Chapter 3
How Much Tax Do You Really Pay?

WHILE INCOME TAX IS THE SINGLE LARGEST TAX CATEGORY, it represents less than half of the total taxes paid by the average Canadian family. The purpose of this chapter is to expand the discussion to include all taxes that Canadians pay.

How much income do you really earn?

Cash income

In order to calculate properly how much tax a person or group pays, it is necessary first to determine income. This is a complex calculation because there are a multitude of sources of income other than wages and salaries. This chapter explains the method for deriving the income figures used in subsequent sections.

The ultimate goal of income calculations is to determine the total income a Canadian citizen would have if there were no taxes of any sort and other factors remained unchanged. To arrive at such a figure, it is necessary to determine all the sources of income a person might have and all of the taxes that would have been paid on this income before the person received it. The first layer of sources is easily discovered: wages, salaries, interest from savings bonds, or rent from the in-law suite in the basement are the sorts of items that make up cash income.

Cash income and under-reporting

In its regular surveys of household income, Statistics Canada finds that people typically omit some income items when they estimate their cash

income. That is, they under-report their income. The particular items omitted vary from family to family but, on average, families tend to underestimate their total income by 4% to 12%. Items that might be omitted include miscellaneous interest income, income from "moonlighting," and so on. Fortunately, Statistics Canada does have a comprehensive measure of income in the National Accounts framework, upon which estimates of cash income used in this study are based.

It may be useful at this stage to provide an example based on a fictitious family. In order to make the example as comprehensive as possible, it is assumed that the family has income from all of the sources identified in the study—an unlikely circumstance for any real family. The example is presented in table 3.1.

Total income

In addition to cash income, most families also have various forms of non-cash income that must be included in a comprehensive income figure. For example, most wage and salary earners receive fringe benefits as a condition of their employment and their income also includes the investment income accumulated by their pension plan and the interest accumulated—though not paid—on their insurance policies.

At a higher level of subtlety, a comprehensive income total should also include a number of other income sources. For example, income must be imputed on account of interest-free loans that people make. The interest foregone is, in fact, implicit income in the form of a gift.

Profits not paid out as dividends by corporations but held in the form of retained earnings are income of the shareholders of the corporation, even though they do not receive it in the year in which it is re-

Table 3.1: Cash income, 2000

Wages & salaries	$36,474
Income from farm operations	271
Unincorporated non-farm income	2,230
Interest	1,867
Dividends	788
Private pension payments	1,755
Government pension payments	668
Old age pension payments	1,494
Other transfers from government	5,626
Total cash income	$51,174

Source: The Fraser Institute, 2001.

ported. Finally, food consumed by farm operators is evaluated at market price and attributed to farm operators as income.

Again, to make the calculation clear, the accumulated total income is shown in table 3.2 for a fictitious family that is assumed to have income from all sources.

Total income before tax

Some of the income earned by Canadians is taxed before they receive it. For example, shareholders receive dividends on corporate profits after corporate profit taxes have been paid. In the absence of taxes, the dividends or retained earnings of the shareholder would have been higher. Therefore, in order to arrive at total income before tax, it is necessary to add the tax on corporate profits collected from corporations. Similarly, if there were no property taxes, net after-tax rental income would be higher than it actually is. Therefore, before-tax income must be augmented by the amount of property taxes paid.

Indirect and hidden taxes reduce the effective income available to Canadians because they increase the prices of items that people buy with their incomes. In effect, income after tax is less, in terms of what it will buy, than it was before the tax. In order to arrive at an estimate of income before tax it is necessary to add to incomes the reduction brought about by indirect taxes. Payroll taxes levied on firms are, as noted earlier, effectively paid by employees, because the taxes reduce the amount of money available to pay wages and salaries. Accordingly, it is necessary to add the amount of payroll taxes to employees' incomes to arrive at an estimate of total income before tax.

Table 3.3 presents an example of a complete income calculation for a fictitious family that is assumed to have income from all of the income sources identified in the study and to have paid all of the identified taxes.

Table 3.2: Total income, 2000

Cash income	$51,174
Fringe benefits from employment	5,346
Investment income from insurance companies	962
Investment income from trusteed pension plans	1,407
Imputed interest	389
Value of food from farms	11
Corporate retained earnings	1,684
Total income	$60,973

Source: The Fraser Institute, 2001.

Calculating the total tax bill

The tax calculation for the average Canadian family consists of adding up the various taxes that the family pays. Hidden taxes, such as taxes on tobacco and alcohol, are allocated according to the method described in chapter 1. To preserve consistency, the family used for the example of the tax calculation in table 3.4 is the same family used in the income calculation.

A note on the calculation of Tax Freedom Day

The calculations in this chapter underlie our calculation of Tax Freedom Day, the day of the year when the average family has earned enough income to pay the total tax bill imposed on it by all levels of government. We are occasionally asked why we calculate Tax Freedom Day using cash

Table 3.3: Total income before tax, 2000

Wages & salaries	$36,474
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Unincorporated non-farm income	2,230
Interest	1,867
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Private pension payments	1,755
Government pension payments	668
Old age pension payments	1,494
Other transfers from government	5,626
Cash income	$51,174
Plus	
Fringe benefits from employment	$5,346
Investment income from insurance companies	962
Investment income from trusteed pension plans	1,407
Imputed interest	389
Value of food from farms	11
Corporate retained earnings	1,684
Total income	$60,973
Plus	
Property taxes	$2,124
Profit taxes	2,468
Indirect taxes	10,671
Total income before tax	$76,236

Source: The Fraser Institute, 2001.

income rather than total income before tax. We use cash income because the main purpose of Tax Freedom Day is to convey the size of the total tax bill imposed on Canadian families in a format that is easily understood. If we told people that taxes are 32% of their total income before tax, they would have a large task ahead of them to estimate all the types of income that must be included to arrive at this measure of income. Many people think of cash income (wages and salaries, government transfers, pension payments, interest and dividends, farm income, and self-employment income) as their total income. Most do not consider all the other types of income they earn but do not see (including corporate retained earnings, the investment income on their pension plans, and indirect taxes) as part of their total income. For example, if we were to report that the total tax burden for the average family was 32% most people with a family cash income of $50,000 would estimate their tax bill at $16,000 when it is actually closer to $24,000. The crucial piece of information is that governments extracted $24,000 from your family; the particular definition of income is secondary. Cash income is a useful tool in describing the tax burden because it does not force people to go through arithmetic gymnastics to arrive at their total income before tax to get an idea of how large the total tax burden is.

Table 3.4: Tax bill of the average Canadian family, 2000

Total cash income (from table 3.1)	$51,174
Total income before tax	76,236
Taxes	
Income taxes	8,071
Sales taxes	3,861
Liquor, tobacco, amusement & other excise taxes	1,457
Automobile, fuel & motor vehicle licence taxes	697
Social security, medical & hospital taxes	4,648
Property taxes	2,124
Import duties	175
Profits tax	2,468
Natural resource taxes	294
Other taxes	514
Total taxes	$24,309
Taxes as a percentage of total cash income	48%
Taxes as a percentage of total income before tax	32%

Source: The Fraser Institute, 2001.