FAIR TAX REVENUE OPTIONS

Submission to House of Commons Finance Committee on PRIORITIES FOR THE 2016 FEDERAL BUDGET

From Canadians for Tax Fairness, February 17, 2016

Running deficits to finance social and physical infrastructure investments may be justified in the short term when the economy is stagnant, but additional revenue options need to be adopted if the government is to achieve its ambitious policy goals in a responsible and sustainable way. Here are some fair tax revenue options, totaling over **$50 billion** that should be considered:

1. Eliminate regressive and ineffective tax loopholes and simplify the tax system

Canada's tax system has become riddled with ineffective, regressive, and expensive tax loopholes. Raising tax rates at the top has the potential to make the tax system fairer. But failing to plug these holes will cause a significant loss of the new revenues. Closing these loopholes also helps to simply the tax system and provides major benefits to provincial governments that derive revenue from the federal tax base.

We commend the new Liberal government's commitment to conduct a wide-ranging review of tax expenditures. Canadians for Tax Fairness has identified over **$15 billion** in annual savings that could be achieved from closing unfair and ineffective tax loopholes:

a. **Eliminate stock option deduction**: This loophole allows corporate executives to pay tax on their stock option compensation at half the statutory rate most pay on their working income. Not only is the deduction highly regressive, with over 90% of the benefit going to the top 1% of tax filers who make more than $250,000 annually, it is also bad for the economy as it encourages CEOs to inflate short-term stock prices through share buybacks instead of investing in the economy. Annual savings are estimated to be about **$750 million.**

b. **End abuse of small business corporations***:* Tax laws allow accountants, dentists, doctors and small business operators to provide their services through Canadian-controlled private corporations (CCPCs) rather than as employees. These individuals then pay tax on income held within these businesses at the much lower small business rate (11%, declining to 9%) on their first $500,000 of income instead of at the federal personal income tax rates of up to 33%. Closing this loophole would save about **$500 million** a year.

c. **Limit capital gains deduction***:* Individuals and corporations who profit from the sale of investments or assets are able to pay tax at half the rate of tax on income from employment. We recommend maintaining the lifetime capital gains exemptions, but

income from capital investments should be taxed at the same rate as employment income after adjusting for inflation. Allowing for an inflation adjustment would also encourage longer term investments rather than short term speculative investments. Annual savings would be **$8 billion.**

d. **Lifetime limit for Tax Free Savings Accounts***:* The decision to reverse the doubling of the annual contribution limit for TFSAs is welcome as the benefits of TFSAs primarily go to those earning higher incomes. But the cost in terms of foregone revenues will still continue escalate to many billions annually unless a lifetime limit is set. The cumulative amount individuals can contribute to TFSAs will be $46,500 in 2016. We suggest therefore that $50,000 lifetime cap be put on TFSAs to avoid a revenue sinkhole in the future. Annual savings would be modest **at $100 million** initially, but would increase to billions of dollars in future years.

e. **Reduce RRSP contribution limits***:* 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. Lowering the annual contribution limit to $20,000 could save **$2 billion** a year.

f. **Cancel family income splitting***:* Cancelling family income splitting will save **$2 billion** a year, revenue that can be more effectively spent to support families with children by boosting the Child Tax Benefit, which provides more support to those who need it the most.

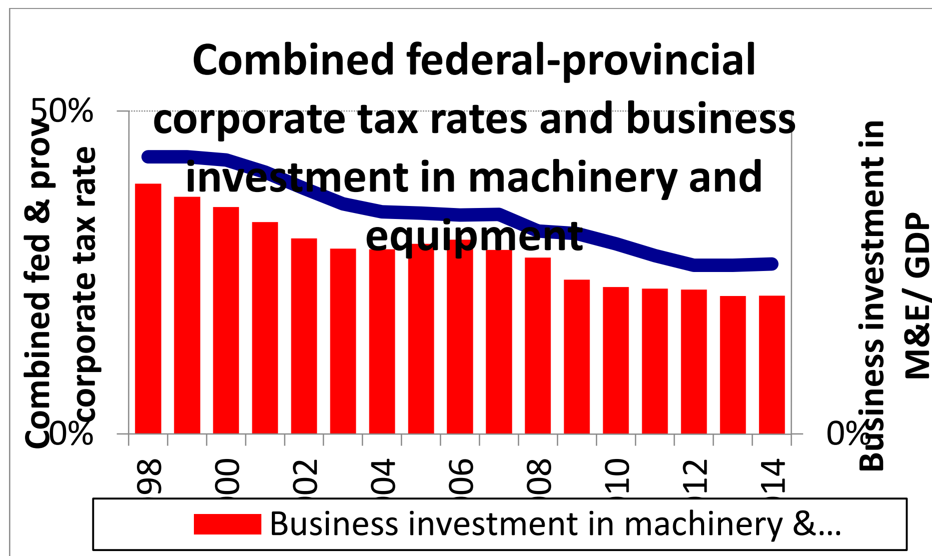
g. **Review and replace ineffective boutique tax credits**: Under the previous government, Canada's tax system became riddled with "boutique tax credits" for specific activities. These made filling out annual tax forms much more complex, and have generally not been effective in their intended objective. These tax credits should be reviewed and those that are ineffective and regressive should be eliminated or replace with direct funding where it can be proven to be effective and equitable. Annual savings of up to **$500 million** could be realized by doing this.

h. **Cancel 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.[1] The meal expense for long-distance truckers could be maintained. Annual savings of **$400 million** could be expected.

i. **End fossil fuel subsidies:** While some fossil fuel subsidies have been reduced, Federal tax subsidies to the fossil fuel industries still amount **to $1.6 billion** annually according to a recent report from Oil Change International. Canada signed on to a G20 commitment to eliminate fossil fuel subsidies and it is time we delivered on this promise.

2. Increase corporate taxes

The deep corporate tax cuts of the past fifteen years have failed to stimulate higher investment, stronger economic growth, or job creation. In fact, as corporate tax rates were slashed almost in half from 29.1% in 2000 to 15% in 2008, business investment as a share of the economy declined while corporations made ever-higher profits and amassed over $600 billion in surpluses and excess cash or "dead money".[2] Lower corporate tax rates have also resulted in tax leakage, as those with the means to do so channel their income through corporate entities rather than through the personal income tax system.



We urge the federal government to gradually increase the general corporate tax rate from 15% to 21%. This would still be slightly lower than it was in 2006, and considerably lower than the 34-35% statutory federal corporate rate in the United States. Annual additional revenue is estimated to be **$9 billion** at maturity, or $1.5 billion per point.

Instead of lowering the small business tax rate to 9% (on the first $500,000 of profit), we urge that it be put back to 15%. This will preserve proportionality between the small and general corporate tax rate, be consistent with the lower rate on personal income, and reduce the abuse of the CCPC regime by individual professionals. This would yield annual additional revenue of about **$3 billion.**

3. Increase taxes on banks and finance

Banks and the finance industry are under-taxed as most of their services are exempt from GST. A number of countries have introduced financial transactions taxes (FTTs), or "Robin Hood" taxes, The International Monetary Fund (IMF) 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.[3]

We suggest one of two options:

- a 5% Financial Activities Tax on profits and remuneration in the financial sector
- or a 0.5% Financial Transactions Tax, on transactions of stocks (similar to the rate in the U.K.) and at lower rates for bonds, derivatives, and foreign exchange transactions (forex) This would be in collaboration with the provinces which are responsible for securities regulation. Annual revenues of **$5 billion** could be realized.

4. Introduce inheritance and wealth taxes

Unlike the United States and most European countries, Canada has no wealth or inheritance taxes. Taxing wealth and inheritances would be an effective way to deal with growing inequality and concentration of wealth, which is one of the reasons for our economic stagnation.

The IMF estimates Canada could generate **$12 billion** annually from a tax of just 1% on the net wealth of the wealthiest 10% of households. An inheritance tax of 45% on estate values over $5 million, similar to the estate tax in the U.S., could raise annual revenues of **$2 billion.**

5. Make income taxes more progressive

Income taxes need to be progressive to counterbalance regressive forms of taxation such as those on property and consumer purchases (sales or value-added taxes). The new Liberal government has made a positive step in this direction by adding a new tax rate of 33% for incomes above $200,000.

However, the lower proposed rate for the second tax bracket is not progressive, as the biggest beneficiaries would be families making between $166,000 and $211,000 (near the top 90-95% of the tax bracket) while two-thirds of tax filers (who earn less than $45,000 in taxable income) will get nothing.[4] This tax rate reduction should be cancelled and the **$3.6 billion** in savings be used to boost the Guaranteed Income Supplement (GIS), the Working Income Tax Benefit and the National Child Benefit Supplement (the Canada Child Benefit under the proposed new regime) to better target those in need.

6. Tackle tax havens and cheats

Canada is losing billions of dollars to tax avoidance, tax evasion, and tax havens.

The capacity of the CRA should be increased to enable it to more effectively go after tax evasion that is facilitated by tax havens. Corporate tax-dodging should be curbed by requiring there to be "economic substance" to any offshore subsidiaries for the purposes of calculating income taxes, as was proposed in Bill C-621 in 2014. A $30-million investment in 2005 to CRA's international compliance division yielded $2.5 billion in recuperated tax revenue over four years. Since tax avoidance is a much bigger problem now than it was even then, we suggest that tax haven–

focused enforcement capacity be increased by $50 million. This should raise an additional $5 billion over four years, or an additional **$500 million** a year initially and rising in subsequent years.

There was $199 billion of Canadian direct investment in tax havens in 2014—a quarter of all Canadian direct investment abroad—and that is just what is officially reported in corporate balance sheets. The main reason for channeling investments through tax havens is to evade or avoid paying taxes in Canada. A 1% withholding tax could be applied on Canadian assets held in tax havens to raise about **$2 billion** in annual revenue, declining over time.

The government should implement, without delay, the measures to combat corporate tax base erosion and profit-shifting (BEPS) that have been proposed by the OECD and G20, including country-by-country reporting of corporate profits and taxes paid, strengthening beneficial ownership registration, and preventing the abuse of tax treaties.

We also call for introduction of an amendment to the corporate tax code which would require that off shore subsidiaries have a legitimate economic reason to be considered as a separate entity for tax purposes. This was proposed during the last Parliament by *Bill C-621, An Act to Amend the Income Tax Act (Economic Substance).* It would make it easier to convict corporations using off shore subsidiaries to shift profits. Deterring this single practice could increase revenue by an estimated **$400 million**.

7. Introduce "green" taxes to address climate change

Carbon taxes or other forms of carbon pricing are critical to reducing our greenhouse gas emissions. They send a strong price signal to businesses and households and raise funds needed for investments in public transit and green energy alternatives. The federal government should ensure that a broad-based carbon tax is in effect in all provinces and territories starting at a minimum rate of $30 per tonne of CO2 emissions on January 1, 2017. This rate should rise by $5 per tonne, per year until it reaches $50 per tonne in 2021.

A substantial share of the revenues from a carbon tax should go to a "green" tax refund to ensure a majority of Canadian households 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). This green refund would be progressive as low income families typically spend less on carbon fuels, while wealthy families spend more. But this would be fair because wealthy families have greater ability to adopt energy saving alternatives to reduce their carbon footprint.

The remainder of the revenues would go to complementary investments in international climate change mitigation and adaptation, as well as domestic investments in renewable energy, energy efficiency, public transit, retrofits for low-income housing, and transition measures for the most affected workers and communities. A large portion of these could be to provincial and municipal governments for these purposes. It is estimated that there would be **$3.2 billion** available for

these investments after paying out the Green Tax Refund on carbon tax revenues of $12 billion at $30 a ton.

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[1] 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

[2] Brennan, Jordan (2015). *Do Corporate Income tax Rate Reductions Accelerate Growth*, Canadian Centre for Policy Alternatives.

[3] See Toby Sanger, *Fair Shares: How Banks, Brokers and the Financial Industry can Pay Fairer Taxes*, CCPA 2011.

[4] Macdonald, David. "Liberal election platform shifts chips for the rich, takes a pass on the middle class," CCPA Behind the Numbers blog, May 2015.