Chapter 7
Who Pays the Corporate Tax?

CORPORATIONS ARE A MAJOR SOURCE OF REVENUE for federal and provincial governments. In 1999, they paid $36.9 billion in direct taxes, 10.4% of all federal and provincial government takings (tables 7.1 and 7.5). These statements are factually correct but misleading. "Corporations" do not really bear the burden of these taxes—people do. This chapter explains which people end up paying these taxes. Even though we are well furnished with data on how much corporations pay and who owns them, determining who pays the corporate tax is not straightforward. A tax on corporations is a tax on capital. When the tax rises, capital will flee and this will affect what capital and labour earn and what consumers pay. Who truly ends up bearing the tax depends on all these effects. Our calculations suggest that the elderly bear the brunt of corporate taxation.

Background on corporations and corporate tax

A corporation is a group of people bound by contract to work together and to share the rewards of that work; in its simplest terms, it is a joint venture between capitalists and workers. This description is too rudimentary to be of much help in explaining why corporations exist and to what subtle incentives they respond but it is all we need for the present discussion. Profit is what is left after labour, interest on capital, and the cost of materials have been paid, and this residual amount can be thought of as going to the people who provided the capital for the business. Corporate tax falls on profits. This is why the corporate tax is a tax on capital.

There is often confusion over what the corporate tax rate is because, as well as having their profits taxed, corporations may receive special tax breaks that allow them to write off more than their true capital expenses. This means a corporation may pay a high statutory rate on its profits but a much lower actual rate because of its deductions.

Statutory rates on capital rose in the 1970s and 1980s but revenue from the corporate tax was unsteady because profits varied and deductions had increased, eroding the tax base. It is a general principle of taxation that, if a government wants to raise a certain amount of revenue, it will distort people's choices less by imposing a low tax on a broad base than a high tax on a narrow base. By the mid-1980s, the base had become too narrow and this prompted the first stage of corporate tax reform. In the 1986 budget, the federal government started phasing out deductions such as the inventory allowance and the investment-tax credit and announced a leisurely pace at which it would reduce the statutory tax rate by 3% on average. However, tax reform in the United States lowered the corporate rate by 12% and this forced Canada to accelerate its own reforms, fearing that it would lose tax revenue to the United States because multinationals would report their revenue in the United States and their costs in Canada.

In 1987, many exemptions in the Canadian system were reduced and tax rates were decreased to 28% for large non-manufacturing firms, 23% for large manufacturing firms, and 12% for small firms. In 2000, the rates were 28% for large non-manufacturing firms, 21% for large manufacturing firms, and 12% for small firms. The 28% rate for large non-manufacturing firms is scheduled to decline from 27% in 2001 to 21% in 2004. All provinces also levy corporate income tax, though at lower rates. Table 7.1 and the accompanying figure 7.1 show how federal and provincial corporate tax revenues have varied between 1961 and 1999.

Why is the corporate tax so popular?

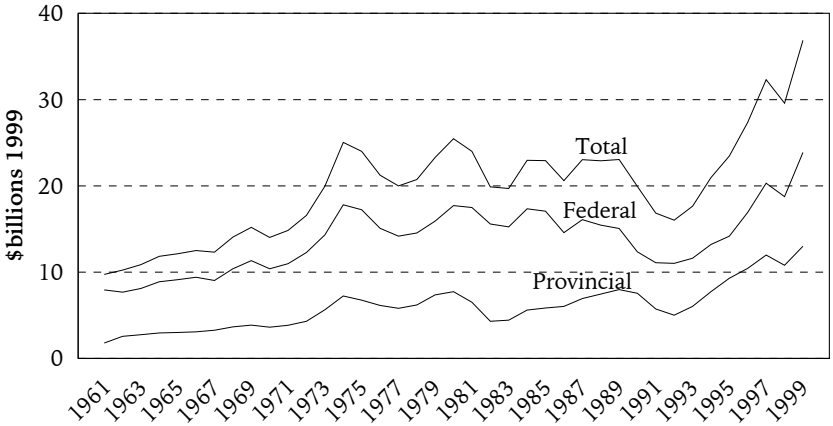
The corporate tax has great political appeal. Ministers of finance argue convincingly that if a corporation makes profits it should pay taxes just as ordinary working people do. This argument is appealing but hides from Canadians the fact that, in the end, ordinary Canadians pay the corporate income tax. We can see this by asking what a corporation is: it is composed of machinery, contracts, office space, employees, shareholders, bondholders, and so on. These parts work together to make income for people and corporate tax is, therefore, a tax on *people*. The corporation itself cannot pay the tax because it is not the final destination of the income it generates. On the contrary, as the next sections show, taxes imposed on the corporation fan out to the general public by a path that is hard to trace. As J.B. Colbert said in 1665, "The art of taxation consists

Table 7.1: Corporate tax collections, 1961 to 1999 ($millions 1999)

	Provincial	Federal	Total
1961	1,796	7,948	9,744
1963	2,757	8,126	10,883
1965	3,011	9,127	12,138
1967	3,279	9,035	12,314
1969	3,868	11,343	15,210
1971	3,856	10,992	14,849
1973	5,647	14,326	19,973
1975	6,771	17,232	24,003
1977	5,810	14,185	19,995
1979	7,378	15,925	23,303
1981	6,516	17,491	24,006
1983	4,452	15,249	19,701
1985	5,859	17,070	22,929
1987	6,950	16,086	23,036
1989	7,988	15,063	23,051
1991	5,747	11,097	16,844
1993	6,044	11,609	17,653
1995	9,296	14,180	23,476
1997	11,989	20,319	32,308
1999	13,001	23,868	36,869

Sources: Statistics Canada, National Economic and Financial Accounts; calculations by the authors.

Figure 7.1: Corporate tax revenue, 1961-1999 ($billions 1999)



Sources: Statistics Canada, National Economic and Financial Accounts; calculations by the authors.

in so plucking the goose as to obtain the largest amount of feathers with the least possible amount of hissing" (Mencken 1989: *s.v.* "Taxes") Corporate taxes cause less "hissing" than the more obvious taxes on sales or personal income. This is why politicians like the corporate tax.

Should it be so popular?

Who, in the end, pays the corporate tax? There are, of course, corporations owned by wealthy families and these families bear a portion of the tax. There are also many ordinary working people, however, who entrust their savings to mutual-fund managers. These managers invest this money in corporations and the income of those corporations flows back to these small investors. Approximately one-half of all Canadians now own shares, directly or indirectly, in the Canadian banks. Money set aside by employers for pensions is also invested in corporations. For example, OMERS, the Ontario Municipal Employees' Retirement System, is one of the largest stock owners and traders in Canada.

What is less obvious, but equally true, is that home-owners, farmers, cab drivers, and anyone who owns capital in the non-corporate sector of the economy also feels the impact of taxes on the corporate sector. How can this be? The reason is that capital is highly mobile. If the opportunities for making money in the corporate sector are reduced, investors will look for opportunities abroad or in the non-corporate sector—largely agriculture and real estate—at home. As investors transfer their corporate capital to this sector, capital will become more abundant there and the returns to capital there will fall. For example, those who invest in high-technology stocks may find the corporate tax gives them too little return for the risks involved and they may decide to invest their money in apartment buildings. This will add to the number of rental apartments, increase the vacancy rate, and lower the margins of profit for landlords. Thus, the tax in the corporate high-technology sector can also affect the market for commercial real estate.

This is one of many possible examples that show why measuring who ultimately pays the corporate tax is a difficult task. There are other factors that add to the complexity of allocating the corporate tax burden: companies can pass the tax on as higher prices or capital can leave the country, thereby making labour less productive and reducing wages.

Estimating the Canadian corporate tax

Since none of these assumptions can be dismissed out of hand, there is bound to be controversy over any estimate of who bears the corporate tax. This is why we provide several sets of calculations, each based on different, but plausible, assumptions. The main assumption we use in our calculations is that owners of capital in both corporate and

non-corporate sectors bear the corporate tax but, for balance, we show what some of our results would look like if labour bore the entire tax or if it were shared between capital and labour.

Table 7.2 shows the breakdown of the corporate tax by lower-income, middle-income, and upper-income groups. As expected, the upper-income group bears most of this tax. Income deciles, however, do not tell us anything about the personal characteristics of taxpayers. A crucial question is how much of the tax various age groups pay. Table 7.3 and figure 7.2 show how much of all taxes that the government collects are paid by people of different age groups and compares this

Table 7.2: Decile distribution of profit taxes (%)

	Income groups		
	Lower 3 deciles	**Middle 4 deciles**	**Upper 3 deciles**
1976	10.3	17.8	72.2
1981	9.1	24.0	66.9
1985	6.7	21.6	71.8
1990	5.8	24.5	69.7
1992	6.1	28.1	65.8
1994	5.6	28.3	66.0
1996	5.8	28.8	65.4
1998	6.4	31.7	61.9
2000	6.5	31.1	62.4

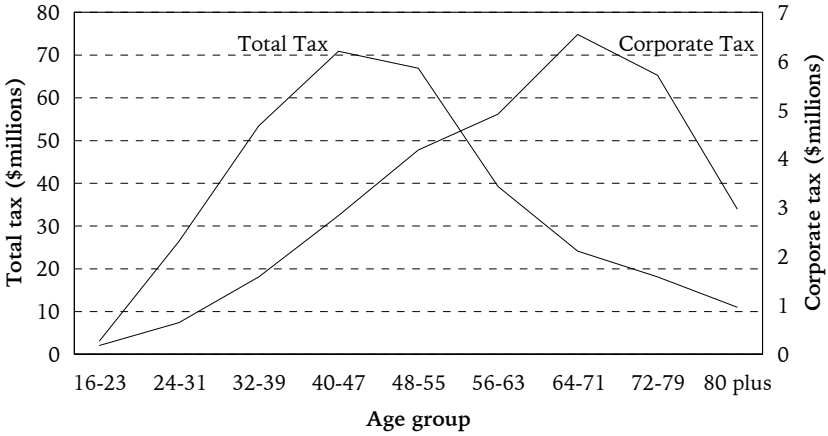
Source: The Fraser Institute, 2001.

Table 7.3: Total tax and corporate tax paid by age group, 2000

Age group	Corporate tax ($ millions)	Share of corporate tax (percent)	Total tax ($ millions)
16–23	177	0.6	3,036
24–31	648	2.2	26,406
32–39	1,582	5.4	53,437
40–47	2,839	9.6	70,884
48–55	4,183	14.1	66,921
56–63	4,916	16.6	39,235
64–71	6,545	22.1	24,139
72–79	5,712	19.3	18,095
80+	2,968	10.0	11,000

Source: The Fraser Institute, 2001.

Figure 7.2: Total tax and corporate tax by age group, 2000



Source: The Fraser Institute, 2001

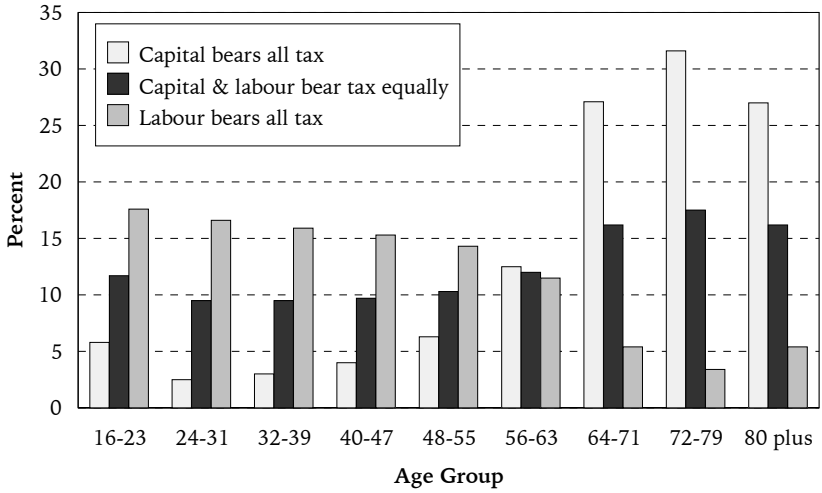
to how much corporate tax each age group pays. Even though people over 65 years of age pay little in overall taxes, they bear a disproportionate amount of the corporate tax.

These results are not surprising given our assumption that capital bears the tax. The elderly and the retired receive most of their income from capital sources such as retirement funds and rental property. For comparison, figure 7.3 shows how much different age groups would pay under the assumptions that (1) capital bears the entire tax; (2) capital and labour share the burden equally (*i.e.*, capital and labour bear the tax in proportion to their shares in national income); (3) labour bears the entire burden. As we can see, the results are very different depending on which assumptions one makes. How reasonable each assumption is depends on what we believe about the mobility of capital between corporate and non-corporate sectors and between Canada and the rest of the world. The more mobile capital is, the less of the burden of the tax it will bear. There is an active debate over the degree to which capital can pass the tax on to labour—a debate that we cannot resolve here. The point to keep in mind is that it is people who pay the corporate tax. Under two of the three possible scenarios (capital bears all, capital and labour bear equally) the elderly pay significantly for a policy that is widely touted as a tax on the "rich."

The myth of the untaxed corporation

By now, it should be clear that the incidence of corporate tax is complex and that brash claims about it have to be examined cautiously. One par-

Figure 7.3: Corporate tax as a percentage of average taxes paid by age group in 2000 under three incidence assumptions



Source: The Fraser Institute, 2001.

ticularly brash claim that often receives great attention from the Press is that some corporations in Canada are not paying their fair share of taxes. In particular, a labour-sponsored study claimed that 81,462 profitable corporations in Canada paid no taxes on profits of nearly $17.1 billion in 1994 and, as a result, have forced ordinary Canadians to shoulder a larger responsibility for paying the nation's taxes (British Columbia Federation of Labour 1997).

A study by the Ontario NDP government's Fair Tax Commission shows a different picture. The Fair Tax Commission analyzed a special 1989 survey of 177,000 corporations in Ontario and reached the following conclusions.

- 54% of the profits that were not taxed were inter-corporate dividends or equity income earned by subsidiaries. That is, profits earned by one branch of the corporation were transferred, after they had been taxed, to another part of the corporation. Taxing these transfers of money would be like taxing a person for moving his wallet from one pocket to another.
- 31% of profits were exempt either because they were used to replace depreciating equipment or because they were "paper gains," that is, assets transferred between members of the same corporate group without any economic gain or loss to the group.

- 11% of the profits not subject to tax were earned by firms that had lost money in the previous year. The tax system takes the long view of profits and allows firms to carry their losses forward. If a corporation lost $1 million last year and earned $1 million this year, over two years it has not made any profit and so should not be taxed within this two-year cycle.
- 4% of profits were exempt from taxation because of the temporary small-business tax holiday.

In other words, in the view of the NDP government in Ontario at the time, the survey of corporations suggested that corporations were not unfairly avoiding taxes.

Those advocating new or increased corporate taxes and claiming that corporations are getting an "easy ride" avoid statistics that show that, in recent years, corporations pay significantly more than they did in the past. Table 7.1 shows that, when we remove the effects of inflation, corporations contribute significantly more to tax revenue now than they did in the 1960s. These critics focus on the proportion of corporate taxes in total taxes collected by government, which has fallen sharply since the 1950s and 1960s. This is deceptive because, as table 7.4 shows, while corporate tax revenues as a percent of total tax revenues have fallen by 39.0% between 1961 and 1999, corporate taxes as a share of GDP have fallen by only 3.7%. Even though governments now get a smaller fraction of their revenues from corporations than they did in 1961, this has been caused by the unprecedented growth in personal taxation that we described earlier in the book and not by corporations cheating the tax system. Table 7.4 also shows that direct taxes on persons as a percent of total tax revenue increased by 61.2% from 1961 to 1999 and that direct taxes on persons as a percent of GDP increased by 154.4%.

Table 7.4: Importance of corporate and personal income taxes in government tax revenues

	Direct taxes					
	As a percent of total tax revenues			As a percent of GDP		
Levied on:	**1961**	**1999**	**Change (%) 1961–1999**	**1961**	**1999**	**Change (%) 1961–1999**
Corporations	17.0	10.4	(39.0)	4.0	3.8	(3.7)
Persons	23.5	37.8	61.2	5.5	14.0	154.4

Sources: Statistics Canada, National Economic and Financial Accounts; calculations by the authors.

Yet another perspective on the claim that corporations are not paying their fair share of tax comes from the work of economist Alan Douglas (Douglas 1990). He performed a subtle exercise to find the reasons that the corporate tax has declined as a share of total government revenue. He found that falling profits were the most significant reason for the decline: "if the profit rate for 1976 to 1985 had remained at its 1966–1975 average of 11.01% . . . average [annual government] revenue would have been $11.31 billion instead of $7.55 billion. An extra $27.6 billion in corporate taxes would have been collected over the decade" (Douglas 1990: 70).

Table 7.5 supports this result: in almost every year shown, when corporate profits as a share of GDP increased, corporate taxes as a percent of total taxes increased. The converse is also true. Mr. Douglas found, in addition, that tax breaks, such as accelerated depreciation, reduced tax revenues much less than did declining profitability. Many of these tax breaks were eliminated in 1987 in any case. Until recently, corporations in Canada had known a long slide in profitability. Governments have not "taken it easy" on these corporations. Rather, it is simply that corporations have become a less lucrative and less reliable source of revenue than individual workers.

The fact that taxes upon corporations' profits depend upon the relative uncertainty of corporate profits is probably the main reason for the growing popularity of taxes upon corporate capital among the provinces. In 1987, four provinces imposed capital taxes on corporations and seven imposed capital taxes on banks. In 1999, only three provinces did not impose corporate capital taxes and all provinces taxed bank capital. (For more information on corporate capital taxes, see Emes 2001).

Table 7.5: Canadian corporate taxes

	GDP ($millions)	Corporate* profits before taxes ($millions)	Corporate* profits before tax as a percent of GDP	Direct taxes from corporations* ($millions)	Corporate taxes as a percentage of profits	Corporate* tax as a percentage of total tax revenue
1961	41,253	4,498	10.9	1,649	36.7	17.0
1964	52,653	6,383	12.1	2,101	32.9	16.4
1967	69,834	7,697	11.0	2,396	31.1	12.8
1970	90,367	8,860	9.8	3,070	34.7	11.6
1973	129,196	16,888	13.1	5,079	30.1	13.1
1976	200,296	22,667	11.3	7,128	31.4	11.8
1979	280,309	38,822	13.8	10,038	25.9	12.7
1982	379,734	28,855	7.6	11,755	40.7	9.9
1985	485,139	54,168	11.2	15,563	28.7	10.4
1988	611,785	70,860	11.6	17,586	24.8	8.6
1991	683,239	37,254	5.5	15,015	40.3	6.1
1994	767,506	69,894	9.1	19,342	27.7	7.1
1997	877,921	93,168	10.6	31,460	33.8	9.7
1998	901,805	88,602	9.8	29,068	32.8	8.7
1999	957,911	109,521	11.4	36,869	33.7	10.4

Sources: Statistics Canada; calculations by the authors; *Includes government business enterprises.