
The following papers by Munir A. Sheikh and Michel Carreau, Thomas J. Courchene, Alan Macnaughton, Jack M. Mintz and Finn Poschmann, and François Vaillancourt and Robert Gagné constitute the third part of the Canadian Tax Foundation’s publication of the proceedings of a conference on personal income tax reform, which was held in Ottawa on April 9-10, 1999.

The conference launched the Foundation’s first intensive look at comprehensive personal income tax reform—an issue that has important implications for how governments finance public services as well as for individual Canadians concerned about their tax burden. Aimed at academics, public policy analysts, and federal and provincial government officials, the conference looked first at the need for reform, the process of reform, and the relationship between personal income taxes and other federal, provincial, and local taxes. Then the focus moved to the specifics of reform: the base, the rates, indexation, and interactions with the social transfer system. The appropriate treatment of retirement savings and the broader issue of the tax treatment of savings rounded out the formal papers.

The papers presented at the conference are being published over several issues of the Canadian Tax Journal. In this issue, the third part of the special report on the proceedings deals with various discussions on the joint occupancy of the personal income tax field. The next issue of the journal will conclude the publication of the conference proceedings with discussions of social transfer and retirement issues, the politics of personal income tax reform, and closing comments.
A Federal Perspective on the Role and Operation of the Tax Collection Agreements

Munir A. Sheikh and Michel Carreau*

INTRODUCTION

In a federation, responsibilities are shared between central and regional authorities. The precise nature of this division of responsibilities can, and does, take many forms since it is shaped by history and by the unique political, geographic, economic, and social conditions in each country. However accomplished, this division represents an effort to balance the objectives of the central government, which must look at national consequences for policies, and those of regional governments, which can better adapt to local variations in economic and social circumstances and in individual preferences.

The tax system plays a central role in this division of responsibilities and in the ability to meet them. While its primary function is to raise revenues, the tax system has become an increasingly important instrument in achieving social and economic objectives.

Since taxes are the primary source of revenue in most industrialized countries, federations must decide how to share and coordinate access to the various tax fields. How this is done in practice varies considerably from one federation to another. In Canada, the British North America Act, 1867, established the basis for joint occupancy of the major tax fields by giving provinces the power to levy direct taxes within their boundaries and permitting the federal government access to any field of taxation.

The sharing of the major tax fields provides provincial governments with the flexibility that has become a central feature of the Canadian federation. However, it also means that the tax policies of various governments interact and hence may conflict. For example, if one province taxed on the basis of residence while another taxed on the basis of the source of income, an individual living in the first province but earning income in the second would be taxed twice. By contrast, someone living in the

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1 The first three sections of the paper reproduce verbatim, or with minor changes, extensive extracts from Canada, Department of Finance, Personal Income Tax Coordination: The Federal-Provincial Tax Collection Agreements (Ottawa: the department, June 1991).
second province but earning income in the first would avoid tax completely. Coordination is required to avoid these consequences.

This paper begins with a brief history of tax coordination in Canada, which has been marked by increasing flexibility for provincial income tax policy. Next, there is a discussion of the evolution of the tax collection agreements (TCAs), followed by an overview of concerns with the existing TCAs and a description of recent changes designed to address those concerns. The paper ends with some brief concluding remarks.

THE HISTORY OF TAX COORDINATION IN CANADA

In 1917, the federal government entered the income tax field in order to finance the costs of World War I. This marked the beginning of the joint occupancy of the personal income tax field, which until then had been used exclusively by provinces and municipalities. British Columbia, in 1876, was the first province to impose an income tax, although some municipalities began levying income taxes as early as 1831.

It was not until the Depression, when federal, provincial, and municipal governments were all attempting to raise income tax revenues to meet increasing demands, that joint occupancy became an issue. At that time, for the most part, there was little or no coordination among governments on the design or administration of their respective tax systems. The lack of a common tax structure and the non-uniformity of tax bases and rates produced large variations in tax burdens between provinces. In addition, tax administration was extremely complex, with a multiplicity of forms, rates, and methods of calculation.

In evaluating this situation (which is frequently referred to in the literature as the “tax jungle”), the Royal Commission on Dominion-Provincial Relations (1940) recommended that provinces withdraw from the income tax field in order to avoid increasing friction between governmental units, increasing double taxation, increasing arbitrary, discriminatory, and confiscatory tax levies, increasing costs of tax compliance, increasing disparities in taxation burdens and government services between regions, and increasing disparities between burdens on and opportunities open to individuals.2

Although the provinces initially rejected this recommendation, Canada’s involvement in World War II necessitated changes to give the federal government access to sufficient funds to finance the war effort. In 1941, the provinces agreed to vacate the income tax and estate tax fields in return for “rental” payments. The tax rental agreements continued until 1962, although with significant changes: Ontario and Quebec withdrew in 1947 but did not (at that time) impose personal income taxes. In 1952, Ontario re-entered the agreement; Quebec implemented its own personal income tax in 1954.

2 Canada, The Report of the Royal Commission on Dominion-Provincial Relations, Book II (Ottawa: King’s Printer, 1940), 134.
Although the tax rental agreements provided the benefit of uniformity of personal income tax across the country, they were subject to criticism. In particular, they acted as a fiscal straitjacket for provinces that were facing increasing expenditure demands. The provinces could neither set tax rates nor use the personal income tax as a policy instrument. Even though personal income tax revenues were shared with the provinces, the fact that the federal government set tax policy and collected taxes meant that there was a strong tendency for taxpayers to see the federal government as the sole taxing authority.

To move beyond the limitations of the tax rental agreements and thus to allow provinces flexibility in the design of income tax policies, in 1962 the federal and provincial governments agreed to a new form of coordination—the tax collection agreements. TCAs were signed by the federal government and all provinces except Quebec (which chose to retain its own personal income tax system). In addition, all provinces, including Quebec, adopted a common formula for allocating income among them for tax purposes—namely, taxation of individuals on the basis of residence (the province of residence as of December 31 of the year).

The history of personal income tax coordination is marked by change, both in the degree and form of coordination and in the number of provinces that have entered into formal tax coordination arrangements with the federal government.

Under the TCAs, the federal government has also agreed to administer and collect provincial corporate income tax. All provinces except Ontario and Quebec entered into the original agreements. In 1981, Alberta withdrew from the corporate income tax agreements but remained part of the personal income tax agreements.

Similar types of agreements have also been established recently in the sales tax field. In 1997, the provinces of New Brunswick, Nova Scotia, and Newfoundland signed comprehensive integrated tax coordination agreements (CITCAs) with the federal government to harmonize their provincial sales taxes with the goods and services tax (GST), creating the harmonized sales tax (HST). Quebec’s provincial sales tax is quite similar to the federal GST.

THE TCAS
This section sets out the conceptual framework of a TCA and then describes the historical evolution of TCAs in Canadian federal-provincial relations.

The Framework
A TCA is a combination of

- a policy framework that provides a balance (however defined) between provincial tax policy flexibility and the need for federal-provincial harmonization; and
- a single administrative process for the collection of taxes.

By necessity, a TCA provides a compromise between the competing objectives of central and regional governments. The central government
strives toward the achievement of national social and economic objectives, whereas a regional government (rightly so) focuses on regional social and economic objectives. While there may be a degree of conflict between these national and regional objectives, there could as well be some complementarity. The central government cannot ignore the fact that regional governments are closer to their populations and may at times have a more direct impact on the achievement of certain social and economic objectives than the central government. Regional governments are likely to recognize that ignoring national consequences of regional policies could weaken the national economy, with negative consequences for all regional economies. This overlapping of national and regional interests was the main raison d’être for the tax rental agreements and for the current TCAs.

Figure 1 illustrates this framework. It explains the nature of the differing federal and regional objectives and shows how TCAs can improve both national and regional welfare.

Solid circle A in the figure reflects federal objectives for the overall national economy that can be achieved with one set of policies, either policies that are totally centralized or federal-regional policies that are perfectly harmonized. Solid circle B correspondingly represents regional objectives and regional policies that can be achieved by regional policy control. The overlapping area indicates that, to some extent, federal and regional objectives and interests overlap.

In this context, what is the role of a TCA? In the absence of such an agreement, the two levels of government could be working at cross purposes, with the policies of one negating those of the other. At the extreme, one could achieve the A objectives or the B objectives, or some portions of the two. A TCA can stop this negation to some extent and provide rules for the achievement of federal and regional objectives.

What could be the parameters of such an agreement? A TCA will obviously impose some constraints on the federal pursuit of harmonized policies, pushing the right wall of circle A inside to the left. The extent of this movement would indicate part of the federal objective that would be difficult to achieve. Any provincial constraint will simultaneously push the left wall of circle B inside to the right. Assume that such an agreement provides the new dashed walls for circles A and B as shown in figure 1. The new dashed shape, under an agreement, reflects the extent to which federal and regional objectives can be achieved, with some constraints on both federal and regional policy flexibility, but expanding the zone of achievement of the combined objectives.

The next question that arises is, what is the rationale for changes to the TCAs over time? The answer naturally depends upon the movement of both federal and regional objectives and the availability and use of policy instruments in figure 1. A small, further leftward movement of the dashed line of circle A could allow a substantive leftward movement of the dashed line of circle B. This would suggest that a marginal reduction in policy harmonization under the agreement, with increased provincial policy flexibility,
may increase overall national and regional welfare. The reverse may also be true where reduced provincial flexibility in other circumstances could be good for the national and regional economies. Under all such changes, it would be optimal to renegotiate the TCA.

Another aspect of welfare maximization to consider, in dealing with the development of or change in an agreement, is that any increased regional flexibility and reduced harmonization may, in certain circumstances, be complemented by the use of other tax or non-tax instruments, to allow both levels of government to achieve their respective objectives that have become constrained by a new, or changed, agreement.

The second aspect of a TCA is that there must be a single administrative process for the collection of taxes. To the extent that a policy framework has been agreed to, there should be no conflict in federal-regional objectives. A single administration avoids overlap and duplication, improves compliance, and should reduce collection costs through the economies of scale. The collection of provincial taxes by the federal government under the TCAs and CITCAs is an example of this lack of administrative conflict.

The 1962 TCAs
The 1962 TCAs were designed to allow provinces to impose personal income taxes directly, while maintaining a degree of tax uniformity among provinces and between the federal and provincial governments. The basic terms and conditions of the 1962 agreements were straightforward. In signing the TCAs, the federal government agreed to

- collect and administer provincial personal income taxes,
- pay provinces the value of the income tax assessed, and
- provide this service without charge.

For their part, the signatory provinces agreed to

- impose a single rate of tax, calculated as a percentage of the basic federal tax;
- make their income tax acts parallel to the federal Act; and
- provide the minister and the Department of National Revenue with all the powers necessary to administer and collect provincial personal income taxes.
The TCAs gave the provinces the ability to determine their revenues independently by enabling them to apply their provincial tax as a single percentage of the basic federal tax—the tax-on-tax framework.

Although the tax-on-tax framework gave each province flexibility over its tax rate and, hence, over the aggregate tax burden and revenue yield of its personal income taxes, the federal government determined the income sources subject to tax, the allowable deductions and exemptions, and the marginal tax rates and income brackets used to compute the tax. Each province then applied a provincial tax rate to that amount to calculate the provincial tax liability.

Taxfilers thus faced a single tax system with a relatively simple administrative process; participating provinces had direct access to the personal income tax field without having to establish their own tax administrations. Since the calculation of provincial tax liability required simply the application of a single percentage to the basic federal tax, taxfilers could determine their provincial liabilities by making only one additional computation. A single annual return could be completed by each taxfiler and sent to the federal authorities.

The Evolution of the TCAs

Over the three decades since the TCAs were first put in place, major changes have occurred, both in the role of the provinces in the economy and in the use that governments make of the personal income tax system. Throughout the 1960s and 1970s, all levels of government began to play an increasing role in the economy, not only in fiscal and economic policy matters, but also with regard to social policy. The federal government, for instance, introduced such measures as high-income surtaxes, the child tax credit, and the sales tax credit.

These new developments naturally disturbed the balance established between the need for policy harmonization and the need for flexibility in provincial policy. To deal with such new developments, the TCAs were amended on various occasions to give provinces increased tax policy flexibility, allowing them, for example, to introduce low-income tax reductions, high-income surtaxes, income-tested credits, and economic-incentive tax credits.

As the TCAs were amended to incorporate these special measures, concern arose about the impact on harmonization and simplicity. To re-establish the balance between federal and provincial needs, the federal government announced in 1981 that, under the TCAs, it would provide increased provincial policy flexibility and would, for a fee, administer special measures on behalf of the provinces so long as they satisfied certain conditions—referred to as the MacEachen guidelines—critical to national objectives:

- Effective administration. The tax measure must be capable of being administered in an effective manner in order to preserve the efficiency and credibility of the system, including being within the legal jurisdiction of provinces.
• A common tax base. The tax measure must respect the common tax base by not changing the federally defined personal and corporate income tax bases.

• Free movement of capital, labour, goods, and services. The tax measure must not impede the free flow of capital, goods, services, or labour within Canada.

The TCAs Today

Given their evolution since 1962, the TCAs today give the provinces considerable policy flexibility and at the same time impose on them certain constraints.

Provincial Policy Flexibility

Provinces are able to use the personal income tax system as an instrument for achieving certain social and economic goals. Provinces can:

• use low-income tax reductions to reduce or eliminate income taxes for low-income taxpayers;

• use income-tested credits to provide relief to low- and modest-income individuals from, for instance, sales and property taxes;

• use high-income surtaxes to alter the income distribution results of their tax systems and make them more progressive; and

• use economic development credits, such as venture capital tax credits, as a means of encouraging particular forms of economic activity.

Constraints on Provinces

Signatory provinces agree to abide by

• a common definition of taxable income,

• a common method of determining provincial residency and allocating taxable income among provinces,

• a common set of federal tax brackets and rates levied on individuals, and

• a common definition of what constitutes deductions or credits for such things as support for families, for education, and for charitable donations.

The Tax-on-Tax Approach

Table 1 shows how the federal and provincial tax computations are linked to basic federal tax under the tax-on-tax approach. The starting point for the calculation of provincial income tax is the basic federal tax (BFT) on which a province can apply only a single tax rate. Provinces are bound by the federal definition of taxable income, the federal brackets and rate structure, and the federal non-refundable tax credits (the shaded area of the table). Provinces can, however, use tax credits or surtaxes to modify the incidence of income tax on their taxpayers.
PROVINCIAL AND FEDERAL CONCERNS WITH THE EXISTING TCAS

As the above discussion shows, social and economic developments have greatly influenced the policy needs of both the federal and provincial governments as well as the balance between these differing needs. As a result, the TCAs have evolved over time. Both levels of government have agreed to TCA changes that provided a new balance between their respective needs consistent with their naturally differing objectives. The following provides a snapshot of provincial and federal concerns with the TCA structure that has existed until recently.

Provincial Concerns with the Existing TCAs

Some provinces felt that the existing TCAs unduly restricted their ability to determine personal income tax policy. For example, reliance on the BFT restricts the flexibility of provincial personal income tax policy because the BFT incorporates both the federal marginal tax rate structure and the federal non-refundable tax credit block. Provincial tax incidence and policy are automatically tied to the federal marginal tax rate structure and to the level and direction of federal support for social and economic policy through tax credits. Such credits include, for example, those for spouses, seniors, the disabled, charitable donations, and medical and education expenses.

While the current tax arrangements provide a degree of flexibility in provincial tax policy through the use of surtaxes and low-income tax reductions, some provinces have felt that these options are cumbersome and insufficient.

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Table 1 Federal and Provincial Tax Calculations, Tax-on-Tax System

<table>
<thead>
<tr>
<th>Federal tax calculation</th>
<th>Provincial tax calculation</th>
</tr>
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<tbody>
<tr>
<td>(Taxable income times federal tax rates) minus (federal non-refundable credits times federal rate) equals Basic federal tax</td>
<td>(Basic federal tax times single provincial tax rate) plus or minus other federal amounts equals Net federal tax</td>
</tr>
<tr>
<td>Basic federal tax</td>
<td>(Basic federal tax times single provincial tax rate) plus or minus other provincial amounts equals Net provincial tax</td>
</tr>
</tbody>
</table>

a Surtaxes or tax credits.

As mentioned earlier, under the personal and corporate income TCAs the federal government administers various special measures for provinces, provided that those measures meet the 1981 MacEachen guidelines. But experience shows that these broad guidelines have been difficult to apply in particular situations. The provinces have expressed difficulties with the transparency of the guidelines, which causes uncertainty over what might be administered by the federal government.

**Federal Concerns with the Existing TCAs**

Provinces have not been alone in their concern about some aspects of the existing TCAs. The federal government’s concerns can be divided broadly into two groups:

1) The existing federal and provincial roles and their interaction in the income tax area have many undesirable effects on tax rates, suggesting a need for improvement.

2) The federal government has also been uncomfortable in the application of the MacEachen guidelines, sharing provincial concerns that they are not transparent and are difficult to apply.

Table 2 illustrates the first of these two federal concerns. The table presents effective marginal tax rates for a one-earner family across provinces. Examined horizontally, the table shows the effective provincial tax rates for each income class; read vertically, it provides a snapshot of a single province’s tax rate for various income classes. Regardless of the way the table is examined, one conclusion jumps out: for no apparent social or economic reason, marginal tax rates in Canada are highly uneven.

With respect to the second concern, the MacEachen guidelines, the federal government played an uncomfortable role in imposing an imprecise set of criteria that affected provincial flexibility and created, at times, serious irritants. This was particularly so for the criterion concerning the economic union. Clearly this guideline represented the federal responsibility to protect the economic union. Federal judgments in this regard may not have been perceived, however, as having the same impact from a provincial point of view. Provinces may not have accepted the federal assessment of provincial measures as being harmful for the economic union; they may have felt that the federal protection provided against such measures did not warrant the loss of their tax policy flexibility; or they may have viewed any negative impact of a provincial action to be too small to be relevant.

The federal government often received requests to administer new provincial tax measures, in particular new tax credits, within days of when the province wished to announce such measures in its budget. This left little or no time for a proper assessment or consultation with other parties. The fact that provinces often expect confidentiality before an announcement further constrained any consultations.

**RECENT IMPROVEMENTS TO THE TCAS**

In dealing with issues related to the functioning of the TCAs, the federal and provincial governments face the same challenge they have faced many
Table 2  Effective Marginal Tax Rates for a Typical One-Earner Family of Four at Selected Income Levels, by Province—1998

<table>
<thead>
<tr>
<th>Income, $</th>
<th>Newfoundland</th>
<th>Edward Island</th>
<th>Nova Scotia</th>
<th>New Brunswick</th>
<th>Quebec</th>
<th>Ontario</th>
<th>Manitoba</th>
<th>Saskatchewan</th>
<th>Alberta</th>
<th>British Columbia</th>
<th>All province average(^a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>5,000</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>6</td>
<td>-24</td>
<td>6</td>
<td>5</td>
<td>-24</td>
<td>6</td>
<td>6</td>
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<td>93</td>
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<td>49</td>
<td>42</td>
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<td>30,000</td>
<td>59</td>
<td>57</td>
<td>61</td>
<td>57</td>
<td>63</td>
<td>65</td>
<td>60</td>
<td>58</td>
<td>57</td>
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<td>70,000</td>
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<td>54</td>
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<td>50</td>
<td>52</td>
<td>46</td>
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</tr>
</tbody>
</table>

\(^a\) Simple average of all provinces at each income level.

Source: Canada, Department of Finance, internal document.
times since the original tax rental agreements in 1941—how to adjust the TCAs so that they continue to give provinces the policy flexibility they require in meeting their regional needs while, at the same time, allowing a degree of policy harmonization and coordination that the federal government considers important from the perspective of national outcomes.

The federal and provincial governments have had many discussions in recent years on finding mutually beneficial ways to modify the TCAs. As a result, a number of changes have emerged that are expected to improve the federal-provincial tax relations considerably. These changes, not all related to the TCAs, can be grouped into four elements, with the elements providing an integrated mechanism to further both provincial and federal objectives.

1) Greater flexibility of provincial tax policy will result from the use of a tax-on-income approach under the TCAs, satisfying specialized needs that certain provinces may have.

2) New guidelines have been established for the federal collection of provincial taxes, allowing further flexibility in provincial tax policy. An important new principle in the guidelines is that the costing structure encourages policy harmonization and coordination.

3) Revenue Canada will be replaced with a more efficient Canada Customs and Revenue Agency (CCRA) that will reduce the cost of tax collection and offer provinces increased and improved service to reduce or eliminate federal-provincial overlap and duplication.

4) The Federal-Provincial Committee on Taxation discusses tax policy changes before they are put into place, so that their regional and national consequences are better understood, and governments will take this analysis into account in modifying policies before they are implemented.

The Tax-on-Income Option
At the December 1997 meeting of Canada’s finance ministers, the federal minister of finance accepted the longstanding request of some provinces to allow them to apply provincial tax directly on taxable income, rather than as a percentage of BFT. Each province is given the option of choosing a tax-on-income approach or retaining the current tax-on-tax approach. The possibility of using a tax-on-income approach allows the provinces and territories to further pursue their social and economic policy objectives through the personal income tax system, within the TCAs.

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3 The tax-on-income option would address the provinces’ desire to shelter their personal income tax revenues from federal tax changes.

4 The new Alberta budget, announced on March 11, 1999, proposed to move Alberta to a tax-on-income basis, and on September 1, 1999, the province announced an implementation date of January 1, 2001.

5 With reference to figure 1, it is the view that a small inward shift of the dashed line of circle A would permit certain provinces to move their dashed line B substantially leftward, raising total national and regional welfare.
The following are the key features of the proposed tax-on-income option.6

**Provincial Policy Flexibility**

1) Each province or territory may determine if, and when, it wants to move to a tax-on-income system, or if it prefers to remain in the current tax-on-tax system.

2) Each province or territory would have additional flexibility to design its personal income tax policies. Under a tax-on-income system, a province or territory would
   a) determine the number of tax brackets and the tax rate applying to each bracket (including the possibility of a zero rate on a first bracket);
   b) be able to have its own distinct block of non-refundable tax credits (to be multiplied by the lowest non-zero provincial tax rate); and
   c) determine to what extent it will use surtaxes, low-income tax reductions, and refundable tax credits.

3) With respect to the distinct block of provincial or territorial non-refundable tax credits,
   a) provinces could supplement federal credits or add any additional unique provincial credits, and
   b) income testing of any federal credits would not affect the amount of any provincial supplement.

**Constraints on Provinces**

Provinces face minimal constraints under the tax-on-income model. Provinces are required to use the same taxable income base as the federal government. The purpose is to have, at least, a uniform tax base across the country on which taxes are levied. Different taxable income bases across the country would create serious economic distortions, as some income might be taxed in one province and not in another. Furthermore, having the same base ensures that there will be no double taxation of multijurisdictional taxfilers.

Table 3 illustrates how, under the new tax-on-income approach, the federal and provincial tax computations would be linked to federal taxable income. Under the tax-on-income approach, the starting point for the calculation of provincial income tax is federal taxable income. As under the tax-on-tax approach, provinces would still be bound by the federal definition of taxable income (the shaded area), but would be able to set their own tax brackets and tax rates. In addition, provinces would be able to establish their own distinct block of provincial non-refundable tax credits.7

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6 Details can be found in Federal-Provincial Committee on Taxation, “Tax on Income,” Report Prepared by the Federal-Provincial Committee on Taxation for Presentation to Ministers of Finance, October 1998.

7 A block of provincial non-refundable tax credits would build on the federal credit block by taking the gross federal credits as a base and adding supplemental provincial credits.
Given the need to develop new systems, and the year 2000 problem, the earliest date by which a province may be able to move to the tax-on-income system is January 2001.

Guidelines for the Federal Administration of Provincial Taxes

Following a discussion at the December 1997 meeting of finance ministers, new guidelines came into force in January 1998 for the types of taxes and measures the federal government will administer on behalf of provincial governments, and their cost. These new guidelines greatly enhance the flexibility of provincial tax policy. The guidelines also encourage provinces to move toward policy harmonization and coordination through the use of the costing structure. The federal government will subsidize the federal collection of harmonized taxes by not charging provinces the actual cost of collection, and will not subsidize provinces for other taxes (that is, it will charge them the actual cost of tax collection). For example, under the new guidelines, provinces would pay for any incremental costs associated with a tax-on-income system.

According to the guidelines,

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Table 3 Federal and Provincial Tax Calculations, Tax-on-Income System

<table>
<thead>
<tr>
<th>Federal tax calculation</th>
<th>Provincial tax calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>(Federal taxable income</td>
<td>(Federal taxable income</td>
</tr>
<tr>
<td>times federal tax rates)</td>
<td>times multiple provincial tax rates)</td>
</tr>
<tr>
<td>equals Federal tax</td>
<td>equals Provincial tax</td>
</tr>
<tr>
<td>Federal tax</td>
<td>Provincial tax</td>
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<tr>
<td>subtract federal tax</td>
<td>subtract provincial tax</td>
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<tr>
<td>times federal rate</td>
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<td>equals Basic federal tax</td>
<td>equals Basic provincial tax</td>
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<tr>
<td>Basic federal tax</td>
<td>Basic provincial tax</td>
</tr>
<tr>
<td>plus or minus other</td>
<td>plus or minus other</td>
</tr>
<tr>
<td>federal amounts</td>
<td>federal amounts</td>
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<tr>
<td>equals Net federal tax</td>
<td>equals Net provincial tax</td>
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*a Surtaxes or refundable credits.

Source: Adapted from Canada, Department of Finance, Personal Income Tax Coordination: The Federal-Provincial Tax Collection Agreements (Ottawa: the department, June 1991), 27.
1) Revenue Canada or CCRA will administer just about any reasonable provincial tax structure (rates, brackets, non-refundable tax credits, and refundable tax credits).

2) Any such provincial tax will be administered
   a) free of charge or at incremental cost under federal-provincial policy harmonization agreements (the tax will be free of charge if it mimics the federal tax, and at incremental cost otherwise); at present, this costing will apply to the TCAs and CITCAs;
   b) at full cost recovery (or average cost) for all other tax collections.

The guidelines provide flexibility beyond what is available under the tax-on-income option. Provinces may use tax credits to alter, for the purpose of calculating provincial income tax, the value of various federal deductions and non-refundable credits to achieve province-specific social and economic objectives. Such flexibility for modification is not allowed on the income side of the calculation for taxable income for a simple reason: such flexibility would allow a province to impose differential tax rates within the province on various sources of income, again with potentially large negative economic effects beyond the provincial borders. As an example, such flexibility would allow a province to establish a very low tax rate on capital income, compared with other sources of income, attracting the highly mobile capital from other provinces, which would negatively affect the national economy.

Canada Customs and Revenue Agency

The federal government announced its intention to create the Canada Customs and Revenue Agency (CCRA) in the 1996 speech from the throne. The creation of the agency will provide an opportunity to reduce much of the duplication in tax administration between the federal and provincial or territorial governments, as well as to foster a better working relationship between the two levels of government.

The creation of the agency is based on two key objectives.

First, the agency will administer tax, trade, and customs programs more efficiently if it is organized and managed according to its own tailored systems, rather than those that apply to the federal public service as a whole. It will be better placed than a traditional government department to respond to client needs, provincial and territorial requirements, and a constantly changing business environment.

Second, a single, dedicated agency for the administration of federal, provincial, and territorial revenue programs and other related programs is
likely to reduce the cost of collecting taxes and the cost of complying with Canadian tax laws, since the marginal cost of tax collection is probably lower than the average cost. It is also likely that there are economies of scale. For both these reasons, the cost to a province if it were to collect its own personal income taxes would likely be higher than the federal cost. As well, dealing with one agency instead of two will reduce the cost of compliance for taxpayers.

The Federal-Provincial Committee on Taxation
The Federal-Provincial Committee on Taxation, with the assistant deputy minister, Tax Policy, Department of Finance Canada, as chair, provides a forum in which the federal and provincial governments may discuss federal and provincial tax policy changes and examine their consequences for the national and provincial economies. These discussions can be extremely useful in providing an exchange of information, with the potential of guiding policy development in an appropriate direction for the benefit of both national and regional economies. At regular meetings, officials from both levels of government discuss proposed federal and provincial tax policies thoroughly to examine their appropriateness and determine their national and regional consequences. The purpose is to ensure that policy changes are regionally and nationally effective and appropriate. These discussions then form the basis for meetings in which the ministers of finance shape policies.

CONCLUSIONS
In a federation such as Canada, it is natural for the federal and provincial governments to have different objectives: the federal government has to consider the overall national economy while a province will focus on the provincial economy. The federal and provincial governments also have a shared goal, however—that the national economy should function well and that there should be as little overlap and administrative duplication as possible to reduce costs. These common interests have brought the federal and provincial governments together in the past through the TCAs.

The TCAs have worked well. As stated in the 1997 OECD Canada Review: “The benefits of decentralised taxing authority can be achieved without sacrificing a harmonised and administratively simple tax system by federal-provincial tax collection agreements. This has been a success story in the case of income taxes in Canada.” The TCAs have worked well because evolution has been their constant feature.

Major new improvements to the TCAs have recently occurred, along with other complementary steps to meet both federal and provincial tax policy objectives. There are four aspects to this change. First, provinces that make use of the tax-on-income option would have more tax policy

flexibility through the application of provincial tax directly on taxable income, rather than as a percentage of the basic federal tax. Second, the new administrative guidelines allow just about all provincial taxes to be collected by the federal government, with minimal constraints. To achieve the objectives of federal policy harmonization and coordination, however, the costing structure subsidizes the federal collection of harmonized taxes, but not that of unharmonized taxes. Third, the new CCRA will significantly reduce duplication in tax administration between the federal and provincial or territorial governments, and will foster a better working relationship between the two levels of government. Finally, with a view to improving policy coordination, the Federal-Provincial Committee on Taxation ensures that major federal and provincial tax policies are discussed thoroughly, before they are introduced, from the perspective of both their national and their regional consequences.