

Reforming Federal Personal Income Taxes

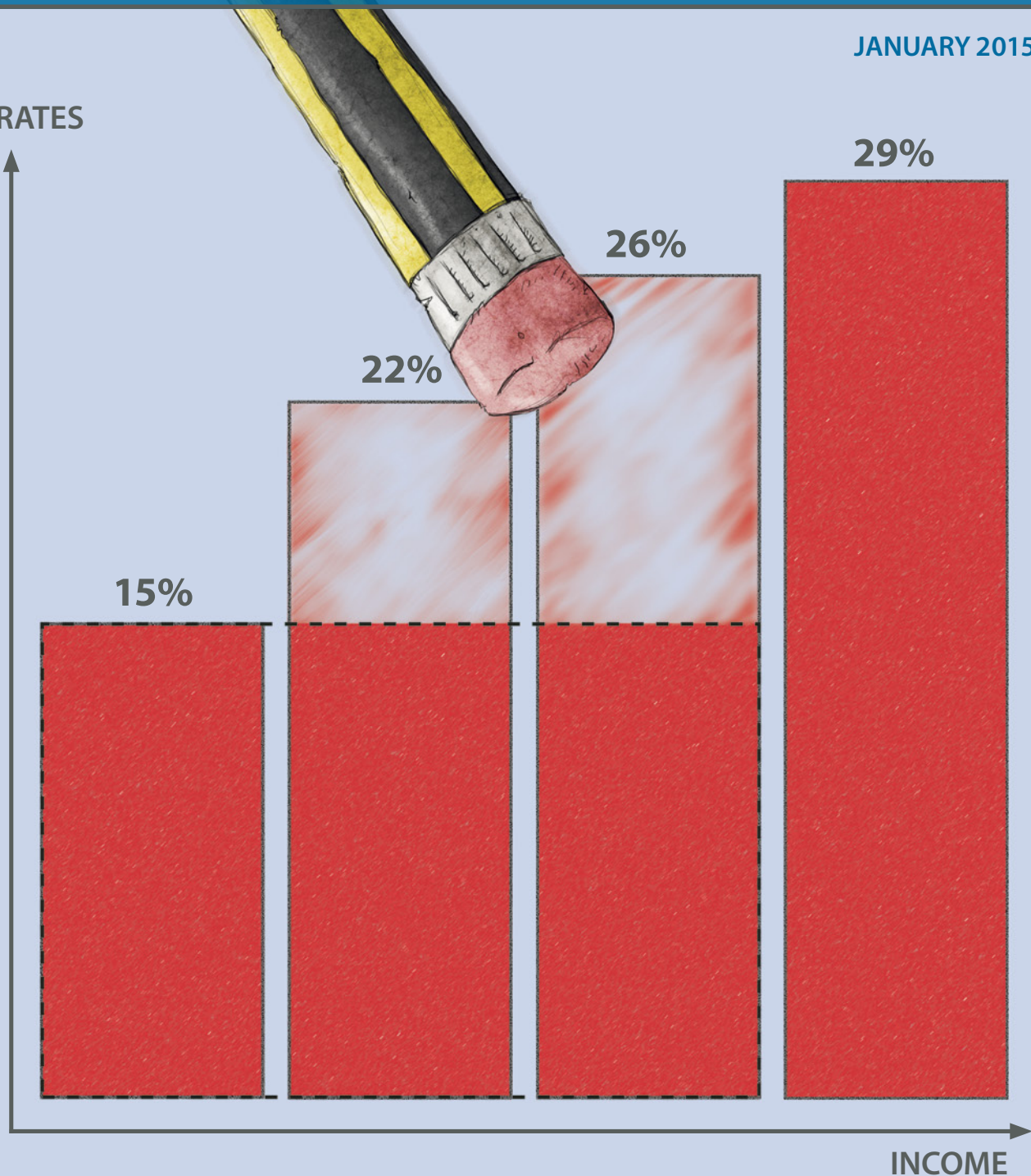
A PRO-GROWTH PLAN FOR CANADA

FRASER
INSTITUTE

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TAX RATES



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Summary

After seven years of consecutive budgetary deficits, the federal government now appears poised to balance its budget in 2015 and has signalled that its top, post-deficit priority is “examining ways to provide further tax relief for Canadians.” The prospect of tax relief comes at a critical time for the Canadian economy. Economic growth remains sluggish and below historical norms dating back to the 1950s. Reductions in marginal tax rates could provide a considerable boost to the economy by increasing incentives for Canadians to work, save, invest, and engage in entrepreneurial activity. Indeed, a considerable body of empirical research shows that broad-based tax reductions can positively contribute to economic growth over the medium- and long-term.

A debate is now emerging about how best to deliver tax relief. There is considerable speculation about the type of tax relief that the government will announce in its 2015 budget—including its past commitment to enact income splitting for families with children for taxation purposes. Another way forward is a major tax reform initiative that eliminates tax expenditures to broaden the tax base and uses the fiscal room to offset the costs of broad-based personal income tax reductions.

The federal personal income tax system has also gone largely unreformed for nearly 30 years. A proliferation of tax expenditures—credits, deductions, exemptions, exclusions, and other tax preferences—in the intervening time has added complexity and in turn increased tax compliance costs for Canadian taxpayers, provided few behavioural incentives (instead often subsidizing behaviour that would have otherwise occurred), and shrunk the tax base upon which taxes are levied, thereby requiring higher tax rates than would otherwise be necessary to generate the same level of government revenue. As a result, the Canadian personal income tax system—above all its marginal tax rates and the income thresholds at which they apply—is decidedly uncompetitive compared to that of the United States and other industrialized countries.

Eliminating a number of tax expenditures would broaden the tax base and allow for reductions in the marginal tax rate that could make Canada’s tax system more competitive and improve incentives to work, save, invest, and be entrepreneurial. An obvious question, though, is: which tax expenditures should be eliminated as part of a major tax reform?

Successive Canadian governments have taken steps to shift the personal income tax base towards consumption through preferential rates (the capital gains inclusion rate, for example) and tax-sheltered savings vehicles (like Registered Retirement Savings Plans or Tax-Free Savings Accounts) for capital income. The basic premise of these types of policies is that the tax paid on an individual's income should be the same on a present value basis irrespective of whether the earnings are consumed immediately or deferred in the form of savings or investment. In effect, the goal is to reduce or eliminate the discriminatory impact of an income tax system that favours consumers over savers.

While there has been progress in shifting the federal income tax base towards consumption, a number of tax expenditures remain that retard progress in this direction. Eliminating these tax expenditures would continue the shift to a consumption-based tax and also be a great help in offsetting significant reductions in marginal tax rates. It is estimated that eliminating these tax expenditures would produce \$20.2 billion in new fiscal room. This could form the basis of substantial broad-based tax reductions.

The new resources available from eliminating the tax expenditures would essentially offset the elimination of the two middle income tax rates of 22% and 26% and create a new tax landscape with just two personal income tax rates—15% for almost all Canadians and 29% for top earners (roughly 2% of tax-filers).

More ambitious options could include increasing the income threshold at which the top rate applies from \$136,271 to \$250,000 and lowering the top rate from 29% to 25%. These changes are important because Canada's top marginal rates (after accounting for provincial tax rates) and the income thresholds at which they apply are uncompetitive and represent a disincentive to work, save, invest, and engage in entrepreneurial ventures. Enacting these more ambitious options would require the government to dedicate future budgetary surpluses to deliver on this tax reform. This could be a productive use of future fiscal surpluses.

The tax policy options set out in this paper would be a major step forward in improving Canada's tax competitiveness and creating a policy framework that is pro-work effort, pro-savings, pro-investment, pro-entrepreneurship, and ultimately pro-economic growth. Put simply: the federal government has an opportunity to be a leader on a dynamic tax reform that could contribute to higher economic growth in Canada.

Introduction

The global economic recession is behind us but post-recession economic growth in Canada remains sluggish. The federal government's latest budget anticipates average real GDP growth of 2.4% over the next five years. One study (RBC Economics, 2013) shows that this level of economic growth is at the lower bounds of historical growth rates dating back to the 1950s. Low economic growth has broad implications and can lead to slower growth in employment, incomes, and, ultimately, living standards.

One area of policy reform that could contribute to higher economic growth is a further shift of the federal personal income-tax system towards consumption and broad-based reductions in marginal tax rates. It has been almost 15 years since the last set of significant changes were made to the tax system and almost 30 years since fundamental reform was undertaken.

Successive governments have taken some steps to shift the personal income tax base towards consumption consistent with a considerable body of research showing that such a policy can encourage work effort, savings, investment, and entrepreneurship and, in turn, contribute to higher levels of economic growth. Recent policies such as the creation of Tax-Free Savings Accounts (TFSA) have contributed to a consumption-based shift in the tax treatment of savings and investment.

Yet government policies in this direction have been piecemeal and *ad hoc*. A proliferation of tax expenditures¹ that essentially function as government spending programs have complicated the income tax system and do not increase incentives for individuals to work, save, invest, or engage in entrepreneurial activities. These tax expenditures are credits, deductions, exemptions, exclusions, and other tax preferences that deviate from a broad tax base and are typically oriented towards social or economic objectives such as attending post-secondary education or enrolling a child in recreational activities. Tax expenditures tend to be inconsistent with a shift towards a consumption-oriented personal income tax base and shrink the tax base upon which taxes are levied, thereby requiring higher marginal tax rates on labour and capital income than would otherwise be necessary to generate the same level of government revenue.

1. Tax expenditures are provisions such as tax credits or deductions that encourage certain activities or behaviours that otherwise might be subsidized by a direct spending program.

There is an opportunity to broaden the tax base by eliminating a number of these measures and to use the fiscal room to offset the cost of broad-based personal income tax reductions. Continuing the shift towards a consumption-based personal income tax system with lower marginal tax rates would help to encourage work effort, savings, investment, and entrepreneurship, and to create the conditions for higher levels of economic activity.

The timing is also important because, after seven years of consecutive budgetary deficits, the federal government is now committed to balancing the federal budget in 2015, and has signalled that its top, post-deficit priority is the introduction of income splitting for families for taxation purposes.

The government's last experience with deficit elimination in the 1990s provoked a constructive public debate about how best to spend the so-called "fiscal dividend". This ultimately led to a combination of new spending in areas such as infrastructure and Aboriginal affairs and tax reductions for individuals and businesses. The public ought to have a similar debate now as the federal government moves towards eliminating its deficit and considers how best to use future surpluses for tax relief. As will be discussed in this paper, the federal government can use its return to a balanced budget as an opportunity to make important changes to the personal income tax system in order to encourage work effort, savings, investment, and entrepreneurship, and contribute to higher levels of economic growth over the long-term.

This paper studies personal income tax reform at the federal level in Canada. The first section describes and analyzes the case for personal income tax reform including a discussion about shifting the personal income tax base towards consumption. The second section outlines the basic details of the current personal income tax system, including the role of tax expenditures and the extent to which the system functions on a consumption base. The third section reviews the current set of tax expenditures in the personal income tax system and distinguishes between consumption-based measures that support work effort, savings, investment, and entrepreneurship and narrow ones that essentially function as indirect government spending and have limited supply-side effects. The final section sets out three options for flattening and lowering the federal marginal tax-rate structure.

These tax policy options would be a major step in improving Canada's tax competitiveness² and creating a policy framework that is pro-work effort, pro-savings, pro-investment, pro-entrepreneurship, and ultimately pro-economic growth. Put simply: the federal government has an opportunity to be a leader on dynamic tax reform that can contribute to higher economic growth and improved living standards for Canadians.

2. Research shows that tax competitiveness—particularly with respect to marginal tax rates—can have an effect on the mobility of capital and labour. For more on the relationship between marginal tax rates and economic performance, see a detailed literature review in Murphy, Clemens, and Veldhuis, 2013.

The Case for an Efficient, Equitable and Simple Personal Income Tax System

The primary purpose of the tax system, including income taxes, is to generate revenues for governments to deliver on core services in the least distortionary manner. Ideally the system would achieve this aim while preserving the principles of efficiency, equity, and simplicity.

Efficiency requires that taxation minimize distortions in the allocation of economic resources. Tax policy should entail a minimum of interference with individual decisions. A sound system of taxes minimizes the number and level of decisions that individuals, families, and businesses make based on taxes rather than the particular costs and benefits of the decision itself. It should not discriminate in favour of, or against, particular consumption expenditures, particular means of production, particular forms of organization, or particular industries.³

The equity of a tax system concerns how the tax burden is distributed among the population. Equity can be assessed in two ways: horizontal equity and vertical equity. Horizontal equity is the idea that taxpayers with similar circumstances in terms of income, family structures, and ability to pay taxes should pay a similar amount. Vertical equity refers to the concept that as the underlying tax base—usually income—increases so too does the tax burden. This is largely the basis for progressivity in the tax system. It is important to note, however, that there is a trade-off between equity and efficiency. Progressivity tends to be achieved by higher marginal tax rates, which distort incentives to work, save, invest, and undertake entrepreneurial activities because the marginal tax rate on income is higher than the average tax rate. So, although the current system achieves vertical equity, it does so at a high cost to the economy.

A simple tax system refers to one that does not require taxpayers to spend considerable time and resources in order to achieve compliance and is generally understandable by average citizens. The current personal income tax

3. See chapter 2 in Clemens, 2008 for more on tax efficiency and the marginal efficiency of different types of taxes.

system is complex and consumes considerable resources in the form of compliance costs. These costs include the time required to collect and organize receipts, accounting and other professional fees, the time required to complete complex tax forms if professionals are not used, appeal costs if applicable, and the general costs of remitting returns.

Research shows that Canada's current personal income tax system imposes considerable compliance costs on taxpayers. An April 2014 study (Speer, Palacios, Lugo, and Vaillancourt, 2014) estimates the cost of compliance for the personal income tax system between \$5.84 billion and \$6.96 billion in 2012.⁴ The analysis shows that this cost falls disproportionately on low-income Canadians who pay a higher share of their income to comply with the tax code. These findings are consistent with those of a similar study undertaken in 2013.

As for the system's efficiency, there is also room for considerable improvement especially considering the large body of research on marginal taxes and economic decision-making. An October 2013 study (Murphy, Clemens, and Veldhuis, 2013) provided a far-reaching review of literature on marginal tax rates and finds considerable empirical evidence that marginal rates play an important role in influencing individual behaviour such as choosing to work more hours during a certain period of time, accepting a new job that involves higher pay but a longer commute, or investing in one's education. The main finding is that, while there is some debate among economists about the extent to which marginal tax rates influence individual decisions, there is no real dispute about the adverse economic effects of high and increasing marginal tax rates.

The same study also finds that Canada's marginal tax rates are uncompetitive relative to those of the United States and other key jurisdictions after accounting for the *combined* federal/provincial rates and the income thresholds at which the rates are applied. The interplay of these factors causes Canada's tax competitiveness to fall to middle of the G-7 and importantly positions the country poorly relative to the United States.

These findings are consistent with the pronouncements of past federal governments of different political persuasions. Paul Martin's 2005 economic plan, *A Plan for Growth and Prosperity*, stated that: "Lower personal taxes would ... provide greater rewards and incentives for middle- and high-income Canadians to work, save and invest" (Canada, Department of Finance, 2005: 130). Prime Minister Stephen Harper's 2006 plan, *Advantage Canada*, also stressed that "Canada needs lower personal income tax rates to encourage more Canadians to realize their full potential" (Canada, Department of

4. A study by Vaillancourt, Roy-César and Barros (2013) estimated that compliance with all forms of taxation, personal and business, cost between \$19.2 billion and \$24.8 billion in Canada in 2011.

Finance, 2006a: 46). Yet, despite this seeming political consensus, there has been little progress in making the federal personal income tax system more competitive and part of a pro-growth agenda in recent years.

As will be discussed in later sections, the increasing number of tax expenditures—many of which substitute for spending programs rather than serving as structural, consumption-based features of the tax system—is an impediment to the type of tax policy envisioned in both government statements. Tax expenditures complicate the tax system, provide few behavioural incentives related to work, savings, investment, or entrepreneurship, and narrow the tax base resulting in higher marginal rates. The indirect consequence is a less efficient and uncompetitive personal income tax system.

Eliminating a large number of these measures would broaden the tax base and allow the government to use the resulting resources to lower marginal tax rates. Such a tax reform policy would improve the system and lead to a less distortive personal income tax regime that could contribute to higher levels of economic growth.

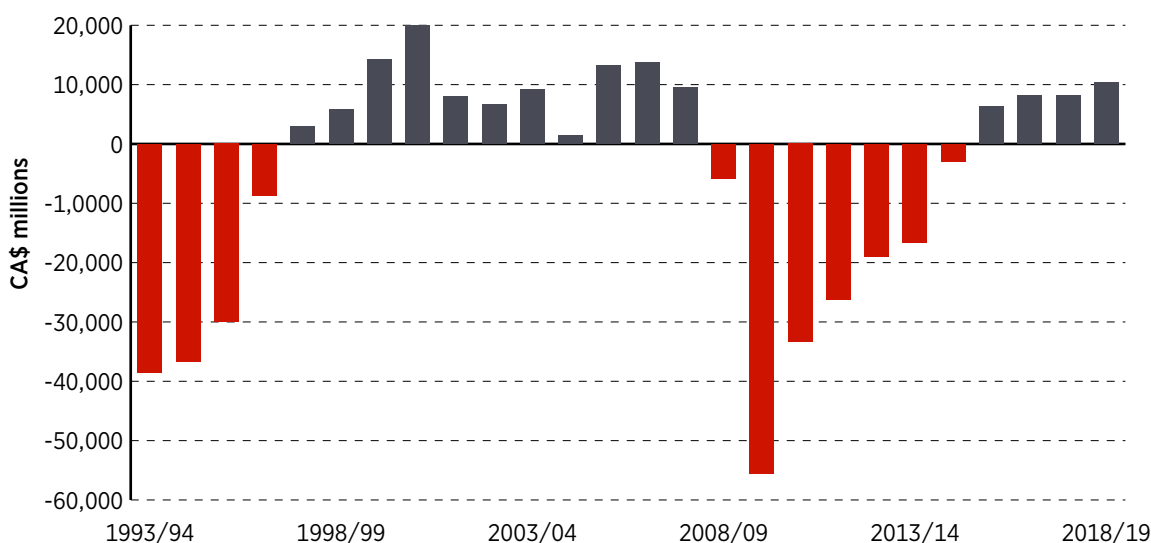
Why tax reform?

Two primary factors are contributing to a growing potential for a reform initiative whereby tax expenditures that function like spending programs and shift away from a consumption tax base are eliminated and used to fund reductions in marginal income tax rates.

First, Canada's economic performance has been sluggish and is projected to remain moderate for the foreseeable term. A tax reform plan that reduces current disincentives to work, save, invest, and undertake entrepreneurial activities can help to bolster economic growth. The dynamic effects of a broad-based reduction in marginal tax rates could be significant. One US study, for instance, finds that a 1% cut in the average personal income tax rate raises real GDP per capita by 1.4% in the first quarter of the reforms and by up to 1.8% after three quarters (Merterns and Ravn, 2012). This type of economic boost could be a powerful shot to the arm of the Canadian economy in the short- and long-term.

Second, the federal government is poised to eliminate its budgetary deficit in the next year and is projecting fiscal surpluses thereafter. The most recent federal budget anticipates a \$2.9 billion deficit in 2014/15 and then a \$6.4 billion surplus in 2015/16 and growing fiscal surpluses thereafter ([figure 1](#)). The last time the federal government eliminated a deficit there was considerable public debate about how best to spend the so-called “fiscal dividend”.

The Fraser Institute hosted a conference with a wide range of participants in 1997 to discuss the priorities in using the budgetary surpluses. One of the prevailing views was that the government ought to use the surplus to

Figure 1: Annual federal deficits and surpluses, 1993/94–2018/19

Sources: Canada, Department of Finance, 2013b, 2014a.

lower marginal tax rates for individuals in order to make the Canadian system more competitive with that of the United States (Grubel, 1998). Mintz and Poschmann (1999) contributed to another study that reached the conclusion that the government should implement a multi-year plan to reduce personal and corporate income taxes. This public debate helped to create the conditions for the federal government's tax reductions in 2000. A similar debate ought to occur now as the federal government moves closer to eliminating its deficit. Balancing the budget cannot become an end in itself or it can come to serve as a justification for spending increases with limited economic benefit. Extending the shift towards a consumption-based personal income tax system with lower marginal rates and improved incentives for work effort, savings, investment, and entrepreneurship would represent a significant change in federal tax policy and help to create the conditions for higher rates of economic growth.

Shifting the personal income tax base to consumption

The real question facing any exercise in tax reform is what principles or ideas should govern the process, including determining which tax expenditures should be eliminated, curtailed, or maintained in their current form and size. There is a considerable theoretical and empirical basis for shifting the personal income tax base towards consumption.⁵ Yet progress towards a consumption-based personal income tax system has been *ad hoc* and incremental in Canada.

5. For a comprehensive review of the literature, see Zodrow, 2005.

At the root of this debate is what should form the tax base. One concept that is commonly referred to in the tax literature is a comprehensive tax base. The notion of comprehensive income dates back to Haig-Simons's definition of income equalling consumption plus savings (Haig, 1921; Simons, 1938). The portion of income not immediately spent on consumption is characterized as savings. Consumption, then, can be measured as total income (from labour and capital sources) minus a deduction for savings. This concept of a comprehensive tax base has received intellectual and academic support in the past—including forming the basis of the policy recommendations of the 1966 Royal Commission on Taxation⁶—but has been criticized as impractical with respect to the complexity of determining the market value of all assets each year to measure gains and losses and biased against savings and investment.⁷

The key difference between an income tax and a consumption-based tax is the tax treatment of income from capital. The comprehensive income model includes income from capital in the tax base and taxes it at the same rate as labour or wage income. A consumption-based tax excludes income from capital or applies a preferential tax rate on capital income or provisions for different forms of tax sheltering such as Registered Retirement Savings Plans (RRSPs).

The basic premise of consumption-based policies such as tax-deferred savings vehicles (as exemplified by RRSPs or TFSAs) is that the tax paid on an individual's income should be the same on a present value basis irrespective of whether the earnings are consumed immediately or deferred in the form of savings or investment. If two individuals have the same lifetime earnings, but one saves some earnings for future consumption and the other spends all his or her earnings on current consumption, the saver pays more tax than the immediate consumer does over a lifetime. The result is that the current system imposes more tax on the saver with respect to future consumption derived from his or her savings than it does on short-term consumption. The bias therefore is against those taxpayers who wish to consume more in the future. The goal of a consumption-based policy is to eliminate the discriminatory impact of income taxes upon savers.

The research has found that this model has significant consequences for savings and investment and in turn economic activity. At its core, the case for consumption-based personal income taxation is improved efficiency. As Kesselman puts it:

The most common argument for a consumption tax base is that it would remove distortion to savings by eliminating tax on capital incomes arising under an income-tax base. That change would raise

⁶ See Canada, Royal Commission on Taxation, 1966 for the Royal Commission's report.

⁷ For a more detailed critique of the Haig-Simons's comprehensive income tax base, see Edwards, 2001.

the after-tax return on capital, thus increasing incentives to save. The resulting increase in aggregate savings would raise the economy's long-run capital stock, which in turn would enhance productivity and growth in both real wages and output. (2009: 537–538)⁸

This perspective is rooted in considerable research showing the potential efficiency gains stemming from consumption-based taxation. Feldstein (1978) considered the efficiency costs of a proportional tax on labour income and a proportional income tax and found that, even if savings remain constant, future consumption can decline if the return on savings is taxed, with the welfare costs of taxing future consumption approaching 20% of revenue on income. Auerbach, Kotlikoff, and Skinner (1983) studied the efficiency gains from a shift to consumption-based taxation and estimated it could produce a sustainable welfare gain of almost 2% of lifetime resources. Altig, Auerbach, Kotlikoff, Smetters, and Walliser (2001) conducted a simulation of five tax reform proposals—including four consumption tax options—and estimated the long-run output gains of 1.9% to 9.4% for the consumption-based scenarios. A 2005 study of US taxation by the President's Advisory Panel on Tax Reform concluded: "While the studies [of consumption-based tax plans] produce different estimates of how taxing consumption rather than income would affect economic growth, virtually all such studies suggest that the long-run level of national income would be higher" (2005: 155).

The case against shifting to a consumption-based personal income tax system tends to be focused on equity concerns. This is because savings rise proportionately with annual income resulting in what is perceived as greater regressivity in the system. There are some underlying problems with this critique. First, a consumption-base system typically involves deferring taxes on savings to future years when they are ultimately consumed and therefore one should calculate the present value of the eventual taxes paid on savings and add this value to current taxes to measure the total amount of taxes paid on overall earnings. Second, this type of "snapshot" distributional analysis is static and therefore fails to account for income and tax mobility on the part of households over time.⁹ Third, the government can still apply a progressive rate schedule with increasing marginal tax rates or redistributive spending programs to achieve desired equity objectives. The main point is that, while a further shift to a consumption-based personal income tax system invariably brings up normal questions of efficiency versus equity, the

8. Kesselman, who had previously written in favour of shifting to a consumption-based tax system, has recently revisited his thinking and released a paper (Kesselman and Spiro, 2014) that argues that the efficiency gains may be overstated and do not necessarily outweigh the perceived equity concerns.

9. For more on income mobility in Canada, see Lammam, Karabegović, and Veldhuis, 2012.

efficiency gains—particularly when one accounts for the potential for lower marginal rates resulting from a broader tax base—would seem to outweigh equity concerns that are overstated and can be mitigated through a series of policy measures.

With this in mind, a tax reform plan focused on shifting the federal personal income tax base towards consumption could have positive long-run effects for savings and economic activity for Canada. A shift to a consumption basis for direct personal income taxation in Canada could be achieved by sheltering all (or most) capital income through RRSP-type vehicles or by allowing the capital income earned to be tax free as in the TFSAs. This would involve an extension or a furthering of the current system because, as will be discussed in a later section, both tax sheltering vehicles already exist. The result would be a progressive rate structure for labour income and then what is known as a “cash-flow tax on returns,” whereby investment is sheltered up front or future capital gains are exempted. The government could then decide how best to direct its resources—including augmenting these tax-sheltered vehicles or, as is considered in this study, flattening and lowering marginal tax rates.

The Federal Personal Income Tax System in Canada

The federal personal income tax system in Canada has evolved over the past 25 years but most of these changes have been incremental and *ad hoc*. We have limited experience with major tax reform such as fundamental changes to the tax base in the ensuing decades. The last fundamental reform to the personal income tax system took place in 1987. The changes stemmed from a major White Paper on taxation and involved a series of comprehensive tax policy reforms including the introduction of the Goods and Services Tax (GST) later in 1991.¹⁰ This publication focuses on the changes to the federal personal income tax system and does not address the other reforms that the government undertook.

The White Paper on tax reform identified the proliferation of “special preferences” and the maintenance of high marginal tax rates as undermining Canada’s economic performance and contributing to a complex and unpredictable tax system. As the report stated: “an income tax system with high rates relieved by an unfair patchwork of special incentives is not what Canada needs. What Canada needs is a fundamentally different approach: lower tax rates and a broader, fairer tax base” (Canada, Dep’t of Finance, 1987: 10). The government responded to the recommendations with a series of changes to the federal personal income tax system. The top marginal tax rate was cut from 34% to 29%; the number of federal tax brackets was reduced from ten to three; and a number of exemptions and deductions were eliminated or converted into non-refundable tax credits in order to broaden the tax base. These changes to the personal income tax system sought to ensure that Canada’s tax regime remained competitive with the United States following its major tax reform in 1986.

¹⁰. The introduction of the GST and the subsequent trend of harmonization between the federal government and several provinces has been a major step in the direction of a consumption-based tax system. For more on the relative marginal efficiency of the GST, see Clemens, Veldhuis, and Palacios, 2007.

The federal government's *2000 Budget* and subsequent *Economic Statement and Budget Update* (Canada, Dep't of Finance, 2000a, 2000b) introduced the most significant changes in personal income tax policy since the 1987 reforms. The federal government presented a five-year tax reduction plan with close to \$40 billion in personal income tax relief. The most significant measure was the restoration of full indexation to tax brackets and the basic personal amount in order to put an end to the bracket creep.¹¹ The middle tax rate was lowered from 26% to 24%. The deficit reduction surtax was eliminated. The first bracket rate was reduced from 17% to 16% and the middle tax rate was further reduced to 22%.¹² A fourth tax bracket was subsequently introduced in 2001.

These tax reductions followed a significant period of deficit reduction and were paid for from the "fiscal dividend" that resulted from the return to a balanced budget. The federal government reversed a budget deficit of \$36.6 billion in 1994/95 to a \$3-billion surplus three years later due to a series of spending reductions and some modest tax increases. Thereafter, the government used fiscal surpluses not only to lower personal income taxes as explained above but also to lower the capital gains tax inclusion rate and also set in motion a multi-year reduction in Canada's corporate tax rate that has made the business tax regime competitive with that of the United States.

The tax reform agenda has since largely stalled. The current federal government's major tax reductions have been limited to decreasing the GST rate from 7% to 5%¹³ and following through on the scheduled reductions to the corporate tax rate. It has left the personal income tax rate structure essentially unchanged.

11. Bracket creep refers to a situation in which inflation pushes an individual's income into higher tax brackets. The result is an increase in income taxes but no increase in real purchasing power.

12. The same year witnessed a significant change in the federal-provincial interaction of personal income taxes. Prior to 2000 most provinces based their personal income tax on the "basic federal tax". Residents of provinces other than Quebec determined their basic tax liability by multiplying the basic federal tax by the province tax rate. This practice was known as "tax-on-tax" and it formed the basis for most of the provincial income tax systems. Quebec has operated its own personal income tax system since 1954 on the "tax-on-income" basis whereby the setting of the rates and the application of provincial taxes was done apart from the federal regime. Several provinces moved to the Quebec model in 2000 and others followed in 2001. Tax-on-income assessments give provincial governments more flexibility to change their personal income tax systems to suit the priorities of their respective residents. It also protects provincial revenue decreases resulting from any changes to federal personal income taxes that would have previously occurred automatically in the tax-on-tax system.

13. See Clemens and Veldhuis, 2005/06.

There have been some steps in the direction of a consumption tax base over the past 20 years, however. Reforms in the 1990s increased the tax-deferred contribution limits for RRSPs and Registered Pension Plans (RPPs) and allowed for unused contribution room to be carried forward. The age limit for contributing to RRSPs was increased from 69 to 71 in 2007. The capital gains tax inclusion rate was reduced from 75% to 50% in 2000. The lifetime capital gains exemption has been regularly increased, most recently in 2013 when it was raised to \$800,000 and indexed thereafter. These measures have sought to reduce the bias in favour of consumption in the personal income tax system.

The most recent change in this direction was the introduction of Tax-Free Savings Accounts (TFSA) in the 2008 budget. TFSAs are individual accounts that provide tax benefits for saving. Contributions to a TFSA are not deductible for income-tax purposes. But investment income, including capital gains and dividends, earned in a TFSA is not taxed even when withdrawn. A TFSA can hold any investments that are eligible under the Registered Retirement Savings Plan (RRSP) rules. TFSAs contribute to the shift to consumption by excluding taxation on capital income earned in the accounts. Kesselman (2009) has argued that this removes distortions against savings by raising the after-tax return on capital and therefore improving incentives for savings. Public take-up of the TFSA has been significant. A recent study by the Department of Finance (2013c) indicates that approximately 8.2 million Canadians had opened an account by the end of 2011, and financial assets held in TFSAs were valued at over \$62 billion.¹⁴

Still, while these measures have contributed to a shift towards consumption-based taxation, there remain a wide range of tax provisions that are biased against work, savings, investment, and entrepreneurship. It is worth reviewing the basic features of the federal personal income tax system. Residents of Canada are liable for tax on all sources of income. Taxpayers are permitted a wide range of deductions and tax credits that can reduce their liability from total (gross) income. Deductions reduce taxable income so their value depends on a taxpayer's marginal rate. Tax credits directly reduce an individual's tax liability and therefore have the same value for all taxpayers with tax liabilities at least equal to the credit. There is also a basic personal amount of \$11,138 in 2014. There are then four statutory marginal tax rates that are applied to an individual's taxable income. Taxable income thresholds and the federal rates of personal income tax are shown in [table 1](#).

14. The study also finds that the use of TFSAs is common across all income levels. For 2011, low- and middle-income earners (individuals with total incomes below \$80,000) make up 82% of all TFSA holders and made 79% of all contributions. Low- and modest-income earners (individuals with total incomes below \$40,000) accounted for 49% of all account holders and 46% of total contributions.

Table 1: Federal personal income tax rates in 2014

Income thresholds	Tax rates
\$11,139–\$43,953	15%
\$43,954–\$87,907	22%
\$87,908–\$136,270	26%
\$136,271+	29%

Source: KPMG, 2014a; KPMG, 2014b.

The provincial governments also have their own personal income tax rate structures. [Table 2](#), which sets out the taxable income thresholds and provincial rates of personal income tax in 2014, shows that the rate structures vary considerably among the provinces. Alberta's stands out as the simplest and most pro-growth. It has a single marginal rate of 10% on all incomes of \$17,787 and above. Nova Scotia, by contrast, has five rates ranging from 8.79% to 21%. Alberta has the lowest top marginal rate while Nova Scotia and Quebec have the highest at nearly 21%.¹⁵

The distribution of income taxation among levels of government in Canada is less tilted in favour of the federal government than in other countries in its peer group. Canadians tend to pay a lower share of their total income taxes to the federal government and a greater share to provincial governments relative to citizens in other federal states.¹⁶ This is an important distinction because it means that one must look at the combined federal-provincial income tax burden when assessing Canada's tax competitiveness.

Lowering marginal tax rates at the federal level, then, is an important first step but it is only part of the solution. It should serve as a catalyst for similar reforms at the provincial level in order to fully address Canada's tax competitiveness. There is strong precedent. Canada's transformation from a high-tax jurisdiction to one with a more competitive regime of corporate taxation began with a multijurisdictional consensus led by the federal government in the late 1990s and continued by the current government in the face of some political opposition in recent years.

¹⁵. Quebec's tax rates are adjusted to reflect the federal abatement. For more on Quebec's personal income tax system, see Speer, Palacios, and Ren, 2014.

¹⁶. This distribution reflects Canada's decentralized form of federalism whereby the provinces have considerable fiscal autonomy and considerable expenditure responsibilities. An IMF study by Dziobek, Gutierrez Mangas, and Kufa (2011) found that Canada is among the most decentralized federations in the world on both of these indicators.

Table 2: Provincial personal income tax rates in 2014

British Columbia		Ontario*		Nova Scotia*	
\$0–\$9,868	0.00%	\$0–\$9,669	0.00%	\$0–\$8,480	0.00%
\$9,869–\$37,605	5.06%	\$9,670–\$40,119	5.05%	\$8,481–\$29,589	8.79%
\$37,606–\$75,212	7.70%	\$40,120–\$70,647	9.15%	\$29,590–\$59,179	14.95%
\$75,213–\$86,353	10.50%	\$70,648–\$80,241	10.98%	\$59,180–\$92,999	16.67%
\$86,354–\$140,857	12.29%	\$80,242–\$83,235	13.39%	\$93,000–\$149,999	17.50%
\$140,858–\$149,999	14.70%	\$83,236–\$149,999	17.41%	\$150,000–	21.00%
\$150,000–	16.80%	\$150,000–\$219,999	18.97%		
		\$220,000–	20.53%		
Alberta		Quebec*		Prince Edward Island*	
\$0–\$17,786	0.00%	\$0–\$11,304	0.00%	\$0–\$7,707	0.00%
\$17,787–	10.00%	\$11,305–\$41,494	13.53%	\$7,708–\$31,983	9.80%
		\$41,495–\$43,953	17.53%	\$31,984–\$63,968	13.80%
		\$43,954–\$82,984	16.37%	\$63,969–\$98,142	16.70%
		\$82,985–\$87,906	20.37%	\$98,143–	18.37%
		\$87,907–\$100,969	19.71%		
		\$100,970–\$136,269	21.46%		
		\$136,270–	20.97%		
Saskatchewan		New Brunswick		Newfoundland & Labrador	
\$0–\$15,377	0.00%	\$0–\$9,471	0.00%	\$0–\$8,577	0.00%
\$15,378–\$43,291	11.00%	\$9,472–\$39,304	9.68%	\$8,578–\$34,253	7.70%
\$43,292–\$123,691	13.00%	\$39,305–\$78,608	14.82%	\$34,254–\$68,507	12.50%
\$123,692–	15.00%	\$78,609–\$127,801	16.52%	\$68,508–	13.30%
		\$127,802–	17.84%		
Manitoba					
\$0–\$9,133	0.00%				
\$9,134–\$30,999	10.80%				
\$31,000–\$66,999	12.75%				
\$67,000–	17.40%				

Note: * = includes surtax.

Sources: Alberta, Min. of Finance, 2014; British Columbia, Min. of Finance, 2014; Manitoba, Min. of Finance, 2014; New Brunswick, Min. of Finance, 2014; Newfoundland & Labrador, Min. of Finance, 2014; Nova Scotia, Min. of Finance, 2014; Ontario, Min. of Finance, 2014; Prince Edward Island, Min. of Finance, 2014; Quebec, Min. of Finance, 2014; Saskatchewan, Min. of Finance, 2014; calculations by authors.

The role of tax expenditures in the personal income tax system

Tax expenditures are now a key feature of the federal personal income tax system. The current system is marked by different tax credits, deductions, preferential rates, and accelerated depreciations. The concept of “tax expenditures” was introduced in 1967 by Stanley Surrey, the assistant secretary of the US Treasury Department for tax policy.¹⁷ He used the term to describe tax provisions that function similar to direct government spending programs. A government, for instance, may provide a tax credit or deduction encouraging a certain activity or behaviour rather than subsidize them through a direct spending program. These types of tax expenditures narrow the tax base by deviating from a benchmark tax structure that does not contain any preferential tax provisions.

The benchmark typically includes the rate structure, accounting conventions, deductibility of compulsory payments, provisions to facilitate tax administration, and international tax obligations. It establishes in effect the basic parameters of a straightforward tax system prior to the inclusion of any credits, deductions, or other special provisions. Any deviations from this basic structure—particularly those that are not broad-based—tend to be characterized as tax expenditures. Even now there is considerable debate about how to define a benchmark tax structure and therefore what ought to be considered a basic, broad-based feature and a tax expenditure.

The federal government “takes a broad approach” in assessing what tax provisions are tax expenditures and which are benchmark features—meaning that only the most fundamental structural elements of the tax system are considered features of the benchmark (Canada, Dep’t of Finance, 2013c: 9). By defining the benchmark in this way, a large number of tax provisions are characterized as tax expenditures.

Irrespective of different definitions there is no question that the tax expenditures result in considerable foregone revenue. A study by Statistics Canada’s former Chief Statistician (Sheikh, 2014) estimates that accounting for the foregone revenue represented by total government tax expenditures (personal, corporate, and sales tax) as direct spending at both the federal and provincial levels would increase the size of government relative to GDP from 44% to 54% in 2009.

The federal government has been producing an annual report with information on the forgone revenue represented by its various tax expenditures since 1994. The most recent Tax Expenditures and Evaluations report (Canada, Dep’t of Finance, 2014b) lists 129 personal income tax expenditures that sum to \$155 billion. The cost estimates show the amount by which federal tax revenues have been reduced as a result of the existence of each tax

17. For more on the history of the tax expenditure, see McBride, 2013.

expenditure assuming that all other factors remain unchanged. The estimates do not account for behavioural changes by taxpayers, the effect on economic activity, or the interaction between individual tax expenditures.

The number of tax expenditures in the personal income tax system has been increasing.¹⁸ Virtually every federal budget since 2006 has contained new or expanded tax credits related to a specific activity or group of individuals. There are, for example, credits for using public transit, placing a child in an athletic or recreational activity, and caring for an aging or ill relative. The most recent federal budget, for instance, introduced a new tax credit for those who volunteer in search and rescue operations in their communities and augmented existing credits for medical expenses and those who adopt a child.¹⁹

These tax expenditures that seek to encourage certain behaviours or activities have similarities to direct government spending programs. The only real distinction is that they are provided through the tax system rather than direct government subsidies. As Surrey puts it: “these tax reductions, in effect, represent monetary assistance provided by the government” (1976: 680).

Questions about the efficacy of tax credits have been raised by various economists and policy analysts.²⁰ Tax credits can reduce a taxpayer’s liability but they do not lower marginal tax rates and therefore do not change the economic incentives to work, save, invest, and be entrepreneurial—activities that help the economy grow and prosper. Tax credits also narrow the tax base, which means that overall higher tax rates are required to raise the same amount of revenue. In effect, the proliferation of tax credits is reducing the tax liabilities for concentrated groups at the expense of higher marginal tax rates for the general population of taxpayers and this diminishes the system’s efficiency.

Tax expenditures—such as non-refundable tax credits—have escaped the scrutiny of past spending reviews and little analysis exists on their effectiveness. This includes measuring the extent to which a tax credit delivers on its policy objective. The reality is there is little evidence that tax credits produce significant behavioural effects. Rather, it is often the case that these measures effectively subsidize behaviour that taxpayers would likely have adopted in any case.

For instance, the Public Transit Tax Credit was introduced in the 2006 budget to encourage Canadians to use public transit in order to reduce traffic

18. See Speer, Palacio, Lugo, and Vaillancourt, 2014 for some analysis on the growth of tax expenditures in the federal personal income tax system between 1992 and 2012.

19. The dollar value of these credits is typically determined by multiplying the bottom tax rate by the credit’s amount. For instance the Children’s Fitness Tax Credit, which allows a taxpayer to claim a maximum of \$500 per child for fees related to the registration or membership in an eligible program of physical activity, lowers his or her tax liability by 15% of \$500 or \$75. A taxfiler must claim a tax credit in order to benefit from the relief.

20. See for instance Taylor and Sand, 2011 and Clemens, 2012.

congestion and air pollution and greenhouse gas emissions.²¹ The Department of Finance (2012b) carried out an analysis of the tax credit in 2011 and found that, while public transit use had increased since its creation, it was not able to assess the net contribution of the tax credit and conceded that other factors such as economic conditions, the cost of using an automobile, quality of service, and demographic changes could have contributed to the increase in ridership. Put differently: the government does not know if this particular tax credit is achieving its policy objective or simply providing a benefit to those who would have chosen to use public transit irrespective of any tax inducement. A similar conclusion was reached by Chandler who found “no economic justification for this tax credit especially when considering the compliance cost associated with tax credits” (2014: 267).

The limited scrutiny of tax expenditures has received considerable attention in Canada and elsewhere. Lester (2012) distinguishes between measures implemented to improve the efficiency and fairness of the tax system and measures that are substitutes for program spending. He argues that tax-based spending programs, or tax expenditures, should be integrated into direct spending categories and subject to the same regular performance reviews as other spending. Researchers with the World Bank carried out a series of jurisdictional case studies to develop a better understanding of how different countries report on tax expenditures and their effectiveness. As the study notes:

[T]he lack of scrutiny [of tax expenditures] is in stark contrast to the scrutiny generally applied to the spending side of government finances. In these situations, it is difficult, if not impossible, to evaluate the cost, efficiency, and equity impact of tax expenditures and the extent to which resources could be rationalized or better allocated to strengthen government finances and to support progress toward broader economic and social objectives. (Polackova Brixi, Valenduc, and Swift, 2004: xi)

The key, then, is that many tax expenditures essentially function as indirect government spending and oftentimes with less scrutiny than direct program spending. These measures erode the tax base and require higher marginal rates than would otherwise be required, thereby diminishing incentives for work effort, savings, investment, and entrepreneurship and, in turn, ultimately affecting economic growth. The time has come to reform the system by significantly reducing the number of tax expenditures and making the rate structure more competitive and further shifting the tax base towards consumption.

21. The budget stated: “this government wants to encourage individuals to use public transit. Increasing public transit will ease traffic congestion in our urban areas and improve the environment” (Canada, Dep’t of Finance, 2006b: 116).

Consumption-based features in the federal personal income tax system

The personal income tax system in Canada is a hybrid model. The taxation of comprehensive income remains its foundation. The basic structure can be traced back to the early 1970s following the Royal Commission on Taxation. The general thrust of those reforms—though not as ambitious as the commission had envisioned—were to move the system towards a comprehensive personal income tax base. But over time the system has taken on several features that shift the overall tax base towards consumption.

A consumption-based tax model can be grafted onto an income tax system in different ways. The RRSP approach involves the government granting a tax deduction for new savings out of otherwise taxable income and then ultimately taxing the savings and any resulting capital gains when they are consumed. The TFSA approach allows after-tax investment to accumulate tax free with no further tax at the time of consumption. In addition, the exemption of capital gains taxation on principal residence and the partial inclusion rate for general capital gains are examples of consumption-based provisions. Indeed, for many low- and middle-income taxpayers whose primary assets are a home or an employer-based pension or RRSP savings, the income tax system already effectively functions as a “consumption” tax.

Bibbee (2008) shows that tax expenditures related to retirement savings represent the lion’s share of federal tax expenditures. Of the \$155 billion in forgone revenue resulting from tax expenditures in 2013, over 20% stems from the tax preferences for RPPs and RRSPs. The result of these types of measures is that it is estimated that about 90% of individuals will ultimately be able to hold all of their financial assets in tax-sheltered vehicles (Bibbee, 2008: 28). This finding is consistent with an earlier study by Poddar and English (1999), who estimated that only 25% of investment income of individuals is subject to tax in Canada. And as the TFSA matures over time this displacement of non-sheltered savings should be progressively reduced.

Yet this hybrid model still carries considerable efficiency costs. The share of individual investment income that is subject to taxation can be considered income that is at the margin with respect to investment decisions and is likely highly mobile. Under the current system, this income is subject to relatively high top marginal tax rates. The hybrid structure means that the average tax rate on investment income is low, but the marginal tax rate is high. Further shifting the tax system towards savings and investment would continue to improve the neutrality and efficiency of the Canadian tax system, particularly by broadening the tax base and in turn lowering marginal rates.

Eliminating Tax Expenditures to Lower Tax Rates

As discussed, the federal government reports annually on the tax expenditures in the tax system and estimates their cost in the form of forgone revenues. As set out in [table 3](#), the latest report lists 129 personal income tax expenditures, which sum to \$155 billion. The sum is indeed biased upwards and simply provided for illustrative purposes of the relative impact of tax expenditures on federal revenues.²² The analysis later on excludes the transfer of income tax points to the provinces and a number of items that were recently reclassified

Table 3: Summary of tax expenditures (\$ millions), 2013

	Simple Cost Estimate
Grand Total	155,408
Reclassified and Tax Point Transfer	31,441
Transfer of income tax points to provinces	19,905
Canada Child Tax Benefit (2012 value)	10,266
Working Income Tax Benefit	1,125
Refundable Medical Expense Supplement	145
Consumption-Based Provisions	101,081
(see table 4 for details)	
Available for elimination	22,886
(see table 5 for details)	

Source: Canada, Department of Finance, 2014b.

²² The 2013 tax expenditure report sets out a number of caveats to the estimates and projections. Among them it states: “the cost of each tax measure is determined separately, assuming that all other tax provisions remain unchanged. Many of the tax expenditures do, however, interact with each other such that the impact of several tax provisions at once cannot generally be calculated by adding up the estimates and projections for each provision” (Canada, Dep’t of Finance, 2014b: 9).

as transfer payments, leaving 125 tax expenditures valued at \$124.0 billion. To put this in perspective, the government is estimated to have collected \$130.1 billion in personal income tax revenues in the 2013/14 fiscal year.

There is value in unpacking the remaining tax expenditures to understand which are consistent with a consumption-based tax system and which deviate from a consumption base. This can serve as a litmus test for which existing tax expenditures ought to be considered for elimination as part of a tax reform package.

Table 4 lists 57 items valued at \$101.1 billion that are considered to be consumption-based and therefore part of the benchmark system for the purpose of the tax reform options set out in this study. This leaves 68 tax expenditures valued at \$22.9 billion available for possible elimination (**table 5**). Additional details on these two groups and the tax expenditures excluded from the analysis follow.

Excluded tax expenditures

As noted, there are a small number of refundable tax credits that the government has recently reclassified as direct spending programs due to new public-sector accounting rules. The largest example is the Canada Child Tax Benefit, which is a monthly benefit payment to low-income families to help defray the cost of raising children. These tax expenditures have been reflected in past Tax Expenditures and Evaluations reports but are now treated as direct transfer programs and will be subject to regular spending reviews rather than forming part of a tax reform package. The federal government's tax point transfers to the provinces that occurred between 1967 and 1977 were intended to be a permanent mechanism to help provincial governments cover their health and education outlays and similarly cannot be considered for elimination. The total forgone revenue of these measures—including the tax point transfers—was \$31.4 billion in 2013.²³

Consumption-based tax expenditures (and other benchmark features)

As explained earlier, a considerable share of federal tax expenditures is consistent with a consumption tax base. Their general purpose is to help promote horizontal equity, support retirement savings, and prevent double taxation. Among the tax expenditures in the second category are: tax deductions related

²³. There is no 2013 estimate for the Canada Child Tax Benefit and as a result the 2012 amount was used as an approximation.

to RRSPPs and Registered Pension Plans that encourage savings and only defer taxation; the capital gains exemption for primary residences; and the partial taxation of capital gains, which seeks to limit the incidence of double taxation and improve conditions for capital investment. Other broad-based features such as the basic personal amount and the spousal deduction are available to most of those who file taxes and are in place to reflect the general living costs that individuals and families must cover. The forgone revenue from these tax provisions was \$101.1 billion in 2013.

Tax expenditures for possible elimination

The group of tax expenditures with the largest number of items consists of those that ought to be considered for elimination in exchange for broad-based reductions to marginal tax rates. These measures deviate from a consumption tax base. In some cases the policy rationales that underpin these tax expenditures are outdated. The Age Credit was introduced in 1972 to help low-income seniors cover their cost of living. The credit has since been augmented with expansions to the Guaranteed Income Supplement and other forms of assistance to Canada's elderly, and yet has subsequently been enhanced to now provide a benefit to seniors earning as much as \$75,000 per year. In other cases, these tax expenditures have limited effectiveness in delivering on their stated policy goals. The Children's Fitness Tax Credit, for instance, costs \$115 million per year in foregone revenues and has been shown to have a limited effect on public health.²⁴ In all cases, these tax expenditures are inconsistent with a consumption tax base, produce little behavioural effect, and erode the revenue base and, in turn, impose a higher-than-necessary tax burden on Canadians than would otherwise be required. The forgone revenue from these tax provisions was \$22.9 billion in 2013.

A review of this third category finds considerable overlap and redundancies. A study by Clemens (2012) for instance finds almost 20 credits or deductions dedicated to work-related expenses, including deductions for union and professional dues, a general employment credit, and a credit for those working overseas.²⁵ This is not the only instance of duplicative or stacked tax preferences for certain constituencies or activities. Those attending post-secondary institutions benefit from tax credits for tuition, textbooks, interest on student loans, and general living costs incurred during the academic year. And, if a student does not have income to report in a given year he or

24. Studies by von Tigerstrom, Larre, and Sauder (2011) and Nguyen and Grootendorst (2012) find that the tax credit has a muted behavioural impact on fitness and physical activity.

25. The 2012 Budget announced the government's plan to phase out this credit over four years (Canada, Dep't of Finance, 2012a: 426).

she can carry forward these tax benefits to subsequent years or transfer them to a spouse or parent.²⁶ There are also several tax credits and deductions for older Canadians including the Age Credit, which is available to any tax-filer who is aged 65 years old or older; the Pension Income Credit, which is available to anyone over 55 years old with eligible pension income; and pension income splitting, which allows individual tax-filers to split up to 50% of their pension income with their spouse or common-in-law partner in order to lessen their tax liability.

This layering of tax expenditures for certain population groups or activities creates tax biases against those who are ineligible for them or activities not supported by special preferences. The solution is to rationalize the system by broadening the tax base and lowering marginal tax rates in order to make it more neutral and simple. But, most importantly, such a tax reform plan can improve incentives for individuals to work, save, invest, and engage in entrepreneurship.

26. Neill (2013) finds that the benefits from these post-secondary tax measures go disproportionately to students from relatively well-off families who are not relatively sensitive to the costs of post-secondary education while students from lower-income families only benefit after they have finished their education and have enough taxable income to claim the credits.

Table 4: Tax expenditures (\$ millions), 2013—consumption based

	Simple cost estimate
Sum	101,081
Basic Personal Amount	31,220
Registered Pension Plans	19,115
Registered Retirement Savings Plans	13,080
CPP\QPP Non-taxation of employer-paid premiums	5,325
Non-taxation of capital gains on principal residences	4,005
Dividend gross-up and credit	4,825
Partial inclusion of capital gains	3,945
Quebec Abatement	4,215
CPP Employee-Paid Contribution Credit	3,315
EI Non-taxation of employer-paid premiums	2,390
Child Tax Credit	1,590
Spouse or Common-Law Partner Credit	1,535
EI Employee-Paid Contribution Credit	1,220
Deduction of carrying charges incurred to earn income	1,165
Foreign Tax Credit	930
Eligible Dependent Credit	825
Lifetime capital gains exemption for small business shares	620
Lifetime capital gains exemption for farm and fishing property	470
Tax-Free Savings Account	410
Capital loss carry-overs	320
Non-taxation of social assistance benefits	170
Non-taxation of Guaranteed Income Supplement and Allowance benefits	125
Treatment of alimony and maintenance payments	86
Farm and fishing loss carry-overs	16
Non-capital loss carry-overs	75
Deferral of income from grain sold through cash purchase tickets	15
Rollovers of investments in small businesses	4
Deferral through five-year capital gains reserve	30
Deduction of allowable business investment losses	35

Table 4 (continued): Tax expenditures (\$ millions), 2013—consumption based

	Simple cost estimate
Inclusion of the Universal Child Care Benefit in the income of an eligible dependent	5
Deduction of home relocation loans	S
Deferral of income from destruction of livestock	S
Saskatchewan Pension Plan	S
US Social Security Benefits	S
Special tax computation for certain retroactive lump-sum payments	S
Deferral through 10-year capital gain reserve	S
Deferral of capital gains through intergenerational rollovers of family farms, family fishing businesses and commercial woodlots	n.a.
Deferral of capital gains through transfers to a spouse, spousal trust or family trust	n.a.
Cash basis accounting	n.a.
Non-taxation of income of status Indians and Indian bands earned on reserve	n.a.
Non-taxation of capital dividends	n.a.
Deferral through capital gains rollover	n.a.
Deferred Profit-Sharing Plans	n.a.
\$200 capital gains exemption on foreign exchange transactions	n.a.
\$1,000 capital gains exemption on personal-use property	n.a.
Accelerated deduction of capital costs	n.a.
Exemption from making quarterly tax instalments	n.a.
Flexibility in inventory accounting	n.a.
Deferral of income from sale of livestock during drought, flood or excessive moisture years	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.
Non-taxation of strike pay	n.a.
Deferral of salary through leave of absence/sabbatical plans	n.a.
Non-taxation of investment income from life insurance policies	n.a.
Non-taxation of lottery and gambling winnings	n.a.
Non-taxation of up to \$10,000 of death benefits	n.a.
Deferral through use of billed-basis accounting by professionals	n.a.
Taxation of capital gains upon realization	n.a.

Notes: S = small (less than \$2.5 million); n.a. = data are not available to support a meaningful estimate or projection.

Source: Canada, Department of Finance, 2014b.

Table 5: Tax expenditures (\$ millions), 2013—available for elimination

	Simple cost estimate
Sum	22,886
Employment	8,150
Canada Employment Credit	2,130
Non-taxation of business-paid health and dental benefits***	2,065
Deduction of other employment expenses	1,000
Child care expense deduction	955
Deduction of union and professional dues	895
Employee stock option deduction	720
Partial deduction of meals and entertainment expenses****	190
Moving expense deduction	105
Overseas Employment Credit**	65
Investment tax credits	18
Apprentice vehicle mechanics' tool deduction	4
Deduction for tradespeople's tool expenses	3
Employee benefit plans	n.a.
Age & Retirement	6,005
Age Credit	3,830
Pension income splitting	1,090
Pension Income Credit	1,085
Medical & Disability	2,899
Medical Expense Tax Credit	1,295
Disability Tax Credit	700
Non-taxation of workers' compensation benefits	595
Family Caregiver Tax Credit	165
Caregiver Credit	110
Non-taxation of certain amounts received as damages in respect of personal injury or death*	22
Infirm Dependent Credit	6
Registered Disability Savings Plans*	6
Disability supports deduction	S

Table 5 (continued): Tax expenditures (\$ millions), 2013—available for elimination

	Simple cost estimate
Charity & Volunteering	2,465
Charitable Donations Tax Credit	2,225
Donation of publicly listed securities	157
Donation of cultural property	25
First-Time Donor's Super Credit	20
Volunteer Firefighters Tax Credit*	15
Tax-free amount for emergency services volunteers*	12
Donation of ecologically sensitive land	11
Education	2,037
Carry-forward of Education, Textbook and Tuition Tax Credit	670
Transfer of Education, Textbook and Tuition Tax Credit	570
Tuition Tax Credit	320
Education Tax Credit	205
Registered Education Savings Plan*	145
Student Loan Interest Credit	45
Exemption of scholarship, fellowship and bursary income*	44
Textbook Tax Credit	33
Adult basic education - deduction for tuition assistance	5
Small Business, Fishing, Farming & Logging	15
AgriInvest (farm savings account)*	10
Agri-Quebec (farm savings account)*	5
Logging Tax Credit	5
Tax treatment of Net Income Stabilization Account	n.a.
Miscellaneous	730
Northern residents deduction	175
Public Transit Tax Credit	170
First-time Home Buyers' Tax Credit*	115
Children's Fitness Tax Credit	115
Deduction for clergy residence	90

Table 5 (continued): Tax expenditures (\$ millions), 2013—available for elimination

	Simple cost estimate
Children's Arts Tax Credit*	38
Political contribution tax credit	24
Adoption Expense Tax Credit*	3
Home Renovation Tax Credit	0
Deduction of certain contributions by individuals who have taken vows of perpetual poverty	S
Assistance for artists	S
Deduction for artists and musicians	S
Targeted Investment	388
Flow-through share deductions	205
Labour-Sponsored Venture Capital Corporations Credit**	150
Mineral Exploration Tax Credit for flow-through share investors	40
Reclassifications of expenses under flow-through shares	-7
Non-taxation of provincial assistance for venture investments in small businesses	n.a.
No Savings - Would Increase Federal Spending	197
Non-taxation of veterans' disability pensions and support for dependents**	100
Non-taxation of allowances for diplomats and other government employees posted abroad**	45
Non-taxation of veterans' Disability Awards**	32
Deduction for income earned by military and police deployed to high-risk international missions**	20
Non-taxation of RCMP pensions/compensation in respect of injury, disability or death**	n.a.
Non-taxation of veteran's allowances, income support benefits, civilian war pensions and allowances, and other service pensions**	S

Notes: S = small (less than \$2.5 million); n.a. = data are not available to support a meaningful estimate or projection. * Not in SPSPD/M. ** Excluded from analysis because either the tax expenditure is being phased out or its elimination would likely result in an equal increase in federal spending. *** Not in SPSPD/M; distributed by wages and salaries. **** Not in SPSPD/M; distributed by self-employment income.

Source: Canada, Department of Finance, 2014b.

Three Options for Personal Income Tax Reductions

Eliminating tax expenditures and broadening the tax base is a means to lowering tax rates. The elimination of tax expenditures will help to offset the cost of changing the rate structure. This section sets out three options for reform in which lower marginal tax rates are largely offset by the elimination of tax expenditures with the result that the net effect upon revenue is neutral.

Cost estimates for lowering tax rates typically use static assumptions and therefore do not account for any behavioural changes stemming from the tax reduction. The revenue loss is projected based on a simple calculation of the size of the tax reduction. If tax rates are reduced by 50%, tax revenues drop by one half. In effect, static scoring assumes that tax reductions do not affect individual behaviour or the overall economy.

Most economists agree that tax reductions can have dynamic effects. That is, that tax cuts with supply-side implications can lead to greater economic activity over time producing greater revenue to offset some portion of the initial revenue loss. But estimating the size of the macroeconomic feedback effects of tax reductions to government revenue is complicated and can be a point of contention. Macroeconomic models of the supply-side effects remain works in progress.

The US economist Greg Mankiw has studied the issue of dynamic scoring.²⁷ In a 2003 speech to the National Association of Business Economists he summarized his key findings:

Although it is hard to estimate the impact of a tax cut on output, we know that it is not likely to be zero. The standard “static scoring” uses a precise but wrong answer—zero—to derive the “sticker price” of a tax cut ... As a result, the true price of a tax cut differs predictably from the sticker price, as higher growth will lead to more revenue.

27. See, for instance, the article by Mankiw and Weinzierl (2006) in which they find that as much as half of a capital tax cut can be self-financing and the feedback for a labour tax cut can be approximately 17%.

I do not believe the revenue feedback is enough to fully pay for a tax cut in most cases, but it is likely to make a meaningful offset. (Mankiw, 2003)

Few would claim that the feedback can be sufficient to completely offset the initial revenue loss but most would concur with Mankiw's insight that the revenue loss estimated using a static model overstates the long-run cost of a supply-side tax reduction.

In light of the challenges in isolating the dynamic effects of tax reductions, however, our analysis must use static assumptions. We note this to show that our estimates are prudent and overstate the ultimate cost of our proposal. It is also important because, while there is a policy rationale for eliminating the identified tax expenditures, we recognize that governments may not be prepared to incorporate all of them in a final tax reform package. Retaining some of these tax expenditures could be offset—partially or entirely—by the dynamic supply-side effects of a meaningful reduction in marginal tax rates.

The cost estimates are produced using Statistics Canada's tax and transfer model (Social Policy Simulation Database and Model). The \$22.9 billion simple sum of tax expenditures shown as available for elimination in table 5 is revised down to \$20.2 billion for the purposes of this analysis. An appendix (p. 39) provides more details on the main differences, including the data sources.

The \$20.2 billion in tax expenditures identified in our analysis provides considerable fiscal room to make meaningful changes to the federal government's rate structure for personal income tax. The government is also projecting a \$6.4 billion surplus in 2015/16. A portion of this surplus could be dedicated to offsetting the cost of reductions in the marginal tax rate. The outcome would be a federal personal income tax system that is more competitive and increases incentives for individuals to work, invest, save, and engage in entrepreneurial activities.

Option 1: Eliminate two middle rates

A simple option would be a two-rate system that eliminates inefficient, non-consumption-based, tax expenditures and uses the resulting revenues to flatten the marginal rate structure.²⁸ Discarding the two middle income tax

²⁸ The most ambitious reform to the marginal tax rate structure would be the introduction of a flat tax, a proposal that would shift the system fully towards a consumption base. This is because a flat tax envisions the elimination of virtually all tax expenditures, moving to a single rate of taxation, and ceasing the double taxation of saving and investment by excluding dividends, capital gains, and interest because they are already subject to taxation under the corporate income tax. In effect, the flat tax would fully replace the current

rates of 22% and 26% would reduce the number of brackets and thus the system's complexity, improve economic incentives, and diminish the need for income splitting.

This would create a new tax landscape with just two personal income tax rates—15% for almost all Canadians and 29% for top earners (roughly 2% of tax-filers). Maintaining the top rate of 29% at its current income threshold means that this tax reform package, fully implemented, would cost \$21.4 billion (in static terms). This is approximately \$1.2 billion more than the estimated value of the tax expenditures identified in our analysis. The result is that the government would need to use a combination of tax reform and a small portion of future budgetary surpluses to offset the cost of this tax reduction.

Option 1—proposed federal tax rates

Income Thresholds	Tax Rates
\$11,139–\$136,270	15%
—	—
—	—
\$136,271+	29%

Option 2: Eliminate two middle rates and raise top income threshold

However, maintaining the 29% rate at the current income threshold would not address Canada's lack of tax competitiveness at high income levels. The government could therefore raise the income threshold at which the 29% rate applies from \$136,271 to \$250,000 to bring the federal income tax system more in line with international comparators as set out by Murphy, Clemens, and Veldhuis (2013). We estimate that these tax changes would cost \$26.4 billion or roughly \$6.2 billion more than the tax expenditures identified in our analysis. This would require the government to use a combination of tax reform and future budgetary surpluses if it wanted to make them part of a revenue-neutral package.

system with an individual wage tax whereby personal income taxes would apply to wages, salaries, and pension benefits. Such a policy reform would also represent a full transition to a consumption-based income tax system and fully eliminate the case for income splitting since its only purpose is to mitigate the unequal effect of progressive tax rates on families with one rather than two income earners. Past research published by the Fraser Institute has calculated that a revenue-neutral flat tax could be implemented at a rate of 15% assuming the elimination of most tax expenditures, the maintenance of the current basic personal amount and spousal exemption, and the creation of an integrated system whereby personal and business taxes would be subject to the same rate (see Rabushka and Veldhuis, 2008).

Option 2—proposed federal tax rates

Income Thresholds	Tax Rates
\$11,139–\$249,999	15%
—	—
—	—
\$250,000 +	29%

Option 3: Eliminate two middle rates, raise top income threshold, and lower top rate

A final alternative could be to lower the top rate from 29% to 25% and have it apply at \$250,000 as set out in the second option. This would improve Canada's tax competitiveness and have the most significant supply-side effects of the various options in improving economic incentives. The estimated cost of this alternative would be \$28.6 billion. This means that this more ambitious tax reduction would require the government to eliminate all of the \$20.2 billion in tax expenditures identified in our analysis, use up all of its short-term budgetary surpluses, and find additional \$2.0 billion if it wanted to implement the tax reform in a deficit-neutral way.

Option 3—proposed federal tax rates

Income Thresholds	Tax Rates
\$11,139–\$249,999	15%
—	—
—	—
\$250,000 +	25%

Impact on income distribution

The net income distribution of these options would ultimately depend on what, if any, other steps the government took in concert with this type of tax reform policy. [Annex tables 1 to 3](#) (pp. 36–38) show the income distribution results assuming that the government eliminated all of the tax expenditures as proposed and made no other policy changes. The distribution leaves those households earning over \$60,000 with a lower tax liability.

This would likely raise equity concerns on the part of some commentators and politicians. But such concerns and the assumptions that underpin them are incomplete and overstated. First, it assumes that the current progressivity in the system is optimal. Yet recent research has shown that these

households currently pay a disproportionate share of income taxes and there is no question there are efficiency costs that result from the status quo.²⁹ Second, the distribution of tax relief over the past nearly ten years has been highly progressive with the greatest benefit directed at low-middle income earners.³⁰ Third, as described, this analysis is static and does not account for income mobility and the lifetime tax implications for taxpayers. Research by Hubbard (2005) found considerable income and tax mobility among US households between 1987 and 1996—with two thirds of taxpayers in the lowest bracket moving to the highest rate after ten years. This is consistent with Canadian research by Lammam, Karabegović, and Veldhuis (2012), which found that, over a ten-year period between 1990 and 2000, 83% of Canadians who started in the bottom 20% moved to a higher income group. Fourth, it is also important to note that redistribution concerns are better addressed through direct expenditures because redistributive spending is more cost effective than highly progressive taxes.³¹ Still if the government wanted to adjust the distributional impact, it could consider augmenting remaining tax expenditures for low-income households.

Impact on cost of compliance

Of course, the cost estimates set out above do not account for the benefits in terms of reduced complexity. As discussed, it has been estimated that Canadian tax-filers spent between \$5.84 billion and \$6.96 billion in 2012 complying with the personal income tax system. It is difficult to estimate the extent to which these options reduce the time and resources that Canadians expend on complying with the system but we can reach some illustrative conclusions using recent findings by Speer, Palacios, Lugo, and Vaillancourt (2014). The study estimates that the incremental compliance cost associated with an individual's use of at least one of a sample of ten federal tax expenditures is \$49.8 (2007 dollars) or 20.3% higher, on average, than using none of them. This finding shows that the net value of these tax expenditures can be lower than their statutory rate after backing out the associated compliance costs and gives some indication of the added compliance costs associated with the use of tax expenditures. This is important because the tax reform

29. For more on the distribution of federal taxes by income quintiles, see Clemens, Veldhuis, and Murphy, 2013.

30. The Office of the Parliamentary Budget Officer (2014) estimated the distribution of major tax changes between 2005 and 2013 and found the cumulative impact on those households earning between \$12,200 and \$23,000 resulted in a 4.0% increase in after-tax income. The after-tax benefit for the highest 10% of income earners was 1.4%.

31. For more on the relative utility of redistributive spending compared to tax progressivity, see Dahlby, 2003.

proposals set out in this paper represent a meaningful reduction in the complexity of the system that should be considered in assessing their benefits—especially since the cost of compliance represents a disproportionate burden on low-income Canadians as a share of their overall income.

Politics of tax expenditures

We understand that tax reform is an inherently political exercise. Certain voices may wish to retain some of the tax expenditures that we have put forward for elimination. Others may wish to eliminate all of the tax expenditures but make different changes to the rate structure. On balance, however, we believe that these options are the best way to build a personal income tax system at the federal level that can contribute to long-term economic growth. It will be especially important if it can serve to galvanize a broader consensus in favour of tax reform among the provinces—similar to Canada’s experience with corporate taxation—leaving the country with a personal income tax regime that makes us more competitive.

Conclusion

The federal government has not made structural changes to its personal income tax system for decades. The tax system is now replete with various credits, deductions, and other preferences that make it less efficient and more complicated. These tax expenditures narrow the tax base with the result that higher tax rates are required to raise the same amount of revenue. Marginal tax rates are uncompetitive, especially relative to those in the United States. The case for tax reform and a broad-based reduction in marginal tax rates is rooted in considerable theoretical and empirical evidence.

The federal government seems poised to eliminate its deficit in 2015/16. It has committed to a handful of tax-related promises that are conditional on eliminating the deficit. The most significant promise is to bring in income splitting for families with children. It has also committed itself to providing new or augmented tax credits for fitness and other activities. The problem with these tax proposals is that neither is broad based and additional tax credits will add complexity to the system with minimal contributions to higher economic growth.

Instead, the federal government could take advantage of this opportunity to be a national leader towards dynamic tax reform that could contribute to higher economic growth and improved living standards for Canadians. The three tax reform options presented in this paper represent a better way forward. Broad-based tax reform that maintains consumption-based tax expenditures, eliminates all other tax expenditures, and uses the fiscal room to lower marginal tax rates would be a major improvement to the federal personal income tax system. It would encourage productive economic activity like increased work effort, saving, investment, and entrepreneurship. It would also reduce the complexity of the tax system so families can spend less time and money filling out their taxes.

The dynamic economic effects of tax reform are critical at this juncture. Canada's economy is experiencing modest growth and is expected to operate below historical growth rates for the foreseeable future. A tax reform plan that minimizes disincentives to work, save, invest, and undertake entrepreneurial activities can help to bolster economic growth. Empirical research has found

a positive correlation between reductions in marginal tax rates and increases in real GDP per capita. This dynamic effect of tax reductions could provide a significant boost to Canada's economy.

This study reviewed Canada's personal income tax system with the goal of rationalizing tax expenditures that deviate from a consumption tax base function and using the resulting resources to offset the cost of flattening and lowering marginal tax rates. This research comprises two linked, yet distinct exercises: first, it involved a detailed review of the tax expenditures in the personal income tax system in order to determine which can be eliminated based on whether they shift the tax base towards consumption; and second, it carried out analysis of how to change the rate structure using the additional revenues resulting from a broader tax base.

The analysis finds 125 tax expenditures in the personal income tax system totaling as much as \$124.0 billion in forgone revenue in 2013. But not all of these tax expenditures can or should be eliminated. Some tax expenditures are consumption-based, promote horizontal equity, support retirement savings, or protect against double taxation. These items can be considered basic features of the tax benchmark and should not be part of a tax reform package.

This leaves a slate of tax expenditures totaling \$20 billion (based on our modeled estimates) that ought to be considered for elimination as part of a tax reform package. These measures deviate from a consumption tax base, complicate the system, produce few behavioural effects, and narrow the tax base, resulting in higher marginal rates.

The second part of tax reform is the use of the additional revenue to offset the cost of changes to the rate structure. Canada's personal income tax rates are decidedly uncompetitive relative to those of the United States, after accounting for the federal and provincial rates and the income thresholds at which they apply. The elimination of \$20 billion in tax expenditures (or some number of the tax expenditures in this category) provides considerable fiscal room to make meaningful changes to the federal rate structure.

The revenue from the tax expenditures identified in our analysis would essentially offset the elimination of the two middle income tax rates of 22% and 26%. This would be a positive step towards a flat-tax personal income tax system. It is important to note that a flat tax or a flatter personal income tax system would diminish the need for income splitting since its only purpose is to mitigate the unequal effect of progressive rates on families with one rather than two income earners.

More ambitious options could include increasing the income threshold at which the second rate applies from \$136,271 to \$250,000 and lowering the top rate from 29% to 25%. These changes are important because Canada's top marginal rates (after accounting for provincial tax rates) and the income thresholds at which they apply are uncompetitive and represent a disincentive

to work, save, and invest. Making these changes would require the government to use future surpluses to offset the loss of revenue that would be the result of this tax reform.

The federal government has said that it intends to provide tax relief to families once it has eliminated its budgetary deficit. The tax reform options set out in this paper represent an alternative way forward. Any of them would be a major step towards improving Canada's tax competitiveness and creating a policy framework that is pro-work, pro-savings, pro-investment, pro-entrepreneurship, and, ultimately, pro-economic growth. The federal government has an opportunity to be a leader on tax reform that would have a dynamic effect and could contribute to higher economic growth in Canada.

Annex Table 1: Distributional impact of tax reduction Option #1 (by census family)

Taxable Income Group	Current Federal Personal Income Tax	Revised Federal Personal Income Tax	Change in Federal Personal Income Tax	Change as percentage of taxable income
Minimum– –10,000	0	0	0	n/a
–9,999–0	483	478	–5	n/a
1–10,000	543	544	1	–0.2
10,001–20,000	689	1,125	436	1.8
20,001–30,000	1,703	2,625	922	2.4
30,001–40,000	3,234	4,251	1,017	1.9
40,001–50,000	5,166	6,028	862	1.2
50,001–60,000	7,345	7,767	422	0.3
60,001–70,000	9,818	9,470	–348	–0.6
70,001–8,0000	12,200	11,230	–970	–1.2
80,001–90,000	14,495	12,894	–1,601	–1.7
90,001–100,000	17,439	14,792	–2,647	–2.4
100,001–110,000	19,265	15,789	–3,476	–2.9
110,001–120,000	22,140	17,578	–4,562	–3.4
120,001–130,000	25,333	19,519	–5,814	–3.9
130,001–140,000	27,170	20,638	–6,532	–4.1
140,001–150,000	31,393	24,578	–6,815	–3.9
150,001–200,000	36,700	30,824	–5,876	–3.0
200,001–250,000	49,531	44,633	–4,898	–2.1
250,001–Maximum	140,666	140,216	–450	–0.3
All	7,286	7,194	–92	–0.3

Source: Canada, Department of Finance, 2014a; Statistics Canada, Social Policy Simulation Database and Model (Version 21.0); calculations by the authors.

Annex Table 2: Distributional impact of tax reduction Option #2 (by census family)

Taxable Income Group	Current Federal Personal Income Tax	Revised Federal Personal Income Tax	Change in Federal Personal Income Tax	Change as a percent of taxable income
Minimum– –10,000	0	0	0	n/a
–9,999–0	483	470	–13	n/a
1–10,000	543	535	–8	–0.2
10,001–20,000	689	1,112	423	1.7
20,001–30,000	1,703	2,613	910	2.4
30,001–40,000	3,234	4,240	1,006	1.9
40,001–50,000	5,166	6,000	834	1.1
50,001–60,000	7,345	7,718	373	0.3
60,001–70,000	9,818	9,416	–402	–0.7
70,001–8,0000	12,200	11,181	–1,019	–1.3
80,001–90,000	14,495	12,834	–1,661	–1.7
90,001–100,000	17,439	14,738	–2,701	–2.4
100,001–110,000	19,265	15,696	–3,569	–2.9
110,001–120,000	22,140	17,465	–4,675	–3.4
120,001–130,000	25,333	19,360	–5,973	–4.0
130,001–140,000	27,170	20,355	–6,815	–4.3
140,001–150,000	31,393	23,096	–8,297	–4.7
150,001–200,000	36,700	26,223	–10,477	–5.2
200,001–250,000	49,531	33,789	–15,742	–6.1
250,001–Maximum	140,666	124,803	–15,863	–2.6
All	7,286	6,908	–378	–0.8

Source: Canada, Department of Finance, 2014a; Statistics Canada, Social Policy Simulation Database and Model (Version 21.0); calculations by the authors.

Annex Table 3: Distributional impact of tax reduction Option #3 (by census family)

Taxable Income Group	Current Federal Personal Income Tax	Revised Federal Personal Income Tax	Change in Federal Personal Income Tax	Change as a percent of taxable income
Minimum– –10,000	0	0	0	n/a
–9,999–0	483	466	–17	n/a
1–10,000	543	533	–10	–0.3
10,001–20,000	689	1,110	421	1.7
20,001–30,000	1,703	2,611	908	2.4
30,001–40,000	3,234	4,237	1,003	1.9
40,001–50,000	5,166	5,992	826	1.1
50,001–60,000	7,345	7,702	357	0.3
60,001–70,000	9,818	9,398	–420	–0.7
70,001–8,0000	12,200	11,166	–1,034	–1.3
80,001–90,000	14,495	12,816	–1,679	–1.7
90,001–100,000	17,439	14,724	–2,715	–2.4
100,001–110,000	19,265	15,679	–3,586	–2.9
110,001–120,000	22,140	17,436	–4,704	–3.4
120,001–130,000	25,333	19,305	–6,028	–4.0
130,001–140,000	27,170	20,288	–6,882	–4.4
140,001–150,000	31,393	23,062	–8,331	–4.7
150,001–200,000	36,700	26,105	–10,595	–5.2
200,001–250,000	49,531	33,613	–15,918	–6.2
250,001–Maximum	140,666	111,684	–28,982	–4.7
All	7,286	6,779	–507	–1.0

Source: Canada, Department of Finance, 2014a; Statistics Canada, Social Policy Simulation Database and Model (Version 21.0); calculations by the authors.

Appendix: Methodology

The estimates used in this paper were produced using Version 21.0 of Statistics Canada's tax and transfer model (Social Policy Simulation Database and Model or SPSPD\M). We chose a modeled approach because the estimates provided by the federal Department of Finance in its *Tax Expenditures and Evaluations* report are determined separately, assuming that all other provisions remain unchanged. Since many of the tax provisions interact with each other, the change in federal revenue cannot generally be calculated by simply adding up the individual estimates.

For example, the simple sum of federal Finance estimates of the tuition, education, student loan interest, and textbook tax credits and relevant carry-forwards yields \$1.273 billion while the combined approach using the SPSPD\M yields \$1.173 billion. If we then add in the ability to transfer credits our combined estimate does not change (because there is nothing to transfer) but the simple sum of the federal Finance estimates increases by 46% to \$1.810 billion.

That said, we can use the simple sums of tax expenditures to provide a sense of how comprehensive our modeling approach is. Table 3 shows the simple sum of the department's tax expenditure estimates at \$155.408 billion. From this we remove \$31.441 billion for the tax point transfer to provinces and items recently reclassified as spending. We identify and remove \$101.081 billion as basic features (details in table 4) of the tax system leaving 68 provisions valued at \$22.886 billion as available for elimination (details in table 5).

We ignore \$0.412 billion because these measures have either been recently eliminated (\$215 million) or would require an equivalent increase in federal spending if removed (\$197 million), which drops the \$22.886 billion sum to \$22.474 billion. We eliminated 13 provisions with a simple sum of \$5.091 billion using the SPSPD/M glass-box facility and 25 provisions with a simple sum of \$14.713 billion using the SPSPD/M black-box facility. The simple sum of these modeled eliminations is \$19.804 billion or 88.1% of the \$22.474 billion total. We eliminated two provisions with a simple sum of \$2.255 (10.0%) by distributing their value among families and adding these values to the revised federal tax bill. The remaining 11 provisions valued at \$0.415 billion (1.8%) cannot be eliminated in the SPSPD/M nor do they have a clear distribution target to allow a modeled estimate. Their value is added to the modeled sums discussed above however.

Disclaimer

This analysis is based on Statistics Canada's Social Policy Simulation Database and Model. The assumptions and calculations underlying the simulation results were prepared by the authors and the responsibility for the use and interpretation of these data is entirely that of the authors.

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Niels Veldhuis is Fraser Institute President and one of Canada's most-read private-sector economists. As an economist, Niels has written six books and more than 50 comprehensive studies on a wide range of economic topics including taxation, banking, productivity, investment, entrepreneurship, labour markets and government finances. His latest book, *The Canadian Century: Moving out of America's Shadow*, is a national bestseller published by Key Porter in May 2010. Niels is in high demand for his opinions and perspectives on major economic and social issues, appearing regularly on radio and television programs across Canada and the United States. He has written more than 200 commentaries that have appeared in over 50 newspapers including the *Globe and Mail*, *Wall Street Journal*, and the *Economist*. He also writes a bi-weekly column for the *Financial Post*. Niels is regularly asked to appear before committees of both the House of Commons and the Senate as an expert witness. He travels widely across North America, speaking to business groups, corporate gatherings, voluntary organizations and students. Niels holds a Bachelor degree in Business Administration and a Master Degree in Economics from Simon Fraser University. In 2010, he was named one of Vancouver's Top 40 under 40 by Business in Vancouver and in 2011 led a discussion between former presidents Bill Clinton and George W. Bush at the Surrey Economic Forum.

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