Fair Tax Revenue Solutions

As Alternatives to Austerity

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Canadians for Tax Fairness, Canada

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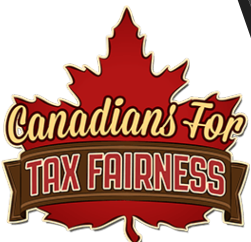

ABOUT US

Austerity and its Alternatives is an international knowledge mobilization project committed to expanding discussions on alternatives to fiscal consolidation and complimentary policies among policy communities and the public. To learn more about our project, please visit www.altausterity.mcmaster.ca.

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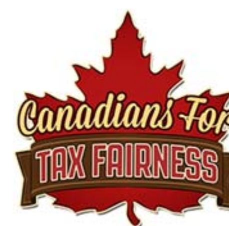

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1. Tax Cut Generated Deficits Used as Justification for Austerity[1]

The biggest obstacle former Prime Minister Harper faced to realizing his dream of small government was Canadians' strong public support for social programs – especially medicare, which many Canadians view as a defining feature of their nation. Harper was a smart enough politician to know that a direct attack on our social program s would not get him far, especially given that the federal government had been running budget surpluses for a decade by the time the Conservatives came to power. With Ottawa enjoying a budget sur plus of$13.2 billion in 2005–6, when Harper became prime minister, Canadians could see that our social programs were affordable. Indeed, it was apparent that there was fiscal room for new programs, such as child care and a national housing strategy. There was certainly no fiscal justification for cutting back social programs.

So Harper first had to create the political and economic context that would allow his government to move forward on its agenda to dismantle social programs. Tax cuts are much easier to sell the public than the shredding of social programs. In its first budget, in 2006, the Conservatives began implementing an ambitious tax cut plan, starting with a1 per cent reduction in the GST. In 2008, they followed this with another 1per cent reduction to the GST. These two cuts resulted in an annual reduction in government revenues of $12 billion.

At the same time, the Harper government announced a plan to reduce the federal corporate tax rate from 22 to 15 per cent by 2012, which would make Canada's corporate rate the lowest of any G7country. These tax cuts would cost the government about $7.5 billion in lost revenue each year. The Conservative government then added a number of "boutique" tax cuts to the mix. Most of these primarily benefited upper income Canadians and had little or no economic or social utility.

In 2009, as if all these tax cuts were not enough, the Conservatives introduced the Tax Free Savings Account, which allow s individuals to save up to$5,000 a year without paying any tax on the interest earned. This cost the federal government $155 million in revenues initially but this will grow exponentially in the future.

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1 The opinions in this paper are those of the author alone and do not represent the opinion of McMaster University and/or anyone else that is associated with the project.

Thus, within a few years, mostly through tax cuts, the Conservatives had given away the budget surpluses they inherited from the Liberals. As a consequence, by 2009 they were running a deficit of more than $40 billion. Between 2009 and 2010, federal tax cuts cost $34 billion in lost government revenues – 63 per cent of the deficit. The recession of 2008–9 reduced revenues and the stimulus program increased spending, yet the federal budget would have gone into deficit in any case as a result of tax cuts, even if the global economic crisis had not hit Canada in 2008.

With a deficit largely created by tax cuts and after winning a majority in the 2011 election, the Harper government was finally impose its austerity policies which included deep cuts to public service jobs and government services as well as major changes to Employment Insurance and pensions. It also eliminated a number of government agencies altogether.

The tax-cutting policies at the federal level were duplicated by many provincial governments. Overall, federal and provincial taxes as a share of GDP fell between 1998 and 2013 from 45 to 31 per cent. Federal and provincial tax cuts have greatly reduced the fiscal capacity of the state and have set the stage for an assault on Canada's social programs.

2. Debt and Deficits – The Wrong Diagnosis; Austerity – The Wrong Medicine

Austerity is a bitter pill to swallow, especially for those who lose their jobs or who depend on social programs. But it is even the more galling for those who understand that it is the wrong medicine for our ailing economy. To cure our economic ills, we need a good diagnosis and the right medicine. The problem with the Canadian economy is not high deficits and debt loads, but weak consumer demand and low productivity resulting from a widening gap in income distribution and from too many people who aren't able to contribute to the economy to their full potential because of poverty and unemployment and lack of public services like quality child care.

Increasing government spending on social and economic infrastructure and addressing the challenge of climate change is the medicine we need to fix our ailing economy. Although the Liberal government won the last election, in large part because the public bought into their promise to run deficits in order to invest more in social and economic infrastructure, they have so far not done much to change the overall level of government spending as a share of the economy. And their level of investment so far has been completely inadequate in terms of addressing social problems such as aboriginal poverty or stimulating the economy to create jobs.

While deficits could be increased some more without creating problems, the level of government investment needed to fix our pressing social and environmental challenges and stimulate the economy cannot be financed by running ever larger deficits. Revenue side solutions are needed to generate the scale of funds needed to address these issues.

3. Revenue Side Solutions

Canadians for Tax Fairness had collaborated for many years with other social movement groups in the Alternative Federal Budget and has helped to draft the tax chapter which has identified a number of fair tax revenue options that would raise significant amount of additional revenue without increasing taxes for 80% of Canadians. The most recent draft of the 2017 AFB has identified **over $40 billion** in additional revenue that could be available to invest in sustainable development.

Some of the key recommended measures include:

3.1 Close Regressive and Ineffective Tax Loopholes and Simplify the Tax System

Canada's tax system has become riddled with ineffective and expensive tax loopholes which disproportionately benefit the wealthy. Recent analysis by the CCPA demonstrates that over 90 percent of federal personal tax expenditures provide greater benefits to higher income earners.

The Alternative Federal Budget 2017 has identified at least **$16 billion** in savings that could be realized from closing unfair and ineffective tax loopholes. Closing these loopholes will also benefit provincial finances because in most cases they also broaden their tax bases as well.

a) Eliminating the **stock option deduction** that allows corporate executives to pay tax on only half of their stock option compensation. Over 90% of the benefit going to the top 1% of tax filers who make more than $250,000 annually **(Savings of $840 million).**

b) Tax income from **capital gains** and investments at the same rate as employment income. Investment income is taxed at only half the rate of employment income and 90% of the benefit of this loophole on the personal income tax side goes to the top 10% and 87% goes to the top 1%. **(Savings of $10 billion).**

c) **Set lifetime limit for Tax Free Savings Accounts. -** A lifetime cap of $50,000 on TFSAs would avoid a revenue sinkhole in the future and to ensure benefits aren't further concentrated among high incomes. Annual savings would be modest at **$100 million** initially, but would increase to billions of dollars in future years.

d) **Reduce RRSP contribution limits and cancel pension income splitting**: High RRSP contribution limits provide government support to high income people who don't need help with their retirement savings while leaving less revenue available to support lower income seniors who need help the most. Reducing annual RRSP contribution limits to $20,000 and cancelling pension income splitting would save an estimated **$2.2 billion** annually.

e) **Review and replace ineffective boutique tax credits**: These make filling out annual tax forms much more complex, and have generally not been effective in their intended objective and are more likely to be used by higher income families. Annual savings of about **$200 million** could be realized by doing this.

f) **Cancel the corporate meals and entertainment expense deduction**: Businesses are allowed to deduct half their meal and entertainment expenses, including the cost of season's tickets and private boxes at sports events. This is widely abused, according to the U.S. study of a similar measure there. Annual savings of **$400 million** can be expected.

g) **Limit deductions for executive compensation.** Canadian corporations can deduct from their expenses all the compensation they pay to CEOs and other executives. Average CEO compensation has increased to $9 million annually, 184 times what the average worker makes. Limiting the deduction to $1 million each for the CEO and other executives as is done in the US could realize annual savings of **$150 million.**

h) **End fossil fuel subsidies:** While some fossil fuel subsidies are being phased out, new ones have been introduced and extended. Federal tax subsidies to the fossil fuel industries have averaged **$1.6 billion annually** in recent years according to the International Institute for Sustainable Development.

3.2 End Corporate Tax Dodging and Make Corporations Pay Their Fair Share

Corporations rely heavily on public services including transportation infrastructure, utilities, education, training, health care, social services, law enforcement and the justice system to operate. High quality public services are more important contributors to corporate productivity and competitiveness than low corporate taxes or labour costs. There's a lot more economic activity in countries with quality public services and higher corporate taxes than in countries with low corporate taxes and low quality public services.

Canada has some of the lowest corporate tax rates among peer competitor countries and we've contributed to driving these rates down around the world.

Federal corporate tax rates were slashed almost in half from 29.1% in 2000 to 15% in 2008, and yet business investment as a share of the economy declined instead of increasing as it was supposed to. Over that time corporations created few new jobs and made ever higher record profits, amassing over $700 billion in surpluses and excess cash.

While corporate profits have escalated to record shares of national income, there's been little increase in the share they've contributed through corporate income taxes. And with weak corporate tax rules and enforcement to prevent it, large corporations have also increasingly used offshore subsidiaries to shift profits to tax havens and pay less tax.

a) Increase the corporate federal tax rate from 15% to 21%

The AFB would increase the federal general tax rate from 15% to 21%. We would also increase the small business rate to 15% to preserve proportionality between small and general corporate tax rates, consistency with the lower rate on personal income, and reduce the abuse of the CCPC regime by individual professionals.

This measure would leave the general federal corporate tax rate still lower than it was in 2006 when the Liberals were last in federal office and considerably lower than the 34-35% statutory federal corporate rate in the United States. Annual additional Revenues of **$11 billion** could be expected.

b) **Crack down on international tax avoidance and evasion through tax havens**

Despite Canada having one of the lowest corporate tax rates in the G7, many multinational corporations use tax havens to almost entirely avoid paying corporate income taxes. Canadian and other governments have been complicit in this, with weak international rules and enforcement that have allowed larger multinational corporations to shift their profits offshore. This also puts smaller and medium sized domestic businesses that don't engage in these activities at a competitive disadvantage.

A recent study found that 56 of the TSX 60 largest publicly traded companies in Canada had a total of 973 subsidiaries in recognized tax havens.

There's been some limited progress from the OECD and G20 BEPS action plan but much more needs to be done to reduce international corporate tax avoidance and evasion. There are several measures the Canadian government could take to reform corporate tax rules and stem the revenue losses due to corporate profit shifting to tax havens:

- **Economic substance.** One way to restrict corporate tax haven abuse would be to require corporations to prove that their offshore transactions have substantial economic purpose aside from reducing taxes owed. Bill C-621, introduced in the last parliament by Murray Rankin, provides a good legislative example of how this could be done. We estimate this measure would raise **$400 million a year**.

- **Capping interest payments to offshore subsidiaries.** Canada used to restrict how much corporations could deduct interest payments to offshore subsidiaries for tax purposes but this was removed by the previous government. It is time to re-instate this measure in order to curb offshore abuse, as the OECD recently recommended through the Base Erosion and Profit Shifting (BEPS) Action Plan. We recommend limiting the deductibility of interest to the entity's share of the group's consolidated net interest expense, apportioned by earnings (EBITDA), combined with a fixed cap 10%. We estimate this measure could raise at least **$200 million** annually.

Applying a 1% withholding tax on Canadian assets held in tax havens - Canadian corporations reported direct foreign investment in our top ten tax havens increased to $270 billion in 2015, amounting to over a quarter of all Canadian direct foreign investment abroad. Applying a 1% withholding tax on Canadian assets held in tax havens would generate over **$2 billion** a year.

3.3 Tax E-Commerce Companies to Level the Playing Field

E-commerce based companies such as Netflix, Amazon Prime, and Google (YouTube), Amazon, Uber, and Airbnb, are capturing a huge and growing share of the Canadian market but pay little or no taxes in Canada. They have been exempted from paying taxes by the Canada Revenue Agency because they have no physical presence in Canada and therefore are deemed not to be "carrying on business" in Canada. This policy is outdated and needs to be updated to reflect changing business realities.

Other businesses, especially small and medium sized businesses--and those who work for them--are suffering enormously because of unfair competition from foreign companies that pay little or no taxes on the profits earned in the same Canadian markets.

The foreign-owned e-commerce sector now has revenues of more than $30 billion a year. Google and Facebook together capture 64% of all internet advertising dollars spent in Canada – over $2.4 billion but pay little or no taxes here. Meanwhile domestic broadcasters and media producers including newspapers have seen their advertising revenues plummet, leading to mass layoffs and an erosion of avenues for broad public discourse. Companies like Netflix and other "Over-the-Top" media services are also not required to produce, broadcast or contribute to Canadian content, contribute to the Canadian Media Fund, or levy taxes on their services.

The European Union, New Zealand, Australia, Norway, South Korea, Japan, Switzerland, and South Africa, have modernized tax laws to respond to changing e-commerce reality. The OECD in its BEPS Action Plan on Addressing the Tax Challenges of the Digital Economy has recommended ways that governments can collect value added taxes where the product is purchased to help level the playing field between foreign and domestic suppliers.

We recommend that the Canadian government level the playing field by:

a) Making all e-commerce companies with Canadian income above a certain threshold pay corporate income tax on profits from products or services sold or rented in Canada whether or not they have a physical presence in Canada. It is difficult to estimate how much revenue this would raise as large foreign companies like Google and Netflix do not separate out their Canadian earnings but could be as high as **$600 million** a year.

Ending the GST/HST tax exemption for electronic commerce services that sell to Canadians and requiring them to collect and remit GST/HST and PST amounts to federal and provincial governments on their sales in Canada. We estimate this would raise **$400 million** a year.

3.4 Introduce a Stronger and More Progressive Carbon Tax

Prime Minister Trudeau announced the federal government's intention to ensure a minimum national price for carbon starting at $10/tonne in 2018 and increasing by $10 a year to $50/tonne in 2022. This is similar to the national harmonized carbon tax we've proposed for many years, but it is too modest and doesn't involve progressive use of the revenues with investments in complementary

environmental measures or to support vulnerable people, industries and communities affected by these changes.

The AFB would ensure a national harmonized $30/tonne carbon tax would be in place starting on July 1st 2017, increasing by $10/tonne a year until it reached $50/tonne in 2019. If provinces don't have a broad-based carbon price at these levels in place, then the federal government would apply one. A substantial share of the revenues from a federal carbon tax would go to a "green" tax refund to ensure a majority of Canadian households affected are better off after accounting for their increased costs as a result of the carbon tax. This would amount to an annual cheque equivalent to $10 for every adult and $5 per child for every $1 per tonne in carbon tax (e.g., $300 per adult for a carbon tax of $30 per tonne). The remainder of the revenues would go to complementary investments in climate change mitigation and adaptation, green infrastructure and to Just Transition measures to assist affected workers, communities and industries. Revenue from a carbon tax would be over **$17 billion** but much of it would be raised by provincial and territorial governments and half of the revenue would be returned to middle and lower income Canadians through a "green" tax refund and the other half invested in green infrastructure and transition. Net revenue to the federal government would be zero.

3.5 Increase Taxes on Banks and Finance

After many years, momentum is building again in Europe to introduce broad-based Financial Transactions Taxes (FTT). FTTs have existed for centuries and now exist in different forms in different countries and are actively adjusted in China and Taiwan to cool real estate or stock markets.

The International Monetary Fund has also proposed a financial activities tax (FAT) on profits and remuneration in the financial industry as a way to apply a value-added tax to this sector. Quebec has had a version of this with a special tax on remuneration in the financial industry.

The AFB would either introduce a FTT in collaboration with the provinces (which have jurisdiction over securities regulation) or a FAT rate of 5% on profits and remuneration in the financial sector. Revenues of approximately **$5 billion** could be expected.

3.6 Introduce Wealth/Inheritance Taxes and Make Incomes Taxes More Progressive

Canada should have broader-based and more progressive wealth and inheritance taxes to combat growing inequalities, which in turn undermine economic growth. The IMF has estimated that Canada could generate $12 billion annually from a tax of just 1% on the net wealth of the top 10% of households, similar to property tax rates on gross real estate values in major Canadian cities.

Introducing a broad-based wealth tax like this would involve coordinated action, so in the interim the AFB would introduce a minimum inheritance tax of 45% on estate values over $5 million, similar to the estate tax in the U.S.

Annual revenues: **$2 billion**.

The AFB would also reverse the income tax cut introduced for the middle tax bracket because the maximum benefits from this actually go to those with taxable income of over $90,000 a year, bringing this rate back to 22%.

Annual revenues: **$2.8 billion**