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CANADIENS POUR UNE FISCALITÉ ÉQUITABLE

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Close Loopholes, Tackle Tax Havens and No More Tax Cuts

Brief to the House of Commons Finance Committee

2014 Pre-Budget Consultations

Our submission addresses the theme of improving Canada's taxation and regulatory regimes. The Federal Government needs to increase its revenue in order to have the resources required to reduce income inequality and poverty, boost investments in social and physical infrastructure and tackle climate change. The government can do this by: 1) Not introducing any more unfair and ineffective tax cuts; 2) Closing unfair and ineffective tax loopholes and, 3) Going after individuals and companies that are using tax havens to avoid paying their fair share of taxes.

1) No more tax cuts

The Finance Minister is expected to declare that there will be surplus in the next Federal Budget and announce more tax cuts. But before considering any further tax cuts, the government should evaluate what previous tax cuts, totaling an annual $43 billion since 2006[i], have accomplished in terms of the economic and social goals that they were supposed to accomplish before proceeding with any further tax cuts.

There is very strong evidence that corporate tax cuts did not boost investment or job creation. Jim Stanford convincingly demonstrates in his chapter in **The Great Revenue Robbery**, that business investment spending in Canada has declined since the federal government began reducing corporate income taxes.[ii] According to Statistics Canada there is now $630 billion in "dead money" in cash reserves, which is not being invested to create jobs. Far more jobs would have been created if the government kept this money and invested it in infrastructure and public services as a Finance Canada study showed that infrastructure spending had a 1.6 multiplier effect.

Many of the "boutique" tax cuts have not generated the intended results. The Children's Fitness Tax Credit, for example, went disproportionately to upper-income families. And according to a University of Alberta study, it did little to encourage participation in youth sport.[iii]

The Office of the Parliamentary Budget Officer issued a report on tax cuts[iv] this spring. News headlines claimed that middle income earners got the most benefit of $30 billion in tax "savings" as a percentage of their income. A careful examination of the findings shows, however, that in absolute dollar amounts, the richest got a disproportionate benefit. The top 20 per cent of income earners got $10.9 billion, or 36 per cent of the total, while the bottom 20 per cent got $1.9 billion, or only six per cent. On a pocketbook level, the lowest 20 per cent of income earners have gained less than $500 in tax reductions, while the top 20 per cent have seen their taxes go down by almost $2,000 a year.

What have we got in exchange for those tax cuts besides a few more dollars in our pockets? The government claims that tax cuts spur consumer spending, investment and job creation. There's very little supporting evidence to back up this claim. While middle and lower income Canadians may spend their extra money, the rich tend to bank most of their savings, and they got the lion’s share. Tax cuts are one of the least effective ways to stimulate the economy.

Given the clear evidence that tax cuts have been unfair and ineffective, it is sheer madness to consider income splitting for families in the next Federal Budget. An analysis by Queen’s University Tax Law Professor Kathleen Lahey[v] shows that almost 30% of the benefit of income splitting would go to the top 10% of families with incomes above $170,600. If supporting families is the goal, then a far better way to do this would be to fund quality, child care.

2) Close unfair and ineffective tax loopholes

Many of the loopholes or tax breaks disproportionately benefit the wealthiest and increase income inequality. They also make the tax system more complex, making it difficult for an ordinary taxpayer to know all the deductions and tax benefits they might be entitled to claim without the assistance of a professional tax expert.

Many of the richest taxpayers pay far less than their income tax bracket would suggest because they are able to use all kinds of loopholes to reduce the taxes they pay. While the top marginal federal tax rate is currently 29%, the average effective income tax rate paid by the richest 1% was 19.7% in 2008.[vi] Many of the very rich hire accountants and wealth managers to do “aggressive tax planning”. A few cross the line of legal “tax avoidance” into illegal “tax evasion” by hiding their wealth in secretive, off-shore tax havens.

The two most important steps the government could take to make our tax system fairer would be to close the unfair and ineffective tax loopholes and tackle the problem of tax evasion facilitated by tax havens.

The most unfair tax loophole is the **Stock Option Deduction** that allows high paid company executives and directors to pay half the rate of tax on their compensation that is given in the form of stock options. This policy exacerbates the problem of growing income inequality, when governments should be doing more to close it.

According to the **Tax Expenditures and Evaluations 2012** [vii] published by the Finance Department, the Stock Options Deduction costs the federal government $785 million a year. If losses to provincial governments are added in the total revenue loss tops $1 billion.

How can we justify subsidizing the incomes of the wealthiest Canadians and then claim that we don’t have the resources to end child poverty or ensure clean drinking water for aboriginal communities?

Canadians for Tax Fairness would also recommend taxing income from capital gains the same as employment income. This tax measure costs the government over $4 billion in lost revenue from personal income tax revenues, and another $4.6 billion from corporate income taxes. These benefits largely go to Canadians in the top income bracket, further increasing economic inequality.

3) Do more to tackle tax havens

We welcome the steps the government has taken to deal with tax havens in the past two federal budgets, including launching the Offshore Tax Informant Program that offers a reward for information on major tax cheats using tax havens and the establishment of a special unit in the Canada Revenue Agency to work on international tax evasion and aggressive tax avoidance.

But much more needs to be done as the use of tax havens continues to grow. Canadian money stashed in 10 offshore tax havens hit $170 billion in 2013 according to Stats Can data released in April 2014. That's $15 billion more than in 2012.[viii]

The government should provide the Parliamentary Budget Officer with the data needed to complete a tax gap report, make going after tax cheats using tax havens a top priority for the Canada Revenue Agency (rather than auditing charities that are critical of government policies) and support Bill C-621, which would make it easier for government and the courts to crack down on corporations who use subsidiaries in tax havens to shift profits and avoid paying their fair share of taxes. Corporations must be able to prove a transaction has economic purpose aside from reducing the amount of tax owed.

4) More revenue is required to reduce income inequality and poverty, boost investments in social and physical infrastructure and tackle climate change.

The reason we advocate against tax cuts and for closing tax loopholes and tackling tax havens is that the government does not have adequate resources to deal with the major economic, social and environmental challenges we face. The problems of growing inequality, deteriorating social and physical infrastructure and climate change require government action. Individuals, on their own, can do very little to address these challenges.

Reducing income inequality would be one of the most effective ways to boost our economy, as Thomas Piketty's **Capital in the 21st Century** and a recent report from Standard and Poor[ix] suggest. Fairer tax policies could not only raise revenue to fund a poverty reduction plan, it could also help to close the income gap by taxing the rich more.

The quality and accessibility of Canadian health, education and social programs such as Old Age Security and Employment Insurance have eroded significantly and are due to be hit even harder when the full cuts to health transfers and the OAS age increase kick in. These social programs have been key to our high quality of life and also help to stabilize the ups and downs of the economic cycles.

There is an equally pressing need to do something about our deteriorating physical infrastructure and improve our public transit systems. Climate change is causing more severe weather events such as flooding, that our aging infrastructure simply can't cope with. A huge investment is needed to adapt to the impact of climate change. We also need to boost investment in climate change mitigation such as public transit and clean energy development. Investments in these areas would not only help to reduce greenhouse gas emissions, they would also create many high quality jobs and boost the economy.

All of these much needed investments could be made if further tax cuts are avoided, the most unfair and ineffective tax loopholes were closed and a stepped up effort made to tackle tax havens.

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[i] Office of the Parliamentary Budget Officer, identified $30 billion in tax cuts in a report on Revenue and Distribution Analysis of Federal Tax Changes: 2005 – 2013, May 27, 2014 http://www.pbo-dpb.gc.ca/files/files/Fiscal_Impact_and_Incidence_EN.pdf and the PBO has also estimated that the revenue loss from reducing the corporate income tax rate from 18% in 2010 to 15% in 2012 is $11.5 billion. http://www.theglobeandmail.com/news/politics/ottawa-notebook/corporate-tax-cuts-costlier-than-tories-let-on-budget-watchdog-says/article612395/

[ii] Jim Sanford, "The Failure of Corporate Tax Cuts to Stimulate Business Investment Spending", in **The Great Revenue Robbery**, Between the Lines, 2013, p. 66.

[iii] Ben Sand and Peter Shawn Taylor, "Harper's Tax Boutique: Rethinking Tax Expenditures in a Time of Deficit, "Frontier Centre for Public Policy. March 2011.

[iv] http://www.pbo-dpb.gc.ca/files/files/Fiscal_Impact_and_Incidence_EN.pdf

[v] http://www.taxfairness.ca/en/news/income-splitting-huge-tax-cuts-rich-families

[vi] Marc Lee and Iglika Ivanova, Fairness by Design, CCPA, February 2013 p.23 http://www.policyalternatives.ca/sites/default/files/uploads/publications/National%20Office/2013/02/Fairness_By_Design_A_Framework_For_Tax_Reform_In_Canada_0.pdf

[vii] http://www.fin.gc.ca/taxexp-depfisc/2012/taxexp1201-eng.asp

[viii] http://www.taxfairness.ca/en/news/canadian-money-offshore-tax-havens-hits-record-high

[ix] http://www.nytimes.com/2014/08/06/upshot/alarm-on-income-inequality-from-a-mainstream-source.html?_r=0