, governments in Canada collected a combined total of $471,268 million in taxes. Over half of total tax revenues were from income taxes, while consumption taxes made up 22.7% and social security contributions (such as Employment Insurance (EI) premiums and Canada Pension Plan/Quebec Pension Plan (CPP/QPP) premiums) accounted for 7.5%. Personal income taxes make up by far the largest share of taxes in Canada, at 40.1% of tax revenue.[1] (See Table 1).

Table 1: Consolidated government tax revenues: Breakdown by tax type, 2008-2009

	% of Total Tax Revenues
From income taxes	52.8
- From personal income taxes	40.1
- From corporate income taxes	10.7
From property taxes	11.6
From consumption taxes	22.7
From health insurance premiums	0.7
From social security contributions	7.5
From other taxes	4.6

Source: Statistics Canada, "Consolidated federal, provincial, territorial and local government revenue and expenditures (revenue)."

Between 2003-2008, the average annual increase in consolidated government revenues was 5.7%. Revenues from income taxes grew 50.1% during this period, while revenues from consumption taxes grew 15.6% and revenues from social security contributions grew 20.5%.[2] As a share of household income, however, personal taxes have been declining for Canadians, while the share of other taxes has been much more dependent on income decile.[3]

At the federal level, total revenues in 2008-2009 were $233,092 million. Half of federal revenues come from personal income tax (49.8%), compared to 12.6% from corporate income tax and 2.5% from other taxes and duties. Over the past twenty-five years, changes to Canada's tax system have increased the relative importance of income taxes compared to EI premiums and other taxes and duties (see Table 2).[4]

Table 2: Federal government tax revenues by tax type, 1983-1984 and 2008-2009

	Personal Income Tax		Corporate Income Tax		Other Taxes and Duties		EI Premiums	
	1983-1984	2008-2009	1983-1984	2008-2009	1983-1984	2008-2009	1983-1984	2008-2009
Total (millions)	$26,330	$116,024	$7,174	$29,476	$16,215	$39,806	$7,229	$16,887
As % of GDP	6.4	7.3	1.7	1.8	3.9	2.5	1.8	1.1
As % of total federal revenue	40.7	49.8	11	12.6	24.8	17.1	11.1	7.2

Source: Finance Canada, "Federal Government Public Accounts, 2009."

Among all levels of government in Canada, spending is highest on social services, health and education, which totaled 65% of all government expenditures in 2009. Between 2005 and 2009, spending on health grew by 29%, spending on social services grew 21%, and spending on education grew 24%.[5] (See Table 3).

Table 3: Selected consolidated government expenditures, 2009

	Dollars spent (millions)
Social services	190,276
Health	121,577
Education	95,732
Protection of persons and property	50,790
Debt charges	43,634
Transportation and communication	32,197
General government services	22,822
Resource conservation and industrial development	19,975
Environment	16,933
Recreation and culture	16,306
Foreign affairs and international assistance	6,508
Housing	6,120
Regional planning and development	2,775
Labour, employment and immigration	2,395

Source: Statistics Canada, "Selected consolidated government expenditures, 2009."

In 2008-2009, 57.9% of federal government expenditures were transfer payments to individuals, governments and organizations. This included $61.6 billion in transfers to individuals, $46.5 billion in transfers to provincial, territorial and municipal governments, and $30.2 billion in other grants and contributions. The second largest area of federal spending was on operating costs for programs at 29.1%. This included $18.8 billion for National Defence, including spending on the Canadian Forces, $8.9 billion for Public Safety, including the RCMP, Canadian Border Services Agency, and the federal prison system, and $7.1 billion to the Canada Revenue Agency. The third largest public expenditure was interest paid on the debt at 13%.[6] (See Table 4).

Because of the recession, the government had a deficit of $5.3 billion in 2008-2009. In contrast, the government had a surplus of $9.6 billion in 2007-2008, which was put towards debt reduction. The recession also had an impact on spending, most notably increasing EI expenditures by $2 billion compared to 2007-2008.[7]

While Canada's total revenues and expenditures have increased, as a percentage of Gross Domestic Product (GDP) (or essentially as a percentage of our economy) revenue and expenditures have decreased over the past decade and a half. In 1992, total government revenues were 44.2% of GDP; in 2008 they had declined to 39.8% of GDP. Tax revenues declined from 36% of GDP in 1992 to 32.2% of GDP in 2008. Government expenditures dropped from 53.3% of GDP in 1992 to 39.7% in 2008.[8] At the federal level, government revenues have declined from 18.4% of GDP in 1992 to 14.6% of GDP in 2009. Expenditures decreased from 16.7% of GDP in 1992 to 13% in 2009. In fact, federal revenues are now at a level they have not been at since the early 1960s.[9] As Armine Yalnizyan has pointed out, that was an era without universal health care, EI, and a significant network of universities and colleges.[10]

Table 4: Federal expenditures 2008-2009

	Dollars spent (billions)	**% of total spending**
Total	**238.8**	**100**
Public debt charges	**31**	**13**
Transfer payments	**138.3**	**57.9**
- **Transfers to persons**	**61.6**	**25.8**
Old Age Security	33.4	14
Employment Insurance	16.3	6.8
Child Tax Benefit	11.9	5
- **Transfers to other levels of government**	**46.5**	**19.5**
Canada Health Transfer	22.8	9.5
Canada Social Transfer	10.6	4.4
Equalization	13.2	5.5
- **Other grants and contributions**	**30.2**	**12.6**
Other program expenses	**69.6**	**29.1**
National Defence	18.8	7.9
Public Safety	8.9	3.7
Canada Revenue Agency	7.1	3
Crown Corporations	8.1	3.4
Other operations	26.8	11.2

Source: Finance Canada, "Where Your Tax Dollar Goes."

Hugh Mackenzie and Richard Shillington have broken down public spending to understand what the impact is at the individual and household level.[11] At the household level, the median benefit from public services paid for by taxes is $41,000, equivalent to about 63% of the median household income. More than two-thirds of Canadians receive a benefit from public services that is greater than 50% of their income. The average per capita benefit from public services in 2006 was $16,952. While lower income Canadians benefit more from personal transfers, above the level of household income of $50-60,000 "benefit from public spending is remarkably evenly distributed on a per-capita basis in households in all income ranges." Even in households earning $80-90,000 a year (just below the top income quintile in Canada), the benefit from public services is equal to about half the household's income. In other words, most Canadians "would have to devote half a year's wages to pay for the public services their taxes provide."

Tax expenditures
While raising revenues is the primary goal of the tax system, taxes can also be used to achieve other economic and social policy goals. Often, this happens through the form of exemptions, deductions, rebates, referrals and credits. These are known as tax expenditures, because they decrease the amount of revenue collected – they are akin to spending by not collecting.[12] At the federal level, there were 256 tax expenditure measures listed by the Department of Finance in *Tax Expenditures and Evaluations* in 2009. This included 134 personal income tax expenditures, 87 corporate income tax expenditures, and 35 Goods and Services Tax (GST) expenditures.[13]

Examples of personal income tax expenditures include the Charitable Donations Credit ($2,380 million in 2009), the Working Income Tax Benefit ($1,075 million), Child Tax Credit ($1,430 million), partial exemption of capital gains ($3,245 million), non-taxation of employer health and dental benefits ($2,710 million), deduction of Registered Pension Plan (RPP) contributions ($9,485 million) and deduction of Registered Retirement Savings Plan (RRSP) contributions ($7,850 million). Examples of corporate income tax expenditures include the Scientific Research and Experimental Development Investment Tax Credit ($2,225 million), the low tax rate for small businesses ($3,375 million), the Dividend refund ($5,450 million) and non-capital losses carried back ($6,005 million). Examples of GST tax expenditures include zero-rating of basic groceries[i] ($3,175 million), rebates for municipalities ($1,705 million), and rebates for registered charities ($290 million). [14]

Tax expenditures have been criticized for being far more opaque than government spending and programs. They do not tend to receive the same level of consultation and public debate when they are developed, as they are often hidden by the cloak of budget secrecy. They also do not receive the same level of analysis to ensure that they are meeting intended policy goals, nor are their outcomes compared to alternative government spending programs. Unless tax expenditures are refundable (giving tax filers money if they have more tax credits than tax owing), they also disproportionately benefit high income earners who have more taxes owing.

For instance, the Frontier Centre for Public Policy examined two tax expenditures created by the Conservative government, the Public Transit Tax Credit and the Child Fitness Tax Credit. They found the credits were disproportionately claimed by Canadians with incomes of more than $50,000, who only made up 25% of all tax filers. In contrast, no benefit was received by nearly one-third of tax filers, despite the fact that they met eligibility requirements. $432 million – or 71% of the total Children's Fitness Tax Credit claimed – was paid to Canadians earning $50,000 or more. There is also no evidence that either tax credit has achieved its stated public policy goal. As a result, these tax measures are viewed as "boutique tax credits": tax expenditures aimed at a narrow demographic slice that are seen as politically motivated to win votes rather than to achieve policy aims.[15]

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[i] Unlike exemptions, when suppliers are not allowed to redeem GST paid throughout the production process, with zero rating GST is not collected on final sales but can be redeemed for inputs.

The Ontario Fair Tax Commission noted that tax expenditures are a major contributor to perceptions that the tax system is unfair. It therefore recommended that tax expenditures be developed and evaluated on the same criteria as spending programs.[16] In particular, tax expenditures are responsible for some high income earners and profitable corporations paying no income tax.

Some forms of tax expenditures are more progressive than others. Income exemptions, such as the partial capital gains exemption, disproportionately benefit those with higher incomes because they are more likely to have such non-taxable income than lower income earners, who primarily depend on wages and salaries. Tax deductions, such as the RPP/RRSP deduction, also disproportionately benefit higher income earners because the deduction from income reduces taxes at the highest marginal tax rate. Tax credits, such as the Charitable Donations Credit, are more equitable since everyone who owes income tax receives the same percentage reduction in income taxes. People with incomes too low to pay income tax, however, receive no benefit from tax credits. Refundable tax credits, such as the Working Income Tax Benefit, are more equitable still because they ensure that those with incomes too low to pay income tax still receive the same amount of value from the credit as those with higher incomes. Income-tested refundable tax credits, such as the GST credit and the Canada Child Tax Credit, do the most to reduce income inequality because the benefit size increases as income decreases.

A decade of tax cuts

Many changes have been made to Canada's tax system in the past decade. The initial context for these tax cuts was the fight against the deficit, led by Liberal Prime Minister Jean Chretien and Finance Minister Paul Martin in the 1990s, which included significant spending cuts. Once the deficit was eliminated in 1998, the changes in spending began to produce large government surpluses. Rather than restore public spending, the government chose to cut taxes. This pattern of tax cuts was continued when the Conservatives took power in 2006.

The former Liberal government enacted a number of major tax changes between 1998 and 2005. These included three increases in the basic personal amount (which is tax exempt), raising the income thresholds for personal income tax brackets and cutting the tax rates on each bracket, introducing a new fourth tax bracket for high income earners, reduction and then elimination of two surtaxes, and full indexation of the tax system to inflation. (The Mulroney government had partially de-indexed the tax system in 1986). Changes to corporate taxes included reduction of the income tax rate from 28% to 21%, an increase in the income threshold for a small business from $200,000 to $400,000, and reduction of the federal capital tax. Changes to other taxes included a reduction in EI premiums, an increase in CPP premiums, and the introduction of an "air travelers security charge." New tax expenditures included an increase in the RRSP contribution limit, the introduction of the Canada Education Savings Grant, an increase in the GST refund to municipalities from 50% to 100%, reduction of the capital gains inclusion rate from 75% to 50%, and creation of the Canada Child Tax Benefit.[17] The OECD estimates that tax changes between 1995 and 2005 cost $50 billion in lost government revenues annually.[18]

The Conservative government has also made many significant changes to taxation between 2006 and 2011. These include a reduction in personal income tax by cutting the lowest income tax rate and raising the threshold for tax brackets, as well as another increase in the basic personal amount (to $10,320 in 2009). Changes to corporate income tax included cutting corporate income tax rates to 15% by 2012, complete elimination of the corporate surtax, and the introduction of a new tax on income trusts. The government also cut the GST from 7% to 5%, and pressured those provinces with a retail sales tax to harmonize their sales tax with the GST, a move made by BC and Ontario in 2010.[ii] The government has focused a lot of policy changes on tax expenditures. Since 2006, many new tax credits have been adopted, including the Child Fitness Tax Credit, the Public Transit Tax Credit, the Textbook Tax Credit, the First Time Home Buyers Tax Credit, and the Working Income Tax Benefit. Other new tax expenditures include the introduction of the new Tax Free Savings Account and the creation of a new Registered Disability Savings Plan, raising the spousal amount and the age credit, increasing the amount of income eligible for the Pension Income Credit, exempting scholarship and bursary income from income tax, and elimination of a range of tariffs on machinery and equipment.[19] According to the government's own forecasts, these tax changes will cost $44.4 billion in lost government revenues annually by 2013-2014.[20]

After years of surpluses, beginning in 2009 the federal government has been running a deficit. In 2009-2010, this deficit was $53.8 billion.[21] In 2010-2011, the deficit is projected to be $40.5 billion.[22] The deficit is projected to diminish by half in 2011-2012, and from there gradually be eliminated by 2015-2016.[23] Tax cuts have contributed a significant proportion of the deficit and will continue to do so. In 2009-2010, tax cuts cost $33.9 billion in lost government revenue, or 63% of the deficit. In 2010-2011, tax cuts are projected to cost $33.9 billion again, or 83.7% of the deficit. By 2013-2014, tax cuts will account for 467% of the deficit. Rather than increase taxes or repeal some of the recent tax cuts in order to deal with the deficit, however, the government is focusing on spending cuts.

While the government has justified the continuation of these tax cuts despite the recession and the deficit as economic stimulus, tax cuts do not make good stimulus. It is difficult to ensure that the tax savings will be spent rather than saved or used to pay down debt, and even more difficult to prevent expenditures from leaking out of the economy by being spent on imported goods. In contrast, government expenditures on physical and social infrastructure directly create jobs and do not risk leaking out of the Canadian economy. A study by Informetrica estimated that $1 billion in tax cuts creates 5,600 jobs, but $1 billion invested in infrastructure nearly triples the number of jobs created, at 15,800. $1 billion invested in health care would create 18,100 jobs.[24] Tax cuts are also permanent, rather than temporary, whereas good stimulus should end when the need has ended.

The provinces have engaged in their own tax cuts over the past decade, with most provinces cutting personal and corporate income tax rates. Provinces also adopted a new form of taxation; previously provincial taxes were set as a percentage of federal income taxes. Between 2000 and 2002, all the provinces switched to a system that allows them to set their own tax brackets. Many provinces also eliminated their capital taxes on corporations.[25]

Provincial tax cuts have been accompanied by downloading of responsibilities to municipalities across Canada. Local governments, which depend on property taxes and transfers from provincial governments for their revenue, have found themselves squeezed. The result has been that local spending has outstripped revenue, even as municipal governments struggle to renew crucial physical infrastructure. In 2008, cumulative local government revenues were $73,758.7 million, while expenditures were $74,310.5 million.[26]

Tax cuts at both the federal and provincial level have resulted in a significant cost to Canadians. Mackenzie and Shillington estimate that 80% of Canadians would have been better off if the 2% GST cut

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[ii] Nova Scotia, New Brunswick and Newfoundland and Labrador had already harmonized their provincial sales tax with the GST.

had instead been passed to local governments. If, rather than exempting another 25% of income from capital gains, the federal government had invested in improved federal public services, 88% of Canadians would have been better off. And 75% of Canadians would have been better off if provincial governments had invested in health care and education, rather than in broad-based income tax cuts. [27]

Concerns about Canada's tax system

In addition to the loss of revenue caused by over a decade's worth of tax cuts at the federal and provincial levels, there are a number of ongoing concerns regarding Canada's taxation system: the loss of progressivity in the tax system, the contribution of the tax system to growing income inequality, the erosion of democratic control over taxation and spending decisions, and the paucity of public debate about taxes and the appropriate level of taxation.

Loss of progressivity

Changes to Canada's tax system over the past two decades have rendered it far less progressive. In fact, Canada's overall tax incidence is an inverted u-shape, progressive through the middle of the income distribution but regressive thereafter. As a result, the top 1% now pay a lower rate than the poorest 10%. Total rates of tax paid range from 30.7% at the bottom of the income spectrum to 36.5% in the middle to 30.5% for the top 1% of families. Tax rates for the top 1% of the income distribution dropped four percentage points between 1990 and 2005, while tax rates for the bottom 10% increased by more than five percentage points.[28]

Personal income taxes, which make up the bulk of tax revenues in Canada, remain progressive until the top 5% of income earners, but they are off-set by the regressive impact of almost all other taxes to make the overall tax system very flat. Payroll taxes are progressive up to the middle of the income spectrum, but thereafter become regressive because of maximum contribution thresholds. Much of the progressivity in the tax system also depends on federal taxes, as changes in provincial taxes between 1990 and 2005 have rendered the provincial tax systems uniformly regressive. However, changes in federal tax rates have exacerbated the impact of provincial changes at the top and bottom of the income distribution.[29]

Growing income inequality

Income inequality has been growing steadily in Canada over the past few decades, and changes in taxation have contributed to that growth. The richest Canadians have seen their before-tax incomes increase, while middle-class and poor Canadians have seen their incomes stagnate and fall. Between 1982 and 2004, the average income of the top 5% of Canadian families increased 50%. The bottom 80% of Canadians experienced little or no income growth over this period.[30] In 2004, the market earnings of the richest 10% of Canadian families with children was 82 times that of the market earnings of the poorest 10% of families.[31]

While Canada's tax and transfer system offsets some of this market inequality, it has not changed the trend of growing income inequality. According to the Vanier Institute of the Family, the after-tax income share of the top income quintile increased from 41% in 1990 to 44.3% in 2008. The bottom four income quintiles have all seen their share of after-tax income decrease between 1990 and 2008. The bottom income quintile receives only 4.9% of total after-tax income in Canada.[32]

Wealth is also relatively concentrated among the richest Canadians, with the average wealth of the top 1% of Canadians being approximately 10 times the wealth of the bottom 80% of Canadians. Houses and cars make up a significant proportion of wealth for the bottom 80% of Canadians; financial assets were a significantly greater part of net wealth for the richest Canadians (61% vs. 37%).[33]

Tax cuts contributed to the growing income inequality. An OECD study concluded that tax cuts in Canada between 2000 and 2006 mainly benefited high income groups, with those earning 150-200% of the national wage seeing their taxes reduced by 2.3% compared to a 1.1% reduction for those earning only one-third to two-thirds of the national wage.[34] An overview of federal budgets between 1995-2005 by economist Armine Yalnizyan found that both tax changes and government spending initiatives contributed to the growing income gap.[35] Tax changes since 2006 have continued to benefit the wealthy.

High levels of income inequality have been linked to a range of social problems, including greater health problems and lower life expectancy, higher rates of mental illness, increased drug use, higher rates of teen pregnancy, more violence and lower social trust. These social problems have been found to be higher at every income level of a more unequal society when compared to a more equal society.[36] Income inequality is thus a concern which has consequences for all Canadians.

Erosion of democratic control and accountability

Taxation is one half of a democratic contract in which citizens contribute taxes in exchange for democratic institutions, effective government programs and services and government accountability for the use of public money. In Canada, democratic oversight of taxation and spending is exercised by Parliament: the Executive can only tax or borrow money with parliamentary approval and it can only spend that money in ways approved by Parliament. There are concerns about Parliament's ability to exercise its oversight, especially due to limits on the information available to Parliament.

Since 1968, "the business of supply," which refers to the examination and authorization of spending legislation, has been the responsibility of standing committees of the House of Commons. This was the result of a change intended to make scrutiny of estimates more efficient and to give more power to standing committees. "Although such a method appears sound in principle, the actual results remain disappointing," reports the Library of Parliament. "Parliamentarians, political scientists and other academics have long commented on the lack of resources to effectively review the estimates, the difficulty in analyzing these complex documents, and the parliamentarians' almost complete lack of means to influence or amend the estimates."[37] As a result, many committees do not even bother reviewing the estimates or reporting back to the House of Commons.

The creation of the Parliamentary Budget Officer (PBO) position in 2006 was intended to be a non-partisan way of providing Members of Parliament with greater support in their role of holding the government to account for financial decisions. While the PBO has certainly done a lot to fulfill this mandate, including detailed analysis of government fiscal projections and cost-analysis of government legislation, the office has been hampered by lack of support from the government. Its $2.8 million budget was cut by a third after it released several reports critical of government spending projections.[38] And the government has alternately tried drowning the office in paper or refusing to share information when requested.[39]

Recently, Parliament has faced even greater challenges in exercising democratic control over spending since the Conservative government withheld information from the House of Commons about cost implications for legislation including the cost of its "Tough on Crime" agenda and the cost of new fighter jets for the Canadian Forces. The government's withholding of this information was considered so serious that the government was found in contempt of Parliament and defeated on a confidence vote in the House of Commons.

Context for debate
The tax cuts of the past decade have taken place in the absence of a real, public conversation about taxes and the services that they pay for. Taxes have been divorced from the public services and democratic institutions which they pay for, rendering the debate a simplistic argument over what level of taxes are too high. Budget surpluses have been spun as over-taxation, rather than a connection being drawn with the reduction in spending and government services begun in the mid-1990s. Budget deficits have been presented as resulting from government overspending, despite the fact that nearly two-thirds of the federal deficit in 2009-2010 resulted from cumulative tax cuts. Tax cuts are promoted as savings for the poor, despite the fact that the poor benefit least from tax cuts and most from public services that are being cut or eroded.[40]

The statements of elected leaders have been representative of this one-sided perspective. Regarding tax cuts, former Finance Minister Paul Martin said "Canadians are entitled to keep more of the money they earn. After all, they worked for it. It's theirs."[41] Prime Minister Stephen Harper has implied that he does not believe that taxes are a good thing, stating "There are economists who believe the GST is a good tax; which of course comes from the school of economics that believes there's such a thing as good taxes." Harper has also promised that his government would develop "one of the most competitive and attractive tax environments on the planet" by cutting taxes.[42] Finance Minister Jim Flaherty, meanwhile, has suggested that we need to keep taxes low in order to keep the rich in Canada.[43]

As a result of this one-sided focus, any serious attempt at discussing the tax mix or suggestion of raising taxes has been shouted down in recent years. This includes the Liberal Green Shift, a proposal from Stéphane Dion to introduce a carbon tax and make it revenue-neutral by cutting other taxes, and a suggestion from Liberal leader Michael Ignatieff that Canada might have to raise taxes to respond to the deficit.

There are signs, however, that the deficit may be creating an opening in the debate about taxes. In March 2010, nearly three out of five CEOs surveyed said they believe that some form of tax increase may be necessary to deal with the deficit.[44]

What is Being Advocated
There is no perfect mix of taxes. To a large extent, what matters more than the particular arrangement of taxes is the outcome of the entire tax and transfer system of a country, combined with its public services and programs. Sweden, for instance, relies more heavily than Canada on highly regressive consumption taxes. However, they more than off-set the impact of the consumption taxes with generous transfers to the poor, making their overall tax and transfer system more progressive than Canada's.

Recognizing that there is no perfect balance to strive towards does not mean that we cannot try to improve the current mix of taxes. Who pays and how much they pay remain important, foundational principles of any tax system. There are a number of different policy options currently being advocated which would change the way Canada raises revenue. Some are changes to the present tax mix, including changes to corporate income tax rates, changes to personal income tax rates, and redefining the tax base by expanding the definition of taxable income. There are also proposals for new forms of taxation, such as a financial transactions tax or carbon taxes and other green taxes. And finally, there are proposals for general reductions in the amount of tax Canadians pay through support for any form of tax cut.

Change corporate income tax rates

Corporate income tax rates have been declining for years. The federal corporate income tax rate is now less than half of what it was in 1960 (19% vs. 41%),[45] and the rate is set to be cut to 15% in 2012.[46] According to the Federal Government Public Accounts, corporate income taxes were 3.2% of GDP in 1961-1962, but only 1.8% of GDP in 2008-2009. In 1961-1962, corporate income taxes were 20% of federal tax revenues;[iii] by 2008-2009, they were only 12.6%.[47] The most dramatic changes have taken place between 2000 and 2011, with the corporate income tax rate being cut from 28% to 16.5% and the elimination of the corporate surtax in 2008. The Library of Parliament estimates that changes to corporate taxes between 1998 and 2005 cost the treasury $4.6 billion in 2004-2005, with $4 billion attributable to the reduction in the income tax rate.[48] Changes since 2006 are projected to cost Canadians $60.2 billion by 2014, with the annual cost in 2010-2011 being $8.6 billion (see Table 5).

Table 5: Projected costs of changes to corporate taxes, Budget 2009 (in billions)

2008-2009	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014	Total
$5.3	$7.1	$8.6	$10.4	$13.8	$14.9	$60.2

Source: Finance Canada, Budget 2009

The income tax rate for small businesses has also been cut from 12% to 11%, while the amount of income allowed a small business was raised from $200,000 in 2000 to $400,000 in 2007 and eventually $500,000 in 2009. Meanwhile, provincial and territorial corporate income tax rates have also been cut, with the rate in most provinces and territories now hovering between 10% and 12%.[iv] Total taxes paid by corporations in Canada are now among the lowest in the world, second only to Mexico, according to KPMG's report on competitiveness.[v][49]

Despite this fact, there are still those who argue that Canada's corporate tax rates need to be cut even further. Some go so far as to argue that corporate taxes should be eliminated entirely.[50] There are four main arguments in favour of further tax cuts for corporations. The first is that tax cuts will lead to greater investment and therefore greater job creation. Taxes discourage investment, according to this argument, because they diminish returns on investments.[51] Another version of this argument focuses more on competitiveness, arguing that unless Canada's corporate tax rates are low, Canada will not be competitive, driving away business investments. The second argument, which is similar, suggests that corporate tax cuts will actually increase tax revenues as lower rates broaden the tax base since more profitable companies will want to be located in Canada.[52] The third argument opposes corporate income tax because it essentially taxes income twice – once when a corporation's profits are taxed, and a second time when shareholders receive dividends. The fourth argument is related: corporations don't pay taxes, people do.[53] Taxing corporate income means reducing either dividends to shareholders or passing costs along to employees in the form of reduced wages. Some proponents of corporate tax cuts therefore argue that corporate taxes primarily hurt working people.[54]

[iii] The Public Accounts does not include EI and other social security contributions in calculating tax revenues.

[iv] The outliers are Newfoundland and Labrador (14%), Nova Scotia (16%), PEI (16%), and the Yukon (15%).

[v] KPMG's study considers total tax costs, using a Total Tax Index. Income tax, sales taxes, property taxes, and capital taxes are included.

The first two arguments are particularly problematic. Canada has seen over a decade of corporate income tax rate cuts, yet investment has remained stagnant.[55] Clearly, tax reductions have *not* resulted in greater investment. This is because corporate taxes are only one small element in business investment decisions. Studies have shown that business investment is more strongly related to the growth of demand than to the cost of capital. Not all investments are mobile, which means that relocation is not always an option.[56] But even when it is, tax rates are only a part of business location decisions. According to KPMG, income taxes represent approximately 12% of location specific-costs, behind labour, facilities, and transportation.[57] Similarly, surveys of CEOs show that taxes rank between 5th and 7th in priority when deciding on location, behind an educated labour force, access to resources and markets, electricity and land costs, labour costs, social infrastructure and quality of life, all of which are supported through public services and programs paid for by taxes.[58] There is a risk, therefore, that corporate tax cuts erode the very public investments that lower business costs and productivity.

Additionally, Canada does not need further tax cuts to be competitive. KPMG, which bases its survey of competitiveness on tax rates and business costs, placed Canada second in the world in 2010.[59] On the other hand, the Global Competitiveness Index of the World Economic Forum places Canada 9th – behind countries such as Sweden, Finland and Denmark that have higher corporate income tax rates than Canada.[60] Clearly, further corporate tax cuts will not inevitably improve Canada's ranking in this Index. Comparatively speaking, the relationship that matters most for Canada's competitiveness is with the US tax system. However, Canada's combined corporate income tax rates are already lower than the US combined corporate tax rates. As a result, Canada has been losing money to the US treasury, which has a global tax on profits from American companies. When a country's tax rate is lower than the American tax rate, the tax must be paid on repatriated profits. The transfer effect may be as high as $6 billion annually.[61]

Rather than investment, increased profits from large corporate tax cuts have been going to shareholders.[62] But what about this argument that it is the working class that pays corporate income tax through lower wages? While there is evidence to support the argument that higher income tax rates do result in lower wages, real wages in Canada have been stagnant over the past thirty years.[63] At the same time, the benefits of economic growth have led to corporate profits increasing as a share of GDP, while wages and salaries have declined as a share of GDP, contributing to increased income inequality.[64] Clearly, corporate tax cuts have not resulted in a significant change for wages, suggesting that there is no argument to be made for corporate tax cuts to benefit employees.

Finally, the argument that corporate income is taxed twice has some merit. However, the dual taxation of corporate income is recognized through a dividend tax credit which reduces the amount of taxable income paid from shares on Canadian companies and through a 50% exemption of capital gains. On the other hand, if corporate income was left untaxed, the wealthy could simply accumulate money by leaving it in a corporation, which would essentially become a tax-free savings shelter.[65] Surely that would be no more fair than the double taxation of corporate income. To the extent that corporate income tax is paid by shareholders, it is a highly progressive tax, as shareholders are more likely to be high income earners than middle or low income earners. A large part of Canada's corporate tax sector is also owned by foreign investors, who pay no personal income tax in Canada. When profits are paid out of the country, they would not be taxed at all without Canadian corporate income tax.[66]

Additionally, corporations themselves benefit from the government programs and services paid for by taxation. Without physical infrastructure like roads and bridges and financial infrastructure like the monetary system and social infrastructure that contributes to a well-educated and healthy workforce, businesses would not be able to produce profits. Surely, there is a responsibility inherent in this benefit to contribute towards these programs and services – a benefit that lies with the corporation itself, and not simply wealthy Canadians who profit from owning shares.

This is also the major argument for raising corporate tax rates, or at least undoing some of the recent corporate tax cuts. Recent corporate tax cuts contributed 13.2% of the federal deficit in 2009-2010. Why should the low income and unemployed bear the primary burden of this deficit through the loss of programs and services when they have not benefited from the rise in after-tax profits of corporations? Corporations should be part of the solution to Canada's deficit – not part of the problem. Canada has room to roll back recent corporate tax cuts without violating any theoretical threshold of competitiveness, and in fact, revenue from corporate taxes will help contribute to crucial physical and social infrastructure that will make Canada's economy and Canada's workforce competitive.

Raise the GST/Increase reliance on consumption taxes

Some economists argue that consumption is a better base for taxation than income, advocating for an increase in the GST or fully replacing income tax with reliance on consumption taxes to raise revenue. They argue that consumption taxes are "more efficient, equitable and simple."[67]

The argument that consumption taxes are more equitable is based on horizontal equity, or the principle that people with the same level of income but different levels of welfare should be treated differently. Economists have rightly critiqued the use of income as the sole measure of economic well-being, noting that well-being is based on a variety of factors.[68] However, some economists argue that equity or well-being should be based on a person's preferences, with consumption serving as the measure of preference. "Consumption is believed to be a better proxy of a taxpayer's well-being than is income, since it is what taxpayers consume rather than what they earn that effectively determines their economic well-being."[69] Rather than tax ability to spend, governments should be taxing actual spending.

Consumption taxes are also promoted as a more efficient form of taxation, because, it is argued, they don't influence people's decisions to save or invest.[70] Over time, all income is either spent or saved. Saved income is eventually bequeathed to someone else who will either spend or save it. Eventually, therefore, all income ends up being taxed. However, consumption taxes apply at the same rate on current and future consumption, so there is no benefit to spending now or saving now. This is in contrast to income taxes, in which investment income on savings is taxed. Thus, consumption taxes are supposedly neutral regarding saving and spending.[71]

Finally, it is argued that consumption taxes are simpler, because they avoid difficulties in properly measuring income.[72] Not all income is taxable, and not all taxable income is taxed at the same rate. With consumption taxes, there is no distinction made between sources of income, and taxation rate is determined by the nature of the good or service being purchased.

Proponents of greater consumption taxes acknowledge that consumption taxes are regressive, but do not seem overly concerned. In some cases, they expect the regressive effect is mitigated by exemptions and zero-rating of basic products and the GST/HST credit provided to low income families.[73] In other cases, they argue that consumption taxes can be structured progressively, for instance with personal expenditures tracked over time in order to target tax credits to those with fewer resources.[74]

There are a number of arguments against such a shift towards greater reliance on consumption taxes. First, consumption is not a reliable indicator of well-being. Poor families can consume more than 100%

of their income – that is, going into debt to cover expenses – without appreciably increasing their well-being. In fact, most low income families consume all or most of their income. Wealthy families, on the other hand, can resist buying the latest yacht or Ferrari without appreciably decreasing their well-being. Preferences in consumption are a luxury that only those with enough disposable income to make choices can enjoy, and they are not a reliable indicator of economic well-being.

Similarly, this approach replaces citizens with consumers. Rather than citizens participating in a shared democratic community, making contributions towards the common good as they are able, individuals are viewed as consumers, whose primary goal is to choose what, when and how to consume. Taxes are treated like a form of punishment for certain decisions, rather than as the procurement of collective programs and services. That everyone – regardless of how much tax they pay – receives a benefit from public programs and services is not taken into account.

Consumption taxes are also not mildly regressive, they are very regressive. In 2005, the lowest income decile of Canadian families paid 17% of their income in consumption taxes, while the second lowest decile paid 15.6% of their income. The highest income decile paid only 3.2% of their income in consumption taxes, while the second highest income decile paid 5.4% of their income.[75] While it is true that the GST/HST credit helps to mitigate the regressive effect, the approach is not without drawbacks. While virtually all families with incomes under $20,000 a year receive the credit, only 26% of the total credit paid by the federal government goes to low income families. In 2003, 20% of the families receiving the credit had incomes between $40,000 and $99,999, while 8% of recipients were families with incomes over $100,000. Unsurprisingly, then, the GST credit has a very minimal impact on the redistribution of income, narrowing the gap between recipients and non-recipients by less than 1%.[76]

Off-setting an increase in consumption taxes with greater GST credits is also inefficient, as it costs the government both to collect the tax and administer the credit. Aldyen Donnelly wrote in the National Post that the United Kingdom and many European Union governments who had switched to greater reliance on consumption taxes during the 1990s realized by the year 2000 that the shift had resulted in their tax systems being both more regressive and more inefficient. The UK then committed to shifting taxation back from consumption to income, although in 2007 the government acknowledged that many changes had not yet been implemented. In 2005-06, the wealthiest families paid only 2.5 more times in consumption taxes than the poor, despite the fact that their incomes were 16 times greater. Meanwhile, the bottom two-thirds of British families received more in government transfers than they paid in tax. Donnelly argues that it would be more efficient for the government to exempt low income families from consumption taxes and offer further support through the income tax system than to maintain the tax and keep paying benefits.[77]

Introduce a flat tax

A flat tax is a popular option among right-wing politicians and economists, promoted by the Fraser Institute, the Frontier Centre for Public Policy, and the former Reform Party and its successor the Canadian Alliance. A flat tax would replace Canada's progressive personal and corporate income tax systems with a single tax rate. A true flat tax would also eliminate nearly all of Canada's existing tax deductions, credits and exemptions. Most flat tax proposals in Canada are hybrids that would retain some or all tax deductions and credits, rather than eliminating them.

Alberta adopted a single-rate tax system in 2000, a major step towards a flat tax. However, Alberta did not eliminate tax credits and exemptions, leaving the system short of a true flat tax system. Many former Eastern bloc countries have adopted a flat tax system, including Russia, the Czech Republic, Estonia, Latvia, Lithuania, Romania, Ukraine and Serbia. Hong Kong also has a flat tax of 15%.

There are four main arguments in favour of a flat tax: simplicity, an increased tax base, an increase in work, savings and investment, and horizontal equity. A flat tax is argued to be simpler because it requires no calculation of tax rates. Proponents such as the Fraser Institute argue that Canadians would be able to fill out a tax return no bigger than a postcard if Canada adopted a flat tax.[78] Such simplicity would reduce the supposedly high compliance costs of Canada's current income tax system, which the Fraser Institute pegged at between $18.9 and $30.8 billion annually.[79] A true flat tax would also increase the tax base by ensuring that all forms of income are taxed at the same rate, rather than exempting or partially exempting certain forms of income which happens in the current system.[80]

Supporters of the flat tax also argue that the progressive tax system, which imposes increasingly higher marginal tax rates on higher income earners, is inherently biased against working, saving and investing. Because of the rising marginal tax rate, they argue, people will choose not to work or invest because the financial return of doing so diminishes.[81] The Frontier Centre for Public Policy claimed that progressive taxes cost the country $42 billion in lost jobs and output in 1999.[82]

Finally, a flat tax is supposed to provide greater horizontal equity because it doesn't discriminate between single and dual-earner households.[83] In the current progressive tax system, a family with one income earner making $70,000 will pay more tax than a family with two income earners each making $35,000 a year. Flat tax supporters argue that this is inherently unfair.

While a single tax rate would make the system proportional, flat tax proponents argue that the system can actually remain progressive if a large personal exemption is instituted to ensure that low income earners pay no tax. Income earners above the personal exemption will still face a rising marginal tax rate as the exemption becomes an increasingly smaller proportion of their income.[84]

Although flat taxers do recognize the inherent unfairness of taxing different forms of income differently, there are a number of problems inherent in the proposal. First of all, the complexity of Canada's tax system is rather exaggerated. The real challenge in calculating income tax is presented by determining what is and what is not taxable income.[85] Once taxable income is calculated, it is a simple process to figure out which tax rates apply to which income, especially since the number of tax brackets in Canada have been greatly reduced. Unless proposals address the issue of deductions and credits, they are not making the tax base any easier to calculate and therefore not making the system much simpler.

Second, the evidence and economic literature regarding the work and savings disincentive is ambiguous. People may work, save and invest more if taxes are lower and they are ensured a higher return for each additional dollar of income. But people may also work, save and invest less if taxes are lower because it takes a lower amount of effort to achieve the same income results.[86] This is also a very reductionist view of human motivation that ignores all of the reasons why people might choose to engage in paid work or save and invest their income in particular ways.[vi]

Third, the concept of horizontal equity between single and dual income earners espoused by flat tax proponents is very narrow. While it is true that two families with the same level of income are being

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[vi] For more on the issue of work motivation, see Chandra Pasma, *Working Through the Work Disincentive,* Citizens for Public Justice, April 2009.

treated differently by the progressive tax system, it is not true that the two families are equal because their income is equal. In the case of the dual income earner household, parents must sacrifice a great deal more time with their family in order to earn the same level of income. This greatly constrains their choices compared to the single income earner household, in which there is enough freedom to make the choice whether or not to engage in paid work, and parents are able to spend far more time with their children. To presume that both families would be equal if they paid the same level of taxes is extremely short-sighted.

Finally, the biggest issue is the presumption that the flat tax would be fair, either because all income earners would be contributing equally or because the personal exemption would free low income earners from paying taxes. A flat tax would offer a greater reduction in taxes to higher income earners than to low income earners in absolute terms, if not in percentage terms. Such a cut would violate perceptions of fairness, even if they wouldn't violate economists' notions of fairness. The flat tax would thus also contribute to rising levels of income inequality, which comes with significant social costs. And most importantly, because Canada's overall tax system is closer to being proportional than to being progressive – with most Canadians paying between 30 and 35% of their incomes in taxes – a proportional income tax system would actually have the perverse effect of making Canada's tax system regressive, with the lowest income Canadians paying the highest proportion of their income in taxes. As Neil Brooks of the Canadian Centre for Policy Alternatives summarizes, "Although many right-wingers claim the tax system should not be progressive, I have never heard anyone make a moral or economic argument for a regressive tax system."[87]

Raise tax rates on the rich

In light of the growing income inequality in Canada, described above, some are calling for an increase in taxes on the highest income earners or the introduction of a new income tax bracket for high incomes. Tax cuts over the past decade have contributed to the growth of income inequality and have rendered the system far less progressive. In fact, for the highest income earners, the system became regressive beginning in 2005, with higher income earners contributing less of their income than lower income earners. This is largely because almost all non-income taxes are regressive, although for the top 5%, income tax rates have also become regressive. High income earners benefited from the elimination of the 5% high income surtax in 2001, but also from the increased exemption on capital gains and the rising limit on the allowable deductions for RRSP contributions.[88] (Over two-thirds of the value of capital gains exemptions goes to tax filers making over $100,000 a year). This violates the principle of vertical equity, and leaves considerable space to enhance the progressiveness of the overall tax system by increasing the progressivity of the income tax system.

Exemptions such as the one for capital gains and deductions for things like RRSP contributions and business losses are more likely to be realized by higher income earners and lead to a situation where low and middle income individuals pay tax on all of their income while the rich pay tax on only some of their income. High income individuals also receive "a hugely disproportionate share of non-taxable income such as accrued gains on shares and real estate, investment income on life insurance policies, inheritances and gifts, income accumulating in pension plans, the imputed rental income due to the equity they have invested in their homes, and employer-provided benefits."[89] While the number of taxfilers who pay no taxes drops as income climbs, the proportion increased in the top 5% in 2004. In the very highest income group, 100 taxfilers paid no tax at all.[90]

High income Canadians benefit personally from the government programs and services funded by tax revenues. In fact, on a strictly dollar basis, the benefit for households earning $120,000 or more is in the range of $14-15,000. But taxes are also part of a contribution to the greater welfare of society, which also benefits high income people. High tax countries have greater income equality, more trust among individuals and for public institutions, more gender equality, more economic security, and better environmental performance,[91] all of which result in greater well-being for both rich and poor.

If taxes are to be based on the ability to contribute to the common good, the wealthiest Canadians can afford to contribute more. The top tax bracket in 2010 begins at $129,021, with a tax rate of 29%. In 2004, roughly 10% of families received market incomes of $125,000 or higher.[92] However, the top 1% of families made $305,000 or more, while the top 0.1% made $1.45 million or more.[93] Yet these families pay the same rate as someone making only half as much or less, despite their considerable ability to contribute more. Bruce Campbell of the Canadian Centre for Policy Alternatives argues that a new, higher tax rate should be introduced for individuals earning $250,000 a year or more.[94]

Those who oppose higher taxes on the wealthy present two main arguments: high taxes may result in an exodus of wealthy Canadians from the country, and wealthy Canadians are already paying a high proportion of total taxes. In 2007, Finance Minister Jim Flaherty suggested that the rich faced disproportionately high tax rates, which should be cut in order to prevent them from leaving the country. This proposal received support from William Robson, president of the C.D. Howe Institute, who argued that Canada is a high tax jurisdiction for people earning $150,000.[95] Arguments of this kind were common with the former Reform party, who tied the theme of exodus to a brain drain of highly-skilled Canadians towards the United States. However, this argument ignores the reality that overall the tax system is actually regressive at the top. Comparisons with the United States also fail to account for differences in the provision of services between Canada and the US. Provision of health care alone is extremely expensive in the US, but is paid for through taxes in Canada. This kind of argument also treats the wealthy like they are a superior kind of people whom we must retain at any cost – even if it means tax concessions that are harmful to the poor.

The second argument is that wealthy Canadians “pay a disproportionately large share of the personal income tax and that share has been getting larger.”[96] However, simply calculating share of personal income tax is misleading as a basis for determining tax fairness. First of all, high income earners pay a high share of personal income tax because they have a very high share of national income. Additionally, not all of their income is taxable, since high income earners benefit most from non-taxable income such as dividends, capital gains, inheritances and gifts. And second, while income tax is progressive, overall the tax system is regressive at the top, with high income earners paying a lower proportion of their income than middle class earners. The facts simply don’t back up this assertion.

Expand the tax base by redefining taxable income

In 1962, Prime Minister John Diefenbaker appointed a Royal Commission on Taxation, headed by Kenneth Carter. After 4 years, Carter’s Commission submitted its report to Lester Pearson’s government. Its principle finding was that the tax system was unfair to the poor, who paid a greater share of their income in taxes than the wealthy, who could avoid taxation through use of loopholes. One of the Commission’s central recommendations was that all income should be taxed equally; “A buck is a buck,” Carter said, regardless of how you earn it.[97] Taxing all income, regardless of source, would allow the same amount of revenue to be collected with lower tax rates. The Carter Commission’s recommendations were never fully implemented, in part due to a vehement backlash from those who benefited under the existing system.[98]

But now, the proposal to expand the tax base by redefining taxable income is resurfacing. Tax loopholes that preclude certain forms of income from being taxed primarily benefit the wealthy, who are the most likely to have such income.[99] They also encourage tax evasion and financial speculation.[100]

Wages and salaries are taxed at a different rate than other income sources, including "dividends, realized capital gains, gifts, inheritances, trusts, royalties, fees, interest, government transfers, and lottery winnings."[101] These deductions and exemptions come with a significant cost to taxpayers: in 2009, the partial exclusion of capital gains (only 50% of income from capital gains is taxed) cost $6.5 billion. The cost was actually on the low side, due to the impact of the recession. Before the recession began, the cost of the capital gains loophole was $11.8 billion in 2007.[102]

The primary beneficiaries of these loopholes are the highest income earners. For example, in 2005, over 66% of the value of the capital gains exemption went to the top 4% of taxfilers, all making over $100,000 per year.[103] As a result of these kinds of loopholes, in 2004, 100 individuals in the highest income group in the country paid no tax at all.[104]

Other costly deductions that benefit the wealthy are the dividend tax credit, which cost $3,055 million in 2009, and the partial deduction of meals and entertainment for business purposes, which cost $435 million in 2009.[105] John McMurtry notes that there is a class element to what is considered a deductible expense: "Business people can write off luxury meals, drinks, and car bills from their taxes, while the salary and wage earners cannot deduct a bus ticket."[106]

While deductions and exemptions of income are usually introduced with certain goals (both policy and political) in mind, there is no accountability to ensure that the measures are actually meeting their intended goals or whether they are the best or most appropriate way of meeting their goals.

Introduce a Financial Transactions Tax or Tobin Tax

A financial transactions tax (FTT) is a tax on financial market transactions, including "equity, bond, derivative or foreign exchange trades."[107] It was originally conceived and proposed by John Maynard Keynes, who was concerned about the impact of short-term speculation on markets. Its most famous proponent was James Tobin, who in the 1970s suggested a FTT on currency speculation as a way of controlling foreign exchange markets. Many people now refer to all FTTs as a "Tobin tax," despite the fact that Tobin's proposal was limited to currency trading.

FTTs have wide-spread support among civil society organizations, including the World Council of Churches, the Halifax Initiative, the AFL-CIO, and the Global Policy Forum.[108] The Halifax Initiative is a Canadian network which includes the Canadian Catholic Organization for Development and Peace, the Social Affairs Office of the Canadian Conference of Catholic Bishops, the Canadian Council for International Cooperation, the Canadian Labour Congress, the Canadian Auto Workers, Kairos, the North-South Institute, Oxfam and Rights and Democracy.[109]

At present, the FTT also has strong political support, including Angela Merkel, the German Chancellor; Nicolas Sarkozy, the French president; Gordon Brown, the former UK prime minister; Naoki Minezaki, Vice Finance Minister of Japan; the governments of Austria and Belgium; the European Parliament; José Manuel Barroso, President of the European Commission;[110] and Nancy Pelosi, former Speaker of the US House of Representatives.[111] In September 2009, the German Finance Minister Peer Steinbruck published a call for a FTT of 0.05% applied across G20 countries.[112] The strongest opposition has come from Canada, which prevented a proposal for a global FTT or a bank levy from reaching the agenda of the Toronto G20 meeting in June 2010.

There is also wide-spread support among economists, with 350 economists in 36 countries signing an open letter calling for a FTT in early 2010.[113] Prominent economists Joseph Stiglitz, 2001 Nobel Prize winner and former Chief Economist of the World Bank, Paul Krugman, 2008 Nobel Prize winner, Jeffrey Sachs, former Director of the United Nations Millennium Development Project, and Paul Volcker, former US Federal Reserve Chair, have all endorsed the call for a FTT.[114] On the other hand, the International Monetary Fund has remained steadfastly opposed to the idea of a FTT.[115]

Currently there is a global campaign calling for a FTT of 0.05% levied on all financial market transactions between financial market actors, commonly dubbed the Robin Hood Tax.[116] It is estimated that the Robin Hood Tax could generate more than US $600 billion a year, which would be divided between international aid and domestic programs. One quarter of the revenue would go towards reducing the US $180 billion shortfall in resources needed to meet the Millennium Development Goals. One quarter would go towards international climate change programs, helping developing countries adapt to and mitigate climate change. And the remaining half would go to developed countries, who could use the funds to make up budget deficits resulting from the financial crisis (estimated to be US $710 billion globally) or to repay taxpayers for bailouts of financial institutions and industries.[117]

There are two major arguments in favour of a FTT. The first focuses on reducing the harmful impact of short-term speculation, particularly on real markets and unemployment. Short-term speculation creates excessive trading and volatility of asset prices. By adding a cost to short-term speculation, a FTT would help to reduce the volume of short-term speculation taking place. It would not discourage long-term investments, since the cost would be minimal. The FTT would thus have a stabilizing effect on prices. It would also help to prevent financial crises like the 2008-2009 global recession, which was caused by financial market speculation in stock markets, housing and commodities.[118]

The second main argument focuses on the revenue that could be generated by a FTT. Calculations suggest that a FTT of 0.01% could raise US $286 billion annually. A FTT of 0.05% could raise US $650 billion annually. A FTT of 0.1% could raise US $917 billion annually. A FTT applied only to currency trading could raise $192 billion annually.[119] Proponents suggest that this revenue could be applied towards development and aid, reducing global poverty and fighting climate change.

A third argument at the present promotes the FTT as a way of ensuring that financial institutions and actors who caused the financial crisis of 2008-2009 help to pay for its costs. Otherwise, there is a risk that working families will pay for the recession twice – first through higher unemployment and greater poverty, and second through the loss of government programs and services when governments cut budgets to deal with the resulting deficit.[120]

Arguments against a FTT focus on enforcement or effect. One of the most common arguments against a FTT is that it would be difficult to enforce unless it was imposed globally, since it would lead to tax evasion and movement of transactions to non-tax jurisdictions. However, as Alex Michalos points out, all taxes are subject to evasion and this is not considered a reason not to have them.[121] Additionally, it is not necessarily the case that a FTT must be imposed globally in order to avoid evasion. There are already countries who have variations of FTTs who nonetheless have robust markets and there are methods of ensuring compliance, such as countries taxing all financial transactions by their citizens, regardless of where the transaction takes place.[122] Rodney Schmidt of the North-South Institute has demonstrated that "levying taxes at the point where trades are cleared or settled, regardless of where the dealing rooms are located or the trade is made, effectively eliminates the possibility that the tax could be easily avoided."[123]

The argument is also made that rather than a positive, stabilizing effect on markets, a FTT would have a negative impact on markets.[124] Critics suggest that the FTT would distort market behaviour and potentially increase costs, thereby adding to volatility rather than reducing it. However, one of the goals of the tax is to distort market behaviour – socially harmful market behaviour in particular.[125] Furthermore, the evidence suggests that by reducing liquidity, the FTT can help to stabilize rather than destabilize prices and exchange rates.[126]

Finally, the IMF argues that a FTT would add costs for small investors, or the middle class, particularly on savings for retirement or education.[127] However, small investors – particularly those saving for retirement or education – do not trade their portfolios frequently and are not engaged in short-term flipping for the sake of the greatest profit. Furthermore, not all proposals include transactions by customers and financial institutions (ie. the actual sale or purchase of shares would be taxed, but not the payment made by the customer to the bank). And finally, because the tax is low, costs would be minimal for occasional transactions. Only those who trade large volumes frequently would pay a significant price.

Introduce a carbon tax or other green taxes

A proposal that has gained recent prominence in Canadian debate as concern over climate change and environmental devastation grows is the introduction of a carbon tax or other green taxes. A carbon tax places a price on emissions of greenhouse gases by taxing carbon-containing fossil fuels.[128] Other green taxes place a price on harmful or wasteful activities such as waste sent to a landfill.[129] Taxes can be imposed "upstream," at the point when the product is introduced to the market, or they can be levied throughout the economy, every time a good or service is bought or sold. Many European countries have implemented a carbon tax, including Denmark, Finland, Germany, the Netherlands, Norway, Sweden and the United Kingdom.

In Canada, two jurisdictions already have a carbon tax: Quebec and British Columbia. Quebec's carbon tax is a levy on petroleum producers of 0.8 cents a litre for gas and 0.9 cents a litre for diesel fuel. The tax is estimated to cost oil producers $69 million annually for gas, $36 million annually for diesel fuel, and $43 million annually for heating oil.[130] In 2008, BC introduced a considerably larger tax on emissions, which began at $10 per tonne of emissions in 2008. The tax is scheduled to rise $5 every year until it reaches $30 by July 2012.[131] The tax is designed to be revenue-neutral, with all tax revenues redistributed through low income credits and personal and corporate income tax cuts. However, the tax has been criticized as regressive, since the value of the low income tax credits has not kept pace with the cost of the tax.[132] The Pembina Institute has called for the replacement of the low income credit with programs aimed at helping low income residents to reduce their emissions.[133] The carbon tax also covers only about 70% of emissions.[134]

Federally, two political parties have proposed a carbon tax. In the 2008 federal election, the Liberal Party's platform called for a Green Shift – a carbon tax beginning at $10 a tonne in 2008 and climbing to $40 a tonne by 2012. The tax would have generated an estimated $15 billion annually, which was to be divided between transfers to low income citizens and a reduction in other taxes.[135] When Michael Ignatieff replaced Stéphane Dion as leader of the Liberal Party in early 2009, the carbon tax was dropped from the Liberal platform. The Green Party of Canada has long advocated for a carbon tax, and is the sole federal party to support one right now. The Green Party's proposal is for a tax of $50 a tonne, which would be applied on all goods and services. The proposal is for a revenue-neutral tax, with credits to low income and rural Canadians, and cuts in other taxes.[136]

A carbon tax is not the only way to put a price on pollution – another option is a cap-and-trade system on emissions. However, a number of arguments are made in favour of a carbon tax. First, a carbon tax is an extremely simple way to put a price on carbon. It does not require any regulation and governments already have the knowledge and infrastructure necessary to implement a tax. Furthermore, the tax imposes a single price on carbon, making it simple to administer, and offering price stability, unlike a cap-and-trade system in which the effect on prices is unknown. In contrast, however, the cap-and-trade offers certainty about the level of emissions reductions, whereas the effect of the carbon tax on emissions is unknown. Governments may need to adjust tax rates in order to achieve desired reductions, therefore.[137]

One of the most common arguments in favour of a carbon tax is that we should be taxing "bads," not "goods." Income, employment and profits are good things, and there is a risk of discouraging them by taxing them, but energy use and harmful environmental activities are bad things, and should be discouraged through taxation, according to this argument.[138]

Arguments against carbon taxes and green taxes focus on their regressive nature, their harmful economic effects, and the limited scope of a national tax. Carbon taxes are highly regressive. Although high income earners consume more energy than low income earners, low income earners spend a higher percentage of their budgets on energy products. When the indirect effect of the tax is included (prices for everything are likely to increase, since almost every product relies on fuel for production or transportation), a carbon tax has an even greater impact on low income family budgets, since most or all of a low income earner's income is consumed. High income earners also have more capital to make changes necessary to lower energy consumption, such as home retrofitting or purchasing hybrid vehicles.[139] However, the regressive impact of carbon taxes can be off-set if the revenues are used for credits to low income people and for programs that help the low income to use less energy.

Opponents also argue that a carbon tax will hurt the economy.[140] While everyone faces the same cost for polluting, some industries are more heavily energy dependent and will pay a higher price with a carbon tax. In Canada, this will have a regional impact as well, since some provinces are more heavily dependent on energy production and energy intensive industries than others. Provinces also rely on different sources for electricity, leaving residents of some provinces paying much more for electricity than in others. Rural residents, and in particular farmers, are also much more dependent on energy than urban residents. However, these arguments fail to take into account the fact that our economy will also suffer – and is already suffering – as a result of climate change and its effects. Whether or not a carbon tax is more devastating for the economy than climate change depends on how the tax is structured and implemented. Tax credits for rural residents and programs aimed at helping the development of new, more efficient technologies can help to off-set the economic impact of the carbon tax.

Critics also claim that it makes no sense for Canada to tax carbon when developing economies such as China and India are producing more emissions all the time without any anti-carbon programs.[141] However, failing to take responsibility for our own climate emissions also does not help the world to reduce overall emissions. International reductions in greenhouse gas emissions will depend on international agreements, programs to help developing countries adapt their economies, and options such as a carbon tariff on imported goods.

There remain two outstanding challenges with a carbon tax or any green taxes. First, the goal of the tax is to reduce and possibly eliminate the behaviour being taxed. As the behaviour changes, revenue will decrease. If the tax is made revenue-neutral through the elimination of other taxes, governments will be faced with declining revenue. It therefore makes more sense to use the revenue generated by green taxes for credits to off-set the regressive impact and for programs to mitigate and adapt to climate change. One proposal is for an eco-tax dividend, which would essentially provide a basic income to citizens,[142] although the level would vary with the revenue collected by the tax.

The second challenge is that taxing bads, not goods, only makes sense when taxes are divorced from the context of the government programs and service they pay for. Taxes are about more than paying for how "bad" you are for society, they are also a contribution to the common good. While to a certain extent, it makes sense to have those who produce a cost to society through environmental degradation help to pay for that cost, ultimately contributions to the common good should be made on the basis of one's ability to contribute, not one's cost to society.

Implement tax cuts

Apart from those who argue that changes to the mix of taxes are necessary, there are those who are in favour of tax cuts generally. It doesn't matter what kind of tax is involved; to these anti-tax campaigners any kind of tax cut is good and necessary. This is particularly the position of right-wing think tanks and lobby groups such as the Fraser Institute and the Canadian Taxpayers Federation.

The arguments in favour of any and all tax cuts rely on two main themes – an ideological opposition to taxes and the argument that tax cuts are actually good for the economy. Proponents often suggest that Canadians are overtaxed, or that we bear a heavy tax burden, and therefore require "tax relief."[143] This is either based on an appeal to emotion or supported by claims regarding the "average taxpayer." The Fraser Institute, for instance, claims that the "average" Canadian family hands over 46.2% of its income to governments.[vii][144]

Jack Mintz, a proponent of tax cuts himself, reveals the motivation behind this ideological opposition to taxes: a preference for smaller government.[145] Mintz argues that the size of Canadian governments is too large at 40% of GDP. Increasing taxes will only allow lead to larger government, he argues. This opposition to government stems from a belief that big government is inherently bad, or that citizens do not benefit from larger governments. Mintz suggests that once government spending exceeds one-third of the economy, citizens are not better off because high public spending and high public taxes erode productivity.

This relates to a second common theme: taxes are bad for the economy, and therefore tax cuts are good for the economy. The Fraser Institute focuses many of its arguments on fiscal competitiveness and economic incentives for hard work, saving, investment and entrepreneurship.[146] In particular, this is often linked to a claim that lower taxes will actually generate higher revenues, an approach known as supply-side economics.[147] Lower taxes are expected to generate so much economic growth that tax revenues will increase as tax rates fall, according to this argument.

[vii] The problem with averages is that there is no such thing as an average taxpayer. The average is determined by dividing total taxes paid by the number of taxpayers, with high taxes paid by fewer high income earners skewing the data for lower income earners who pay lower taxes. When tax incidence is examined by decile, most Canadians pay between 30 and 35% of their income in taxes.

However, the data does not back up the supply-side theory. While revenue may increase in spite of tax cuts, due to strong economic growth, there is no evidence that revenue increases because of tax cuts. In fact, evidence suggests that tax cuts slow revenue growth. In the US, where Ronald Reagan was a major supporter of the supply-side theory, huge tax cuts contributed to an even bigger government deficit. Meanwhile in Canada, BC experienced higher revenue growth in the 1990s than next door Alberta, despite the fact that Alberta had faster economic growth and a greater increase in corporate profits, largely because of deep and extensive tax cuts in Alberta.[148]

Supply-side economics actually relies on the same ideological basis as opposition to tax cuts. David Stockman, a former Director of the Office of Management and Budget in the US has since explained that supply-side economics was a strategy to promote tax cuts for the wealthy by arguing that everyone would be better off as a result. He told *Atlantic Monthly,* "It's kind of hard to sell 'trickle-down'… So the supply-side formula was the only way to get a tax policy that was really 'trickle-down.' Supply-side is 'trickle-down' theory."[149]

While there is no evidence that tax cuts will lead to economic growth, there is a strong argument that the policies and programs paid for by taxes can help contribute to economic growth. As Neil Brooks and Thaddeus Hwong explain, "Policies furthering social justice are likely to contribute to efficiency and growth, for a number of reasons: spending on education and health care contributes to a better educated and healthier workforce; the increased economic security of workers enhances their capacity to adjust to change, bear more risk, acquire more specialized skills, and pursue investment opportunities; social justice policies can channel and mitigate industrial conflict in periods of structural adjustment and foster political stability and social cohesion; a smaller range of wage dispersion encourages structural change and thus productivity growth; and a more equal society bears fewer of the costs of social stratification such as increased health costs, crime control costs, and the cost of inner city decay."[150]

With regard to the size of government, how big government should be is a legitimate subject for democratic debate. However, it should be debated openly and honestly and not hidden behind rhetoric that insists on divorcing taxes from public spending. There is no set size of government that is bad, and in fact there is evidence to suggest that higher taxes and greater public spending can indeed have a very beneficial effect for citizens.

International Comparisons

Tax comparisons are difficult to make across countries, because not only do tax rates differ, so do definitions of taxable income. However, the Organisation for Economic Cooperation and Development (OECD) makes comparisons on the basis of taxes as a percentage of GDP. When compared to other OECD countries, in 2008 government revenues as a percent of GDP were higher in Canada than the OECD average (39.8% vs. 37.9%). However, total tax revenue as a percent of GDP was lower in Canada than the OECD average (32.2% vs. 35.3%). In fact, Canada was 18th out of 26 countries for total tax revenue.[151]

Compared to other OECD countries, Canada has relatively high taxes on income, profits and capital gains (ninth out of 33 countries) and relatively high property taxes (tied for second out of 33 countries).[152] In contrast, Canada has relatively low social security contributions (26th out of 31 countries) and relatively low consumption taxes (29th out of 33 countries).[153]

A 2006 study of the social benefits and economic costs of taxation found that high tax jurisdictions (the Nordic countries) had significantly better social outcomes than low tax jurisdictions (Anglo-American countries). Out of 50 social indicators, the high tax countries scored significantly better on 29 and somewhat better on 13. Low tax countries scored better on 7 indicators, but the results were not statistically significant. The high tax Nordic countries had lower poverty rates and greater income equality, more gender equality, more economic security, better health and educational outcomes, lower homicide rates, more trust between individuals and for public institutions, less drug use, more leisure time, more freedom, more life satisfaction, better environmental performance and gave more in foreign aid.[154]

Furthermore, the high tax jurisdictions achieved this positive social outcomes without paying an economic price. Over the past 15 years, low tax jurisdictions did achieve slightly greater economic growth, but out of 33 indicators, high tax countries were stronger on 19 and the low tax countries better on 14. The high tax Nordic countries had marginally higher GDP per capita, higher GDP per hour worked, lower unit labour costs and lower rates of inflation, higher budget surpluses, higher total labour participation rate and higher female labour participation, higher rates of household saving and net national saving, higher ranking on indexes of innovation, a higher percentage of GDP spent on research and development and a higher percentage of workers in research and development, a higher level of network readiness, a higher number of broadband subscribers, a significantly higher ranking on growth competitiveness by the World Economic Forum, and a higher ranking on a global creativity index.[155]

United States

Compared to the United States, Canada has higher tax revenues as a percentage of GDP (32.2% vs. 26.9% in 2008).[156] Taxes on income, profits and capital gains, property, and goods and services are all higher in Canada than in the US. Social security contributions are lower in Canada, however.[157] Much of the difference between Canadian and US tax rates can be attributed to spending on health and education in Canada.[158]

While comparisons with the US are often made by Canadian proponents of lower tax rates, there are reasons to be hesitant about embracing the US model. While the US does have lower taxes, it also has one of the worst rates of poverty in the industrialized world, the worst income inequality in the industrialized world, and ordinary workers have much less economic security than in any other industrialized country. In addition, most US health care is private and not paid for by taxes. But while the US spends more than twice as much of its GDP on health care as does high tax Finland, its health outcomes are far worse.[159]

Europe

Tax revenues as a percentage of GDP were higher in Denmark, Finland, France, Germany, Norway and Sweden than in Canada in 2008.[160] Canada was relatively more dependent on property taxes than the European countries, but collected less from social security contributions and consumption taxes. Canada collected more taxes on income, profits and capital gains than France and Germany (10.4% and 11.5% respectively), but lower than the Scandinavian countries (who ranged from 16.8% to 29.2%).[161]

2. Core Principles and Values

There are several very different perspectives on taxes that exist in Canada today. At one extreme is the libertarian perspective that taxes represent theft. From this perspective, individuals alone own the product of their labour and should have the right to dispose of it as they choose. The government takes some of your income relying on coercion, therefore taxes are theft of your individual property.

A less extreme, but still negative, perspective of taxes represents taxation as an onerous burden. Taxes are divorced from any of the outcomes they pay for, the only topic that matters is how much tax you pay, with less always being better. The language that gets used reflects this idea of taxes as onerous: tax burden, tax relief, and tax grab. Governments are portrayed as greedy, always willing to grab more taxes. Taxpayers – who are always taxpayers and not citizens – are overburdened by taxes, regardless of what benefits they receive in exchange for their taxes. It is this perspective that gives rise to Tax Freedom Day – the day we supposedly stop working for the government and start working for ourselves.

When this perspective is tied to government benefits, it is often from the perspective that "other people" benefit, while taxpayers themselves receive little or no benefit from taxes. Taxes are viewed primarily as redistribution, paying for programs for poor people and the unemployed. This then becomes tied to negative perspectives regarding poverty and unemployment, including the sense that the poor are freeloaders who are not contributing to society.[viii]

An alternative perspective ties the concept of taxes to citizenship. "Taxes are the price we pay for a civilized society," former US Supreme Court Justice Oliver Wendell Holmes once said. Taxes fund our democratic institutions, build our roads and bridges, pay for our police and firefighters, offer support for raising children, provide income security for the elderly, and help to ensure our environment is clean and safe. Taxes are part of our common wealth as a society, and they are used to help foster the common good. Paying taxes is therefore a contribution to the common good.

There is also a link between taxation and democratic government that views taxation as the foundation of accountability between the state and its citizens. Paying taxes makes citizens feel invested in the decisions of their government and more likely to track government decisions and demand changes when they don't approve. While the cry of the American Revolution was "no taxation without representation," an argument could be made that there is "no representation without taxation." In fact, in both England and France, democratic institutions arose from bargaining over taxation (usually to finance wars) in which governments had to give greater control and opportunities for deliberation to the people in exchange for higher taxation. Todd Moss also argues that this link is responsible for the "resource curse" in which governments who have access to large amounts of unearned income seem to be less accountable, less effective and more prone to conflict. Taxation creates an incentive for government accountability.[162]

A related perspective looks at taxes as dues for participation in society and for benefits received from our common knowledge and infrastructure. Just as people who participate in a club or organization benefit from infrastructure and practices that they have not created, citizens benefit from infrastructure they have not paid for – such as existing transportation systems, water and sewage treatment, schools and universities – and knowledge and wealth that has been produced by previous generations.[163] This perspective also supports a progressive understanding of taxation. Wealthy individuals and corporations actually depend more on our common wealth to create or extend their own wealth. The legal system protects intellectual property rights, the finance system offers access to secure banks and stock markets, courts enforce contracts, the public education and health care systems provide a healthy, well-educated

[viii] For a deeper exploration of this understanding, see *Justice and Jubilee: A CPJ Foundational Backgrounder on Poverty.*

work force. Therefore, wealthy individuals and corporations have a greater moral obligation to sustain our common wealth.[164]

This perspective has also led to the suggestion of a "Tax Repayment Year," to counter the anti-tax concept of Tax Freedom Day. Tax Repayment Year calculates the amount of time it takes the average taxpayer to pay back the investments older taxpayers have made in him or her by the age of 21. Including 3% interest a year on the repayment, economist Nancy Folbre calculates Tax Repayment Year in the US to be year 17, or age 38 if someone began paying taxes at 21.[165] In Canada, where health care is publicly funded, the repayment age is likely to be even higher.

Of course, Tax Repayment Year only repays the investment made when you are young and not when you are old. Elderly Canadians also benefit from income security and age-related programs such as Old Age Security, the Guaranteed Income Supplement, CPP, and health and assisted living programs. In fact, one perspective on taxes is that taxes represent a form of income redistribution over the course of an individual's lifetime. We pay the bulk of our taxes as working age adults, but we receive significant benefits as children and as seniors.

Taxes also help us as individuals to procure services in a cost-effective and efficient way. Many Canadians could not afford health care, education, water treatment, sewage and waste removal, fire and police protection, roads, bridges, parks, food inspection, and traffic control if we had to procure each one of these services individually. Pooling our resources together allows us to purchase better, more efficient services than we could on our own.

Finally, taxes are seen as an important method of redistribution. Our capitalist economy is structured to generate inequality, ensuring that without some kind of remedial action, some people will always be left behind. Inequality is a moral issue, but it is also a very practical issue – evidence suggests that more unequal societies suffer from greater health and social problems, and that both the rich and poor in more unequal societies have worse outcomes.[166] Inequality very much affects well-being. Taxes, in addition to the transfers and programs they fund, help to reduce the inequality inherent in market income in Canada, helping to reduce poverty and the income gap between rich and poor.

Principles of taxation

Beyond these perspectives regarding what taxes are fundamentally about, there are a number of principles that are used to guide creation of a tax system that focus on what makes a particular tax or entire tax system good or bad. These principles include:

- Progressivity – progressive taxation is the principle that taxation should be based on ability to pay, with higher income earners not only paying higher dollar amounts but also a higher *proportion* of their income than low income earners.

- Equity – equity is also about relating fairness in taxation to ability to pay. There are two forms of equity:
    - Vertical equity – the principle that people in different economic circumstances should pay different amounts of tax.
    - Horizontal equity – taxpayers with the same ability to pay should pay the same tax. However, people with the same level of income but different abilities to pay should pay different levels of tax. Families with children or people with disabilities who have

greater expenses should therefore not be expected to pay the same amount of tax as families without children or persons without disabilities.

- Neutrality – taxes can affect the behaviour of individuals and corporations. Sometimes this is intentional, when tax policy is used to encourage or discourage certain actions. Other times, the effect is unintentional. The principle of neutrality suggests that taxes should be designed as much as possible to minimize unintentional impacts on behaviour.

- Simplicity and transparency – the tax system should not be difficult to understand, and the tax impacts of decisions and behaviours should be clear to taxpayers.[167]

- Stability of revenue – governments need to know how much revenue to expect in order to effectively plan and to ensure that there is enough income to pay for public services.

- Revenue-raising capacity – in addition to the stability of revenue, the revenue raised by the tax system must be sufficient to cover the costs of government programs and services (on balance; there are also times when for economic reasons governments choose to spend more than they take in).

- Administrative simplicity – taxes should not be extremely difficult to assess and collect. Administrative simplicity requires that the tax base, taxable income or taxable activity be relatively easy to define and quantify, the tax rate should be easy to apply, and compliance relatively easy to ensure.

- Fairness – while fairness can be hard to define, the tax system must conform to social concepts of what is fair. For instance, many people consider it inherently unfair when people who are wealthier than they are pay less tax or no tax at all. Tax avoidance and tax evasion also contribute to perceptions that taxation is unfair. For certain taxes (ie. EI premiums, water fees), user-pay is generally perceived as a fair model, while for other taxes, user-pay seems like an unfair system for funding universal entitlements (such as health care or education).

Canadian's Core Values

It is not easy to get a sense of Canadians' core values on taxation through polling, since the response is highly dependent on what questions are asked and how they are asked. For instance, an Ekos poll conducted for the CBC in February 2010 found that significantly more Canadians supported spending cuts as a way of dealing with the federal deficit than raising taxes (46% vs. 14.1%),[168] while a Strategic Counsel poll conducted for the Canadian Federation of Municipalities in January 2010 found that half of Canadians supported tax increases to deal with the deficit, while half supported spending cuts.[169]

However, Hamish Marshall, a research director with polling firm Angus Reid Strategies, has noticed that attitudes have become harder towards tax increases over the past five or six years. He attributes this to the popular myth that government spending is extremely wasteful and government waste should be eliminated before taxes increase, a myth based on propaganda from anti-tax groups rather than reality.[170] Mike Harcourt, former BC premier, insists that "When people are shown exactly how their tax money is spent and get an accurate picture of the services they're getting, they tend to accept tax levels."[171]

This analysis is supported by polls showing greater support for tax initiatives when they are tied to particular spending programs. For instance, the Strategic Counsel poll found that 32% of Canadians would support an increase in the GST to pay for the federal deficit. However, if the GST increase were targeted to development of local infrastructure, support more than doubles to 70%. Similarly, when asked what would improve quality of life most, 57% of those surveyed said improving local infrastructure, compared to 45% who said tax cuts.[172] Canada's debate on taxation therefore suffers greatly when taxes are divorced from public services in the debate over tax levels.

3. CPJ's Work on Taxation

CPJ's context for considering economic policy – including tax policy – has always focused on a broader definition of prosperity rather than a narrow focus on economic growth. In numerous briefs and submissions, CPJ has reiterated calls for the integration of social and environmental policy with economic policy.[173] Rather than allow its policy vision to be determined by the recession or surplus of the moment, fixated on economic growth or deficit and debt reduction, CPJ has insisted on asking questions about what kind of society we want to live in and how social and economic policy can help us to develop that kind of society.[174]

A narrow focus on economic policy or economic goals to the detriment of social and environmental policy results in negative consequences such as poverty, income inequality, homelessness, unemployment and underemployment, pollution, and resource depletion.[175] These consequences not only have environmental and social impacts, but a financial cost. As CPJ noted in 1994, "Too often developments in the economy are seen as necessary and inevitable while social policies are optional, after-the-fact responses to the failure of the economy to serve the real needs of Canadians."[176]

Rather than focus solely on economic growth, CPJ has argued for a broader perspective of well-being, including social, environmental and economic flourishing.[177] The path to well-being, CPJ has consistently argued, requires the integration of social and environmental policy with economic policy in a way that supports justice. This means promoting equity, fairness, stewardship and community, [178] including equity between and within generations.[179] This integration must take place in tax policy, employment policy and income security policy, among others.[180]

A second theme that has been prominent in CPJ's work on taxation has been understanding taxes as an investment – taxes are the other half of public spending and services. In CPJ's perspective, taxes are part of our contribution to the common good – an investment in shared prosperity and a reflection of our shared responsibility.[181] The tax system raises the revenue necessary to fund public services and create physical and social infrastructure.[182] Among other things, taxes are necessary to pay for our democratic institutions, health care, child care, education, research and training, transportation, roads, bridges and ports, our monetary system, police and fire protection, arts, recreation, parks, civic spaces and environmental protection.[183] Investments in these necessary and important services shouldn't merely be allocated as budget surpluses allow, but should be paid for through fair taxation, CPJ has argued.[184]

CPJ has taken issue with the individualist approach, perhaps best articulated by former Finance Minister Paul Martin, "Canadians are entitled to keep their money. They earned it, it's theirs."[185] Beyond our shared responsibility to one another, CPJ has pointed out that there are many services and programs that individual Canadians wouldn't be able to afford or that would be far less affordable and efficient if Canadians had to procure them individually.[186] The benefits of services funded by taxes are enjoyed by individuals – both low and high income, businesses and communities.[187] In fact, CPJ has pointed out that taxes and their services contribute to economic development, contributing to the dynamic process of building a nation's workforce and attracting and retaining workers.[188]

Conversely, tax cuts represent the loss of public services and infrastructure, or cripple the government's ability to respond to major challenges such as affordable housing, health care or economic uncertainty. Often, the loss of these services hurts poor Canadians the most, while the tax cuts also contribute to income inequality.[189]

The third theme that appears consistently throughout CPJ's work on taxation is the question of who pays and how much. Many early pieces refer to two of the principles contained in CPJ's Guidelines for Public Justice: mutual responsibility and fiscal fairness. Mutual responsibility is "the duty of all persons to contribute to the well-being of the community as they are able, and the duty of each community to contribute to the well-being both of all its members, regardless of their ability, and those in the larger society."[190] Fiscal fairness is "the right of all persons, communities and institutions to fair fiscal treatment and the responsibility of all to contribute fairly for the well-being of all."[191]

In practice, mutual responsibility and fiscal fairness translated to a concern about progressivity, or equity in taxation. Those with greater means should contribute proportionally more than those with lesser means. Those with the same income but higher expenses, such as families with children or the disabled, should see their taxes reduced to help cover those expenses.[192] This concern about progressivity was deeply tied to CPJ's Christian principles. Speaking about CPJ's Social Development and Job Creation Fund proposal in 1986, John Olthuis noted, "The progressive element is a very biblical notion…Those blessed in society should tithe more."[193] CPJ also explained that "A more equitable sharing and distribution of wealth, resources, and power is required for people to exercise their social rights and responsibilities. This may require special policies, taxation measures, and program expenditures."[194]

CPJ's belief that everyone must pay their fair share extended to corporations.[195] "Corporations benefit from the social infrastructure in Canada through a highly educated, healthy, motivated workforce. If the infrastructure is reduced and the workforce becomes less healthy and less educated, the productivity and competitiveness of corporations will be affected. Corporations need to pay their fair share for these benefits," CPJ told the House of Commons Standing Committee on Human Resources in 1994.[196] In 2007, CPJ reiterated these points to the House of Commons Standing Committee on Finance, arguing that tax rates alone do not make for competitive corporations, and that corporations should help to pay for public infrastructure that makes them more competitive.[197]

On the other hand, for the poor paying their fair share means not paying income tax. In a 1993 brief to the Ontario government, CPJ called it "unfair and unacceptable" that people below the poverty line were paying tax.[198] Several times, CPJ called for the elimination of income tax payable for those below the poverty line.[199] CPJ also recommended the government address consumption taxes, recognizing that the very poor do not pay income taxes, but pay a high percentage of consumption taxes.[200]

CPJ has consistently criticized federal budgets, economic statements and government policy proposals for offering tax measures that favour high income Canadians at the expense of low and middle income Canadians.[201] Several times, CPJ has written the Finance Minister or Prime Minister of Canada to recommend changes to Canada's tax policy or to request parliamentary examination of tax policy to evaluate it for fairness.[202] And CPJ has often recommended changes for fair taxation or critiqued existing policy in its pre-budget submissions and other briefs to parliamentary committees.[203] Some measures have been criticized repeatedly by CPJ for contributing to inequity, including broad-based income tax cuts,[204] deductions for RRSPs/RPPs,[205] tax expenditures – particularly those aimed at corporations and wealthy Canadians,[206] and partial de-indexation of tax brackets and tax credits, implemented in 1986 and ended in 2000.[207] CPJ has also proposed progressive tax measures to pay for its social policy proposals.[208]

4. Public Justice and Taxation

CPJ's public justice framework states that all people are created by God to live in dignity as God's image bearers with rights and responsibilities within a social context in which justice and compassion are the foundation for peace and joy in social relationships. The role of government is to promote just relations and foster conditions that enhance the common good by adopting fair laws, legally recognizing rights and responsibilities, identifying and resolving injustices and ensuring access to services and infrastructure that benefit all. Citizens, meanwhile, have the right and obligation to participate in the creation of laws, with the responsibility to ensure that public justice is pursued and the rights of the marginalized are protected and promoted.[209]

We all have a right to the resources necessary to live out God's calling, including the basic resources necessary to live in dignity and to participate in our community. With this right comes a responsibility, however: the responsibility to contribute as we are able to ensure that this right is respected for everyone. Part of this responsibility is fulfilled through the contribution of our taxes. While there are other ways of contributing, including support for just policies and supportive programs for the poor, charitable donations, and volunteer work, this obligation also includes collective action and systemic support through the actions of government.

Citizenship for public justice requires that we evaluate government policies and initiatives in the light of public justice, rather than personal benefit. We have an obligation to participate in public life in a way that enables justice, including the promotion of social structures and associations that contribute to the common good. One of the primary ways in which we can do this is through the contribution of our income and wealth through taxes. Taxes pay for the democratic institutions of government, as well as funding the transfers, programs and services governments provide. Taxes therefore help to create a democratic, just and equitable society. Taxes also foster a common good that benefits everyone. In fact, most Canadians receive greater benefit from the public services and programs paid for by taxes than they contribute in income.

In a sense, taxes can also be seen as a form of tithing. We recognize that we are not solely responsible for the wealth that we generate, nor does it belong to us alone. We are grateful for the gifts that God has blessed us with, mindful of the contribution of our society and community in helping us to use our resources to create income and wealth, and cognizant of the benefits we receive from creation. Therefore, we share a portion of the income that we have received or the wealth that we generate, as an expression of our gratitude and a contribution towards the sustainability of our community and collective care for creation.

Public justice also entails a moral responsibility on the part of citizens to be transparent and forthright in their financial transactions. Hiding income and evading taxes are both unlawful and unethical.

For governments, tax policy can be used to do justice and promote the common good, in addition to tax revenues being used to foster justice and to build the necessary infrastructure (physical and social) for our common life. Public justice calls for government to provide or ensure "access to infrastructure and public services that benefit all, with a focus on access for those who might not be able to access such services on their own." Government transfers, services and programs also help to reduce poverty and inequality, ensuring that every person is able to live in dignity and participate in their community.

Public justice also suggests a number of guidelines for developing appropriate tax policy. For instance, one of the public justice tasks of government is to nurture an equitable society. In support of an equitable society, progressive taxation can help to redistribute income, ensuring that poverty and the income gap between rich and poor is reduced. Equitable taxation also implies that everyone should contribute as they are able. When wealthy individuals and corporations are able to avoid paying taxes based on their social status or their relative influence with government, it is inequitable and unjust.

Tax decisions, including tax rates, types of taxes, and tax expenditures, need to be made transparently with appropriate consultation, democratic deliberation and accountability. In order to be able to hold their governments accountable, citizens need to be able to identify tax measures and understand their impact and outcomes. Tax policy cannot become a back door way of making unpopular government decisions, such as favouring certain groups through tax expenditures or ensuring that government programs will need to be cut because of insufficient resources. Parliamentarians also need sufficient information in order to practice effective government oversight.

Similarly, citizens have the right to know that governments are spending their tax dollars wisely, effectively and efficiently. While CPJ's public justice framework acknowledges that there are unusual times when non-violent civil disobedience is the only way to call governments maintaining harmful and severely distorted policies or practices back to their God-given calling, in general citizens do not have the right to withhold taxes simply because they disagree with particular democratically-approved government programs. However, governments who spend wastefully or without appropriate democratic consultation and accountability make a mockery of citizens' contributions to the common good. Governments have a duty to use tax dollars in a way that is accountable and promotes justice and the common good.

5. Questions for Moving Forward

1. What is CPJ's perspective on taxes and the role they play in promoting public justice?

2. What principles does CPJ think are essential for our tax system?

3. What changes to the present mix of taxes does CPJ think are necessary?

Appendix

Glossary of tax terms:

- Average tax rate – the tax paid divided by income.
- Compliance – the degree to which people pay the taxes they legally should.
- Effective tax rate – the percentage of income paid in tax when all taxes are considered together.
- Marginal tax rate – the tax rate imposed on the last dollar of income.
- Progressive tax – the average tax rate increases with income.
- Proportional tax – the average tax rate remains the same over all income.
- Regressive tax – the average tax rate falls as income increases.
- Single-rate tax – has a constant marginal tax rate.
- Tax avoidance – the effort to reduce taxes through legal exemptions.
- Tax base – the income or expenditures to which tax applies.
- Tax evasion – the illegal effort not to pay taxes through concealment or by non-reporting.
- Tax rate – the percentage levied on the tax base.

  Source: Flanagan, "Shifting the Burden," *Alberta Views.*

Typology of taxes:

- Income taxes – taxes on wages and salaries, profits, inheritances, capital gains and dividends. In Canada, income taxes are levied on individuals and corporations by the federal government and the provinces and territories.
- Sales and consumption taxes – taxes on purchases of goods and services; can be point of sale purchases only or a value-added tax. A value-added tax levies a tax on the estimated market-value added to a product at each stage of production and distribution.
- Property taxes – taxes levied on the assessed value of property, including land and homes, office buildings and factories. In Canada, property taxes are collected by municipal governments.
- Payroll taxes – payroll taxes include taxes imposed on employees and employers, usually as a percentage of salaries and wages. In Canada, specific examples of payroll taxes include social security contributions such as EI premiums and CPP/QPP premiums, as well as Workers' compensation premiums.
- Corporate – in addition to corporate income taxes, corporations may be liable for special taxes such as a capital tax, corporate surtaxes and tariffs on machinery and equipment. In Canada, the federal capital tax was eliminated in 2006, but some provinces still maintain a capital tax.
- User fees – taxes collected as fees-for-service. Payment is therefore expected to cover the cost of the service, although some user fees are arranged as single-cost and others tie payment to the amount of the good or service used. Examples of common user-fees in Canada include public transit fees, bridge and road tolls, airport fees, building permits, camping and park permits, utility fees (sewer, water and electricity), fishing and hunting licences, marriage licences, commercial licences, and drivers licences. User fees are collected by all levels of government.
- Other taxes – taxes, tariffs and duties can be levied on particular activities and commodities. Examples in Canada include taxes on alcohol, cigarettes and gasoline.

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