Backgrounder

Fair Taxes
Tax Avoidance

June 2018

For Canadians, services like Medicare are part of our national identity. Those services were built by past generations that recognized that only by working together could we hope to provide the services our families and our communities needed. And those services reflect our belief that we have a responsibility to look out for our fellow citizens.

A fair and progressive tax system is essential to funding the public services Canadians rely on. Part of a fair tax system is tax rates that are based on people's ability to pay. The other part is making sure that the wealthy and large corporations aren't able to use loopholes and other dodges to avoid paying their fair share. Unfortunately, at the same time they were benefiting from cuts to income tax rates, the wealthy and large corporations have been making greater use of loopholes and tax havens.

The good news is that, as a result of growing public awareness, governments are starting to recognize the need to deal with tax havens and loopholes. Yet there is still more talk than action. However, provided that public awareness of the problems caused by tax havens and loopholes continues to increase, it is clear that governments will be forced to take meaningful action.

Tax Dodging

Income tax cuts are only one way that large corporations and the wealthy are able to avoid paying their share. Tax havens, secrecy around beneficial ownership, laws that make it easy for corporations to transfer money to tax havens, and a lack of enforcement mean that what many wealthy individuals and large corporations actually pay is often considerably less than the rate they should be paying.

Whether it's tax havens or loopholes, almost all of the benefit goes to the wealthy. People working in fast food restaurants tend not to benefit from the stock options deduction or have secret accounts in Swiss banks.

Offshore tax havens

Offshore tax havens are being used by the wealthiest individuals and corporations to avoid paying their fair share of taxes. Globally, it is estimated that between $21 trillion and $32 trillion is hidden away in tax havens. Canadian money in tax havens is at an all-time high—$300 billion at last count, and growing.

According to Statistics Canada, the amount of Canadian money in the top 11 tax havens is equivalent to 14% of Canada's GDP. Federal and provincial governments are losing between $10 billion and $15 billion in revenue each year because of tax havens.

To date, the response from the federal government has been limited. In response to public outrage about tax havens, the federal government increased funding for the Canada Revenue Agency (CRA) in 2017 so it could crack down on tax havens.

However, the lack of progress on high-profile cases involving tax havens has led to growing concern that the increase is not enough to offset years of funding cuts to CRA by the previous federal governments.

In 2015 it was revealed that KPMG had set up a particularly blatant tax-avoidance scheme in the Isle of Man, but instead of laying charges, the CRA negotiated a secret deal with KPMG. Canadian efforts to recover funds from those identified in the leak of the Panama Papers, which provided information on Canadians involved in tax dodging, lag behind those of other countries.

Canadian corporations are big users of tax havens
In 2017, Canadians for Tax Fairness revealed that the 60 largest corporations listed on the Toronto Stock Exchange had a combined total of 1,021 subsidiaries in tax havens. Among the corporations with subsidiaries in tax havens are all 5 major banks.

While companies funneling money into tax havens try to claim the funds are for legitimate investments, the low number of employees of subsidiaries operating in tax havens tells another story. Foreign subsidiaries operating in non-tax haven countries employ between 1,244 and 2,760 people per $1 billion in assets. In tax havens, the number of employees is as low as 1 per $1 billion in assets.

Secrecy around corporate registrations helps tax dodgers
While Canada isn't a tax haven, the secrecy around registering corporations makes it easy to establish shell corporations that are needed by those wanting to use tax havens—as well as by people wanting to launder money and fund terrorism.

In Canada, the real owners of companies are able to remain anonymous. Even law enforcement agencies find it difficult or impossible to get the information. That makes it very easy for those trying to hide and launder money. In addition to helping corporations and wealthy individuals dodge taxes, the anonymity also helps those trying to hide the proceeds of crime or fund terrorist activities.

Rules for registering companies in Canada are among the weakest in the world. As Transparency International pointed out, "In Canada, more rigorous identity checks are done for individuals getting library cards than for those setting up companies."

While rules for registering corporations in Canada are lax, our international reputation is solid. For terrorists, tax dodgers, and money launderers that's an ideal combination. It's easy to stay anonymous with a shell company registered in Canada, and the shell company won't be subject to the same scrutiny as it would be if it were registered in a tax haven like Panama or the Bahamas. This practice is referred to as *snow washing*.

Other countries are making it difficult for the owners of shell companies to remain anonymous. The United Kingdom and Denmark already require that corporate registries include the names of the individuals or corporations that own a company. The European Union is in the process of requiring all member countries to have public registries.

The federal government has talked about the need to force companies to reveal their real owners, known as beneficial owners. However, the federal government has not committed to having a public registry. Without a public registry that can be easily checked by banks and others who are supposed to enforce rules on illegal financial transactions, the benefits of requiring companies to disclose their beneficial owners are limited.

Failing to tax digital companies places Canadian businesses at an unfair disadvantage

If you buy a service from a Canadian company, you pay sales tax. That company has to pay tax on its Canadian profits.

But if you buy the same service from a digital company based outside of Canada, no sales tax is charged. The company isn't required to pay taxes on its Canadian profits.

The failure of the Canadian government to tax foreign digital companies operating in Canada creates 2 problems. Federal and provincial governments lose hundreds of millions of dollars in revenues, and Canadians pay the price through poorer public services or higher taxes. It also places Canadian businesses at a competitive disadvantage.

What's happened to advertising revenues is a good example of both how federal and provincial governments are losing tax revenue and Canadian companies are being placed at a competitive disadvantage. Google and Facebook receive 30% of all advertising spending in Canada. That represents 72% of all internet ad spending in Canada. At the same time, loss of ad revenue is making it hard for Canadian media outlets to survive, and many are closing.

The federal government is now looking at using public funds to subsidize media outlets by allowing them to obtain charitable status. What would be fairer and cost Canadians a lot less is for the federal government to require digital companies based outside of Canada to pay the same tax as Canadian companies. This is what many other countries, including the entire European Union, are already doing.

Tax Loopholes, Deductions, and Subsidies

Large corporations and wealthy individuals are also benefiting from an array of tax loopholes, subsidies, and deductions that undermine the fairness and integrity of the system. The tax subsidies for fossil fuel and mining industries and the corporate meals and entertainment expense deduction are good examples. But the most flagrant loopholes are the capital gains and stock option deductions, and the lack of an inheritance tax in Canada.

Capital gains income taxed at half the rate of earned income
There is a large gap between tax rates on employment income and tax rates on income from capital gains, i.e., income that is earned in trading financial instruments and real estate, or by selling a business. The tax system allows people who earn income through capital gains to claim a tax deduction of 50%.

So if you work at McDonald’s, you pay tax on all the wages you earn. But if you earn income from real estate investments, you pay tax on only half of the money you make.

One of the most popular ways of rewarding Canada’s highest-paid CEOs is through the granting of stock options. One of the reasons stock options are a popular form of executive compensation is that stock option income is taxed at half the rate of ordinary wages and salaries.

The special tax deduction given to capital gains and stock options has caused a serious degree of unfairness in the tax system. A tiny percentage of very high-income earners receive most of the tax advantage from these loopholes. These loopholes also help fuel the kind of reckless speculation that sparked the 2008 financial crisis around the world.

Lack of inheritance taxes passes on income inequality to the next generation
Another significant loophole in Canada's tax system relates to inheritances. The US and many European countries have an inheritance tax. Canada does not. This means the wealthiest Canadian families can pass on enormous inheritances without paying any tax. And the problem of income inequality is passed onto the next generation.

Resistance to closing tax loopholes for private corporations a lesson for the future
There has been some progress on closing the tax loopholes available to people with private corporations. Well-off, self-employed professionals like doctors or lawyers were among those making increasing use of private corporations. These loopholes allowed wealthy individuals to lower the rate of tax they paid by routing their income through private corporations. They were then able to lower their tax rate by *sprinkling* their income amongst family members, paying income as a dividend or capital gains, and paying a lower rate of tax on income they planned to invest.

The government made changes that will reduce the cost of the lost revenue from these loopholes, but what happened during that debate shows how hard the well-off will fight to keep the tax system skewed in their favour and the type of tactics they will use.

Canada Has a Revenue Problem, Not a Spending Problem

Contrary to what we often hear, governments in Canada have a revenue problem, not a spending problem.

Total government spending in Canada has dropped dramatically over the last few decades. In 1992, total government spending as a share of our economy was at 52%. In 2016, it was 41%. When it comes to the G7 countries (the 7 richest democratic countries in the world), over the last few years Canada has either been below average in total government spending as a share of our economy or in the middle. When spending as a percentage of GDP has dropped by over 10%, governments don't have a spending problem.

Tax cuts cost $90 billion a year
Instead, Canada has a revenue problem. According to a 2006 study by independent economists Hugh Mackenzie and Michael Rachlis, the choices made by the 3 levels of government in Canada in the last 25 years reduced their combined fiscal capacity by $90 billion a year. With inflation that amount is now significantly higher.

Lost revenue, not necessity, the reason for cuts to services
Lost revenue due to tax cuts has starved Canadian governments of the funds needed to maintain, improve, and expand social programs and quality public services. But you wouldn't know this from listening to governments that are cutting, underfunding, or privatizing public services. They always claim it is financially necessary. But the massive spending on tax cuts done by these very same governments makes it clear there is an alternative to cuts and privatization. Without 30 years of tax cuts for large corporations and the wealthy, it would be impossible for these governments to pretend that quality public services are unaffordable.

Inequality Trap = Tax Cuts + Service Cuts

The combination of tax cuts and cuts to public services is the inequality trap.

Governments lose revenue on tax cuts that overwhelmingly benefit the richest Canadians, and then those Canadians get richer. Low- and middle-income families get poorer as they pay more in regressive taxes. And income inequality rises.

At the same time, tax cuts hamstring governments when it comes to funding quality public services. Governments end up increasing regressive user fees for services. Or they eliminate the services altogether. Low- and middle-income families end up paying more out of their own pockets. And income inequality rises.

In addition, lost revenue due to tax cuts has created bigger deficits. Governments turn around and use these deficits as an excuse to further slash funding for quality public services. These families then have fewer opportunities, and it becomes harder to get ahead. And income inequality rises.

Fair tax system an essential part of alternative to income inequality
Contrary to what the super-rich, large corporations, and their political allies claim, there is an alternative to the inequality trap. With a fair and progressive tax system, the trend towards greater income inequality can be reversed.

The good news is that there is a consensus in this country that taxes are the best way to provide for the common good. There is also a consensus that when you make a lot of money, you owe some allegiance to the system that helped you to earn that money in the first place—the system of public services, physical and social infrastructure, and the laws and rules of the game under which you have succeeded.

What needs to be done now is to build that consensus into a demand for action that governments can't ignore.

Sources available on 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)

The National Union of Public and General Employees is an affiliate of the Canadian Labour Congress and a member of Public Services International.

15 AURIGA DRIVE
NEPEAN, ONTARIO
CANADA / K2E 1B7

[613] 228-9800
FAX [613] 228-9801

www.nupge.ca

national@nupge.ca

NATIONAL UNION UNION MADE OTTAWA PRINT SHOP