CANADIANS FOR TAX FAIRNESS
CANADIENS POUR UNE FISCALITÉ ÉQUITABLE

Close More Tax Loopholes, Simplify Tax System and Reap Revenue Dividends

Presentation to House of Commons Finance Committee Pre-Budget Consultations

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The 2013 Federal Budget identified "Tax Fairness" as a key theme and included some welcome first steps in closing tax loopholes and taking action on tax havens.

We would like to suggest that the Federal Budget 2014 close a number of additional unfair and ineffective tax loopholes in order to simplify the tax system and raise additional revenue that could fund public services.

A concerted effort to go after tax cheats who use tax havens and to close a number of unfair and ineffective tax loopholes could yield significant revenue. We estimate that closing unfair and ineffective tax loopholes could raise $10 billion of additional revenue for the federal government as well as an additional $200 million for provincial governments.

It is more difficult to estimate what additional revenue could be realized from a more aggressive policy to counter tax cheats using tax havens. We have estimated that Canada loses about $7.8 billion a year. Not all of this can easily be recovered without concerted international action. However much more revenue could be raised by boosting the capacity of the Canada Revenue Agency to go after tax cheats using tax havens and by tightening up the tax code to prohibit profit shifting by multinational corporations when this is being done specifically to avoid paying their fair share of taxes in Canada on profits generated in Canada.

Tax loopholes undermine tax fairness by providing unfair benefits to some taxpayers and not to others. 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 tax loopholes that have been introduced over the years have also been shown to be ineffective in achieving their intended objective. The Public Transit Tax Credit, for example, did not increase ridership. It would be far more effective to invest the tax expenditure wasted on this ineffective tax credit in building public transit services so that higher quality options other than the automobile were available to the public.

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.[i] 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** [ii] 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?

If wasting money were not bad enough, the Stock Options Deduction has been criticized as bad for business as well. According to Roger Martin, former dean of the Rotman School of Management at the University of Toronto, stock options generally encourage short-term horizons and game playing with stock market expectations at the expense of boosting long-term corporate performance through major new investments and other determinants of company performance in the real economy.[iii]

Canadians for Tax Fairness would also recommend taxing income from **capital gains** the same as employment income. Income from different sources should be taxed equally: As Kenneth Carter, who was appointed by PM John Diefenbaker to chair the Royal Commission on Taxation said, "a buck is a buck."[iv] Even Bill Gross, who founded and runs the world's largest mutual fund, recently strongly argued for this not just for equity and fiscal reasons, but also because it would be better for the economy. As he put it "The era of taxing "capital" at lower rates than "labor" should end."

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.

An adjustment could be made for inflation on capital gains so taxpayers don't pay taxes on increases due to inflation. This would significantly reduce the tax rate for those selling assets or properties held for a number of years. Those with investment income would still benefit from deferral of taxes in most cases and would benefit from not having to pay payroll taxes.

The Business Entertainment Expense Deduction may be the most abused tax loophole. It allows businesses to deduct half the cost of meals and entertainment expenses from their taxable profits. Tax law stipulates that business must be conducted at these events to be eligible to be claimed, but a US study[v] found that this tax measure was widely abused and impossible to police. While trades people cheating on HST/GST payments are dealt with harshly, little or no effort is made by tax authorities to police business entertainment expense fraud. This tax loophole costs $400 million.

Other unfair and ineffective tax loopholes that should be closed or capped include:

- Capping **RRSP** contributions at $20,000 a year would save $232 million and affect only those making over $110,000 a year. The high annual contribution limit effectively subsidizes the retirement incomes of the rich, who least need the help.
- Lowering the contribution limit of the **Tax Free Savings Account** to $4000 a year and setting a total lifetime cap of $20,000 would save $100 million a year. Although this tax expenditure cost $305 million in 2012 the cost is expected to double each year and balloon to $6 billion a year in a few years time.
- Many of the so-called **Boutique tax cuts** are ineffective in achieving their stated purpose[vi] or are unfair as they only benefit those with taxable income and should be re-considered. They also make the tax system more complicated. It would be better to eliminate them and apply the over $400 million to direct investment in public transit, universities so tuition fees can be lowered, and to children's sports and arts programming.
- The Fossil Fuels sector not only benefits from low provincial royalties but also gets significant federal tax subsidies as well. Canada committed to phase out fossil fuel subsidies at the G20 Summit in 2009, and took a few small steps but then stalled. Subsidies for this highly profitable sector remain. **Eliminating fossil fuel subsidies** could provide $800 million in savings and would contribute to lowering carbon emissions as well.

We need to make our tax system fairer, not just to reduce inequality and increase revenues, but also because it would strengthen our economy—*and* it would make the tax system simpler.

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[i] 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

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

[iii] Martin, Roger, **Fixing the Game**, Harvard Business Review, 2011

[iv] McQuaig, Linda**, Behind Closed Doors, How the Rich Won Control of Canada's Tax System ... and Ended Up Richer,** Viking Penguin Books Canada Ltd., 1987

[v] Richard Schmalbeck and Jay A. Soled, **Elimination of the Deduction for Business Entertainment Expenses** http://scholarship.law.duke.edu/cgi/viewcontent.cgi?article=2733&context=faculty_scholarship

[vi] Ben Sand and Peter Shawn Taylor, **Harper's Tax Boutique Rethinking tax expenditures in a time of deficit,** Frontier Centre for Public Policy, 2011 http://www.fcpp.org/files/1/FB091_PSTMiddle_F3.pdf