Backgrounder

Fair Taxes
Making Income Tax Fairer

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Canadians know that taxes fund the public services we rely on. But people want the tax system to be fair.

A fair tax system is one where the amount people pay in taxes is determined by their ability to pay. It's a tax system that helps reduce the problem of income inequality.

In the last 4 decades, the tax system has become less fair. Tax loopholes and cuts to tax rates have primarily benefited the well off and large corporations. And little has been done to curb the use of tax havens.

But that trend is starting to be reversed. While progress is slow, an increasing number of governments are looking at whether income tax cuts for the wealthy and large corporations need to be reversed and whether loopholes need to be closed. Governments are saying the right things about tax havens and loopholes, even though their actions are still limited.

The challenge now is to build on that limited progress. That means continuing the push to increase tax rates for those who can afford it and to close tax loopholes. And it means ensuring that governments take real action on tax havens and loopholes instead of just talking tough.

Quality public services need a progressive tax system
Public services developed because past generations recognized that the most effective way to provide services like roads, schools, and health care was to pool their resources and work together. The development of a progressive tax system made that possible.

Individually, people couldn't afford to pay to build the roads, or hospitals, or to staff the schools, but together, through their taxes they could. With a progressive tax system, the amount people paid reflected what they could afford.

It is not possible to have quality public services without a fair tax system. When tax cuts and loopholes allow some people to avoid paying their fair share, government revenues are not enough to meet public needs. Then the resulting underfunding of health care, education, and social services becomes a problem.

Fair tax system reduces income inequality
A fair tax system is also an essential tool for reducing income inequality by redistributing income through major investments in quality public services.

The public services our taxes fund, like Medicare, education, pensions, social services, road maintenance and transit, are ones that everyone benefits from. However, it is low- and middle-income families who receive the greatest benefit. A 2009 study, *Canada's Quiet Bargain*, by researchers Hugh Mackenzie and Richard Shillington, found that for a typical middle-income family, the value of the public services they use is equivalent to roughly 63% of their income.

Personal Income Tax Rates

A progressive personal income tax system helps reduce income inequality by ensuring those individuals who can afford to pay more, as a percentage of their income, do so.

Unfortunately, for almost 4 decades, starting in 1982, our tax system has become more regressive. Cuts to federal and provincial income tax rates disproportionately benefited the well off. The top federal income tax rate for the wealthiest Canadians dropped from 43% to 29%.

A reduction in the number of tax brackets also made the tax system less fair. People with very different incomes found themselves in the same tax bracket. For example, until recently, a person making $135,000 was paying the same top rate as a person making $1 million.

Cutting income tax rates penalized low- and middle-income earners
Cutting personal income tax rates means that tax fairness has been flipped upside down in Canada. The loss of revenues from income taxes has meant that governments have made increased use of taxes that are not based on ability to pay. These are known as regressive taxes. Regressive taxes include consumption, sales, and property taxes.

Because regressive taxes are not based on ability to pay, a shift from income tax to regressive taxes helps wealthy individuals. The additional amounts they pay in sales, property, or payroll taxes are less than what they saved from cuts to income tax.

For low- and middle-income earners, the situation is reversed. The small amounts they saved due to cuts in income tax rates are more than offset by the impact of regressive taxes.

A 2007 study by the Canadian Centre for Policy Alternatives found that when all of the taxes we pay are factored in, the poorest 10% are paying a higher tax rate than the wealthiest 1%. The study also found that middle-income families are paying a rate that's 6 percentage points more than the wealthiest 1% are paying.

Introduction of new sales tax closely related to income tax cuts
The introduction of the Goods and Services Tax (GST) was part of a package of tax changes that included a cut to the income tax rate for the wealthiest Canadians.

Because the cuts to income tax rates were implemented prior to the 1988 election, and the GST was implemented after, the link between them is sometimes overlooked. Both the GST and the Harmonized Sales Tax (HST) that followed mean more goods and services are subject to sales tax. The GST and HST are regressive taxes because everyone pays the same rate no matter what their income level is. They therefore take a bigger bite out of the wallets of poorer families.

Downloading costs to municipalities

Also linked to tax cuts was the downloading of services from provinces to municipalities. Provinces losing revenue due to income tax cuts transfer responsibility for services, such as highway maintenance and social assistance, to municipalities. Municipalities are then forced to fund these services with regressive property taxes.

In 2003, a Statistics Canada study found that people earning less than $20,000 paid 10% of their income on property taxes, while those earning more than $100,000 paid only 1.8%. Other ways for municipalities to generate revenue, like user fees, are even more regressive. For most user fees, a person on social assistance is paying the same as a millionaire. Yet downloading has forced municipalities to introduce new user fees and to increase existing fees by more than the rate of inflation.

Public service cuts another consequence of reducing income tax rates

The impact of income tax rate cuts on public services is another way cutting income taxes leaves most of us further behind. Cutting tax rates means less funding for public services, and in many cases, that means cuts to services.

One way or another, cuts to public services are costly for the public. The cost can be in the form of user fees or of having to spend large sums of money purchasing services privately. Even when these aren’t necessary, people are likely to end up paying a price when public services are cut. For example, when spending on road maintenance is reduced, people can easily find themselves spending more on car repairs.

Income tax cuts failed to produce economic growth

Proponents of more cuts to personal income tax rates argue this is a good way to boost the economy. The argument is that the super-rich will have more money to spend, and the benefits of this spending will trickle down through the economy to middle- and lower-income families. However, the research shows that income tax cuts are a poor source of economic stimulus.

The super-rich usually end up saving the extra money from tax cuts. If they do spend the extra money, they are not spending it on ordinary goods and services in the mainstream economy. Instead, they spend it on niche luxury goods, like a winter home in the Caribbean, and invest more in speculative ventures, often overseas. This does nothing to help low- and middle-income families in Canada.

Tide turning on income tax cuts

People are increasingly aware of the damage done by cuts to income tax rates that disproportionately benefit the wealthy.

In 2015, the province of Alberta scrapped its flat tax system, in which millionaires and people earning minimum wage paid the same tax rate, and replaced it with a more progressive system. The gap between what the poorest and wealthiest pay is still relatively narrow, but the new tax brackets for higher incomes are a step forward.

Similarly, in the 2015 election, a proposal to introduce a new higher tax rate for income over $200,000 proved a vote winner for the federal Liberals.

Details important when governments promise tax fairness
While there have been some steps to make the tax system fairer, they don't go nearly as far as people have been led to believe. The rhetoric used to describe proposals can give a very inaccurate impression of how big an impact the changes being made will have.

An example is the changes made to income tax rates by the federal Liberals in December 2015. The rate for the middle-income tax bracket was reduced from 22% to 20.5%, and a new higher tax rate for the income people earn above $200,000 was created. This change was described by the federal Liberals as a "middle-class tax cut."

But based on how those changes affect the taxes paid by people with different incomes, middle-class Canadians see little or no benefit. Instead, most of the benefit went to people earning over $90,000.

The reason for this is that the tax rates for each tax bracket apply only to the portion of a person's income that falls within that tax bracket. For the two-thirds of Canadians whose incomes are entirely within the lowest tax bracket, the cut in the rate for the middle tax bracket had no impact. In contrast, those with incomes in the top tax brackets were being charged a lower rate on roughly $45,000 of income.

Similarly, the new higher tax rate applies only to income over $200,000. People with incomes over $200,000 pay lower rates for the first $200,000 of income.

Corporate Tax Rates

Since 1951, the percentage of government revenues coming from corporate income taxes has dropped dramatically. By 2017, it was down to 9.4%—less than half of what it once was. Between 1951 and 2017, the profits of the 60 largest corporations, as a share of Gross Domestic Product (GDP), doubled. Due to tax cuts, corporations are making higher profits and contributing less to the public good.

Since 2000, the federal corporate income tax rate has been cut 9 times. It's gone from 28% to 15%. Most provincial corporate income tax rates were also cut, as provincial governments joined the race to the bottom. And if that wasn't enough, corporations benefited from the elimination of capital taxes.

Governments claim that tax cuts will encourage corporations to invest the extra cash in company operations, and will therefore boost economic growth, productivity, and jobs. However, after decades of corporate tax cuts, there is not a shred of evidence to support this claim.

Other factors have more impact on investment decisions than tax rates
Corporate tax rates are only one factor in a company's decision about where to invest or locate. Some of the other factors are an educated and healthy workforce, and good physical and communications infrastructure. When corporate income taxes are cut, the loss of revenue means countries lose the ability to fund the services and infracture they need to attract investment..

Even large cuts to corporate income tax rates seem to have limited impact. This year, after President Donald Trump's administration reduced the top corporate income tax rate in the United States from 35% to 21%, only a small minority of those businesses planning to increase spending on capital goods mentioned the cut in the tax rate.

What also limits the effectiveness of corporate income tax cuts is that many of the biggest and most profitable corporations in Canada are in the natural resources sector, especially in the oil, gas, forestry and mining sectors. Even if these corporations wanted to move to a lower tax jurisdiction, they couldn't take the natural resources with them. If they want the resources, they obviously have to operate in the jurisdiction where the resources exist, regardless of what the corporate tax rate is.

Business investment has dropped since cuts to corporate income tax started
While a 2015 study by the Canadian Centre for Policy Alternatives, called *Do Corporate Income Tax Rate Reductions Accelerate Growth?,* found that there was no link between corporate tax cuts and economic growth, it did find that since cuts to corporate income tax started, business investment has dropped. In the 35 years between 1945 and 1980, when the combined federal and provincial corporate income tax rate was roughly 52%, investment in fixed assets averaged 12.8% of GDP. Since cuts to corporate income tax rates began, investment in fixed assets has averaged 10.5% of GDP.

The drop in business investment is exactly the reverse of what proponents of tax cuts claimed is supposed to happen.

Governments claim we must cut corporate taxes or corporations will move their investments, plants, and jobs to other jurisdictions with lower rates. But this argument does not stand up to scrutiny.

Corporate income tax cuts increased income inequality
While corporate income tax cuts failed to produce economic growth, they did succeed in increasing income inequality. Instead of investing in the economy to create jobs, corporations are hoarding their extra profits or spending them on things like higher dividends or higher salaries for CEOs.

For the last several years, many large corporations have been sitting on hundreds of billions in cash. Former governor of the Bank of Canada Mark Carney described this cash as "dead money."

A lot of the extra profits from tax cuts have gone to pay higher dividends to shareholders and higher salaries for CEOs. According to Statistics Canada, in 2000, corporate Canada was paying out 30% of its profits to shareholders in the form of dividends. In recent years, more than 50% of after-tax profits were paid out in dividends to shareholders.

The Canadian Centre for Policy Alternatives reported that in 2016 Canada’s 100 highest-paid CEOs each earned an average of 209 times more than the average Canadian. Canada’s 100 highest-paid CEOs pocketed an average of $10.4 million each, while the average Canadian earned $49,738. To give a sense of how much income inequality has increased, in 1998, on average, the 100 highest-paid CEOs each made 109 times the average income.

Provinces leading the way in reversing corporate tax cuts

As with personal income tax rates, it has been provincial governments that have led the way in reversing cuts to corporate tax rates. British Columbia, Alberta, and New Brunswick have all reversed some of the cuts made to corporate tax rates. Ontario and Saskatchewan canceled plans to make further cuts to corporate tax rates.

But even though corporate income tax cuts have failed to produce growth, and have starved public services like health care of funds, there are still people pushing for them. Quebec is in the process of reducing its corporate income tax rate. Donald Trump’s cuts to corporate tax rates in the United States are being used by some to justify a further round of tax cuts in Canada.

Robin Hood Tax—a new tool to ensure corporations pay their share

A growing number of countries are adopting a Financial Transactions Tax (FTT). Because large corporations and the wealthy are the ones paying it, the FTT is also known as the Robin Hood Tax (RHT).

The FTT is a low rate of tax (0.05%) on financial sector activities that are considered to be of limited usefulness or to be damaging to the economy. The FTT does not affect the activities of regular bank customers. Instead, it is targeted directly at the risky short-term speculation that was a major cause of the 2008 financial crisis. It is applied to transactions that involve trades in stocks, bonds, currencies, derivatives, and other financial products.

France and Hungary have introduced an FTT at the national level. 10 European Union countries are trying to implement a harmonized FTT. A Robin Hood Tax Bill has been introduced in the U.S. Congress. Unfortunately, in Canada, the federal government has not been willing to consider it.

Fair Taxes an Essential Step to Fairer Canada

Canadians have made it clear that they don't just want to protect existing public services, they want to improve and expand them. People want better infrastructure like roads and public transit. People want to know services like health care are there when needed. And people want the improvements to public services needed to ensure that all Canadians are able to share in our country's prosperity.

The only sustainable way to make that happen is a fair tax system. Without a fair tax system, services people rely on get cut and government debt increases. This means that, if we want a fairer, more equal Canada, a fair tax system is essential.

Sources available upon request.
Email national@nupge.ca.

NATIONAL UNION OF PUBLIC AND GENERAL EMPLOYEES

- B. C. Government and Service Employees' Union (BCGEU)
- Health Sciences Association of British Columbia (HSABC)
- Health Sciences Association of Alberta (HSAA)
- Saskatchewan Government and General Employees' Union (SGEU)
- Manitoba Government and General Employees' Union (MGEU)
- Ontario Public Service Employees Union (OPSEU)
- Canadian Union of Brewery and General Workers (CUBGW)
- New Brunswick Union of Public and Private Employees (NBU)
- Nova Scotia Government and General Employees Union (NSGEU)
- PEI Union of Public Sector Employees (PEI UPSE)
- Newfoundland & Labrador Association of Public and Private Employees (NAPE)

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