Current Tax Reading

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Advisory Reports

Over the past year, three reports from advisory groups covering very different aspects of tax policy have appeared. The first, published by the Organisation for Economic Co-operation and Development (OECD), focuses on administrative issues in international corporate taxation. The second looks at reform of the provincial tax system in Quebec. The third makes recommendations for reforming the royalty structure in Alberta’s oil and gas industries. Unlike many tax policy proposals, elements of these reports seem destined to be implemented.


The base erosion and profit shifting (BEPS) project is a collaborative effort of the OECD and G20 member countries. It formulates tax strategies to deal with the ineffectiveness of national tax laws in coping with tax-minimization actions of multinational corporations. In these final reports, the project identified 15 actions that nations could undertake collectively to counter BEPS. The intention is to tax profits where they are generated by economic activities—that is, on a territorial basis; to increase certainty by reducing disputes over tax rules; and to standardize compliance procedures. The final reports constitute 15 separate lengthy components covering each of the actions. The executive summaries outline each of the actions in a concise and readable form.

Five of the actions are concerned with well-known ways of shifting profits from high-tax to low-tax jurisdictions: (1) transfer pricing of intrafirm transactions (actions 8-10); (2) financial arrangements such as borrowing in high-tax countries to finance investments in low-tax countries in order to take advantage of interest deductibility (action 4), and (3) profit-shifting opportunities in the digital and information economy, such as locating intellectual property rights in low-tax jurisdictions (action 1).

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Action 7 addresses problems associated with artificially avoiding permanent establishment status so as to escape taxation in a country in which business activity is actually undertaken. Action 6 is concerned with claiming treaty rights when they are not appropriate. Some actions are directed at problems that arise when tax laws of two or more nations are inconsistent so corporations can exploit them to achieve double non-taxation (action 2) or when controlled foreign company rules can be manipulated by a parent corporation to shift income to a foreign subsidiary (action 3).

Other actions are devoted to increasing transparency and thus accountability. Action 11 proposes ways of improving the data available to assess the extent to which BEPS is occurring; for example, governments would be asked to provide more corporate tax statistics in an internationally consistent way. Action 5 deals with the issue of preferential tax regimes as a source of artificial profit shifting, and with the lack of transparency and effective action to counter them. Action 12 makes recommendations for the design of mandatory disclosure rules concerning abusive arrangements as a way of enhancing transparency and of providing early information about tax-planning schemes that exploit vulnerabilities in tax systems. The rules would require disclosure by both the promoters of such schemes and the taxpayers, and would be enforceable by penalties. Information sharing would also be encouraged among tax administrations, subject to reasonable privacy constraints. Action 13 requires that rates be developed for consistent transfer-pricing documentation and country-by-country reporting.

The final two actions deal with process. Action 14 seeks to enhance dispute settlement mechanisms. Action 15 is concerned with modernizing bilateral tax treaties, many of which go back to principles developed by the League of Nations in the 1920s. The OECD and the United Nations have developed an updated model tax treaty convention more suitable to today’s globalized world. Action 15 proposes to develop a multinational instrument that can be used to update existing bilateral tax treaties.

R.B.

Québec Taxation Review Committee, *Focusing on Québec’s Future: Summary, the Reform in Brief* (Quebec: Government of Quebec, March 2015), 33 pages (www.examenfiscalite.gouv.qc.ca/uploads/media/SummaryCEFQ_ReportENG.pdf)

The Québec Taxation Review Committee, chaired by Professor Luc Godbout, was established in June 2014. Its remit was to analyze and propose reforms that would make the Quebec tax system fairer and more efficient and would foster work, saving, investment, and growth, while contributing to budget balance. Remarkably, the committee’s final report was published in March 2015, less than a year later. The report consists of six volumes, and this summary provides an overview of its recommendations.

The committee proposes a revenue-neutral reform of the provincial revenue system encompassing all its elements, including personal and corporate taxation, sales
and excise tax, and user pricing. Nine basic principles—some in conflict—inform the report. They include adopting a system wide approach that takes into account equity, neutrality, simplicity, transparency, predictability, minimization of cost, diversity, and compliance. In turn, this approach leads to eight objectives: economic growth, business investment, labour market participation, savings, sustainable development, full revenue collection, adaptation to a changing society, and an equitable distribution of wealth with support for the disadvantaged.

Broadly speaking, the proposed reform would reduce personal, corporate, and payroll taxes, funding this change through reduced tax expenditures and increases in consumption taxation and user fees. In other words, it would broaden income tax bases, reduce rates, and change the tax mix from direct taxes to consumption taxes and user fees. As well, there would be some increase in progressivity of personal taxes, and some structural enhancements to facilitate labour market participation for both young and old workers and to increase investment by facilitating transfers of businesses. In addition, some forward-looking proposals are made for major adjustments to the tax system.

More specifically, some of the key recommendations include the following. In the personal tax system, progressivity would be enhanced by increasing the basic personal exemption and the number of tax brackets from four to nine while holding the top rate at 50 percent overall. The health-care contribution would be eliminated, and the income-splitting proposal of the federal government would not be followed. For the corporate tax, the general rate would fall from 11.9 to 10 percent,1 and refundability of tax credits would be eliminated for large corporations. For small and medium-sized enterprises (SMEs), payroll taxes would be reduced and the small business deduction would be replaced with a growth premium available to SMEs with at least five employees. The small business rate would be 4 percent on income between $100,000 and $500,000, compared with the current rate of 8 percent on all income up to $500,000.2 The Quebec sales tax rate would increase from 9.975 to 11 percent,3 and specific excises on tobacco, alcohol, fuel, and insurance premiums would all increase; low-income persons would be compensated by an enhancement of the solidarity tax credit. There would be an increase in electricity prices for both households and corporations, and in the fee for child care. There would be an enhancement of the tax credit for work and a new work premium for experienced workers, as well as a tax shield that reduces the adverse effect of increases in work income on refundable tax credits. Finally, there would be an enhanced effort to combat tax evasion and tax avoidance, to improve the taxation of e-commerce, and to better oversee the provisions respecting trusts.

In the longer term, the committee recommends replacing the partial exemption of capital gains with the taxation of real capital gains on assets held for at least one

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1 At 18.
2 At 19.
3 At 12.
year. In addition, the capital gains exemption on principal residences would be transformed into an additional RRSP contribution, and the treatment of stock options as capital gains would be changed. More radically, the committee recommends that the government study changing the income tax system into a dual income tax system of the sort used in the Nordic countries, recognizing that this would entail collaboration with the federal government.

Overall, the report of the committee respects the current structure of major taxes, eschewing the call for major changes in the base of the personal and corporate tax system found, for example, in the Mirrlees review in the United Kingdom. Nonetheless, several of the proposals represent a divergence of the Quebec tax system from that of the federal government and other provinces. Quebec can act on most of these matters unilaterally because it is not bound by tax collection agreements, but obviously what Quebec does may have implications for future federal tax reform.

R.B.


The focus of the panel’s work was on the broader royalty framework rather than on the rates alone. Its mandate combined giving optimal returns to Alberta on its oil and gas resources with encouraging investment, job creation, diversification, and innovation, and supporting responsible development. The new framework that it proposes would apply to new wells operating from 2017. Broadly speaking, the panel suggests that the oil sands royalty framework works well, based as it is on profits. But it calls for more transparency on oil and gas to be achieved by several measures, including publication of a capital cost index and of revenue, expense, and royalty information on each oil sands project. It also recommends the annual publication of the returns to the province, industry costs, investment levels, job creation, and environmental performance. More generally, the panel emphasizes the crucial difference between the value of a resource (price less cost) and its final price or the revenue it generates.

To put royalties in context, the panel compares Alberta’s share of resource value with the shares of jurisdictions elsewhere, and finds it to be comparable. Alberta takes in a share of resource value that is roughly in the middle of the pack among its peers, and it provides a competitive investment environment. Interestingly, its share lags behind that of the US states.

Apart from the oil sands, existing royalty rates apply not to value but to revenues or production levels of resources, albeit in a way that takes into account resource

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prices and project size. The royalty structures for crude oil, liquids, and natural gas do not respond well to changes in costs, technology, and productivity. Moreover, although the distinction between oil and gas wells is not meaningful, the two are treated very differently. This contrasts with the revenue-minus-costs approach taken in the oil sands, which is consistent with best practices. But there is a lack of transparency about costs, and thus there is less trust in the system.

The panel makes a number of recommendations based on the guiding principles mentioned above. Most important, the royalty framework for crude oil, liquids, and natural gas should be modernized. Above all, it should emulate the revenue-minus-costs approach, including recouping certain upfront capital costs, much like the cash flow tax principle often used as a benchmark ideal. The panel proposes harmonizing the royalty structures across crude oil, liquids, and natural gas to remove distortions. It would replace existing drilling programs with a single formula to calculate the drilling and completion cost allowance for each well, and calibrate it to a capital cost index reflecting current average costs. A flat royalty rate of 5 percent would be applied until cumulative revenues from a well equal the well’s drilling and completion cost allowance, followed by higher post-payout royalty rates that increase with price.\(^5\)

The existing system for oil sands would be maintained. This system involves an initial royalty of up to 9 percent on gross revenues until initial costs are covered, followed by a profit-based royalty of 25 to 40 percent.\(^6\) The transparency of allowable costs would be enhanced. At the same time, the panel recommends a strategy of increasing value-added production in both bitumen and natural gas.

Overall, the panel stresses the importance of including costs consistently in the determination of royalties, so that they are based more on value than on production (the revenue-minus-costs approach). This approach would bring the Alberta royalty regime closer to standard systems found in jurisdictions such as Norway and Australia, where the aim is to design resource taxes that apply to resource rents. Oddly, there is limited discussion of the complementary role of auctions as efficient revenue generators. These represent a significant source of Alberta oil and gas revenues.

R.B.

**EXCISE TAXES**

Excise taxes are mainstays of virtually all tax systems. Unlike other taxes, they fulfill more than a revenue-raising role. Excise taxes on tobacco and alcohol products address costs that users impose on third parties (externalities) and discourage behaviour that leads to social problems and addiction. Excise taxes on petroleum products address different sorts of third-party issues, including environmental costs and congestion. The three papers reviewed below provide useful perspectives on some of

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5 At 57.
6 At 12.
the economic issues associated with excise taxes on tobacco, alcohol, and petroleum and use very different methodologies.


Richard Bird explores problems with designing excise taxes to address the adverse health and social consequences of consuming tobacco and alcohol and using the proceeds to finance public health initiatives. The marrying of sin taxes with virtue expenditures has apparently been successful in the Philippines. Should it be emulated elsewhere? Bird’s message is cautionary: it is difficult to know the right level for such taxes in any given country, and there is no good economic or political case for earmarking excise tax revenues to public health programs.

Bird begins by outlining three different approaches to the taxing of alcohol and tobacco. The first is the public health approach, which favours reducing consumption of tobacco and deterring excessive, but not moderate, consumption of alcohol. He argues that it is difficult to design a system that is directed to the most harmful use, as opposed to aggregate consumption, and that differentiates among different product forms. The second is the economic approach, which focuses only on externalities caused by consumption rather than total costs, including those to users. It also addresses equity, efficiency, and administrative cost issues. The neglect of costs to users calls for lower tax rates, but ignoring addiction problems is questionable. Moreover, identifying externalities is difficult. The alternative to taxing externalities often used is the regulation of cigarette and alcohol use. The final approach is the political economy approach, which treats alcohol and tobacco taxes as acceptable ways of raising revenues while deterring bad consumption.

Bird relates these three approaches to three concepts of the appropriate excise tax level: (1) the revenue-maximizing tax rate (RMTR), (2) the socially optimal tax rate (OTR), and (3) the politically acceptable tax rate (PATR), and they are not likely to be the same. In principle, the RMTR is based on elasticities of demand, but these are not known with any certainty. Calculating the OTR is both conceptually and practically very difficult. The PATR can be interpreted as the one actually enacted, which varies notably across countries.

Bird then discusses other factors involved in choosing excise tax design. One is the choice between specific (per unit) and ad valorem tax rates. The former are simpler to administer but must be revised periodically. Another factor is the choice between uniform rates and rates that are differentiated by product characteristics, such as alcohol content, type of drink, and type of tobacco product. Again, no clear principles emerge, other than the truism that simpler taxes are easier to administer.
Other factors are equity and efficiency, which are typically in conflict. Bird points out that differentiated rates can be used to reduce regressivity, but at the expense of simplicity. Regressivity may even be a virtue, since the poor may be more price-sensitive and so will benefit more from the tax. Ease of administration is an issue, and is made more difficult by illegal sales and smuggling from abroad. Simple tax forms and a strong tax administration are important for achieving the objectives of excise taxes. A final factor is the mix of taxation and regulation: the latter can be useful in targeting certain users (for example, the young) that taxes cannot target.

Bird then briefly turns to earmarking. He argues that although it is tempting to argue for linking good taxes with health benefits to good expenditures on the improvement of health, there is really no long-term rationale for doing so. The chances that revenues raised by excise taxes will equal the amount that should be spent are small, and earmarking cannot be perfect given the fungibility of money. Earmarking has little empirical effect on amounts actually spent, and it may reduce accountability.

Bird concludes that it is best to use simple taxes, to use regulation for fine tuning, and to pay close attention to tax administration. He illustrates his arguments by using examples from the United Kingdom and the Philippines and other ASEAN (Association of Southeast Asian Nations) countries.

R.B.


Ian Irvine and William Sims consider a situation in which legal and illegal tobacco sales coexist. Like Richard Bird, they suppose that tobacco taxation can have different objectives: to reduce consumption, to raise revenues, and to reduce illegal activity. The existence of illegal activity complicates the effect of excise taxes: higher taxes can increase consumption by stimulating illegal sales. This point is relevant in the Canadian context, where illegal sales are estimated to be up to 20 percent of total consumption.

Irvine and Sims formulate a function that the government optimizes that is based on different types of consumption—premium legal, discount legal, and illegal—and that captures the foregoing three objectives. Illegal consumption can be more toxic than legal consumption, and the tax applies only to the two forms of legal sales. A revenue-maximizing government maximizes the revenue from legal sales. A paternalistic government aims to minimize aggregate consumption, which is the sum of the three types of consumption, weighted by social costs. A tough-on-crime government minimizes illegal sales.

Consumers are assumed to have constant-elasticity-of-substitution preferences over the three types of cigarettes. Parameters are chosen to calibrate the demand for cigarettes to the actual market shares, given the overall elasticity of demand for cigarettes of $-0.3$, and assuming either high or low elasticities of substitution among cigarette types. There is an assumed cost of illegal cigarettes, which includes toxicity,
policing, loss of social capital, and social norm effects. The exercise is to simulate the effects of tax policy changes.

The main results for each of the three objectives include the following. With respect to the paternalistic objective, higher taxes are not particularly effective in decreasing overall weighted demand. The higher the social costs of illegal cigarettes, the less effective the taxes when people shift to socially costly illegal purchases. In fact, weighted demand could increase with a tax increase. With a revenue-maximizing objective, tax cuts will not raise revenues when the share of illegal products is relatively small. The tough-on-crime results are clearcut: a decline in cigarette taxes reduces illegal purchases. The conclusion is that the impact of tax policy on paternalistic quantity-minimizing policy is ambiguous in light of the extra weight given to illegal consumption. Reduced cigarette taxes may be welfare-improving, except for a revenue-maximizing government.

R.B.


Joel Wood constructs a calibrated empirical model to calculate optimal gasoline taxes in Ontario and the Greater Toronto-Hamilton area (GTHA), using Canadian data and taking account of distortionary income taxes. The task is ambitious, given that gas taxes exist at more than one level of government. Additional gas taxes have been suggested as an option for financing transit in the GTHA. The optimal gas tax has both an externality-correcting (Pigouvian) component and a revenue-raising (Ramsey) component. Wood estimates the size of these for the GTHA and for Ontario, building on an existing model by Parry and Small and assuming that all revenues are earmarked for transit.

Wood uses a representative household model—equity considerations are ignored—with aggregate consumption, variable leisure, travel distance and time, pollution, and accidents as variables. The government taxes income and gasoline and has access to a lump-sum tax intended to approximate the harmonized sales tax. The model is solved by using 2006 Canadian data, with parameter values used to calibrate the model solution to actual data. The author calculates optimal gas taxes containing both Pigou and Ramsey components algebraically using the calibrated model. The Pigou components correct for congestion, pollution, and accident externalities, while the Ramsey component is based on the inelasticity of gas demand.

The optimal GTHA gas tax is calculated to be $0.4057 per litre, which is $0.247 higher than the existing tax but $0.02 lower than that in Vancouver. If no GTHA tax is imposed, Ontario-wide tax should be only $0.2851, reflecting the lower level of average congestion Ontario-wide. The Pigouvian component makes up over two-thirds of the total. These results suggest that a regional gas tax is justified while the Ontario-wide tax remains at its existing level. Moreover, a higher gas tax would be justified regardless of what is done with revenues. These results are similar to those that have been calculated for the United Kingdom and the United States.
Wood discusses briefly the effect of the gas tax on equity. He also notes the impact of increased fuel efficiency, which would reduce both revenues and externalities from driving.

R.B.

TAXATION AT THE TOP

In the past few decades, income inequality has increased significantly; the increase has been driven in large part by a growing concentration of income at the top. There has been much interest in the potential role of tax policy in addressing this issue, and particularly in whether tax rates at the top should be increased. The three papers reviewed below deal with different aspects of the problem. Lemieux and Riddell examine the characteristics of the top 1 percent of income earners and, in particular, the factors that might have driven their relative success. Milligan and Smart consider the effects of increasing the tax rate faced by the top 1 percent, both on the revenue raised and on the measure of inequality. Osberg addresses the topical question of how high the top tax rate could be, and what it should be.

Thomas Lemieux and W. Craig Riddell, “Who Are Canada’s Top 1 Percent?” in David A. Green, W. Craig Riddell, and France St-Hilaire, eds., Income Inequality: The Canadian Story (Montreal: Institute for Research on Public Policy, 2015), 103-55

There are many possible explanations for the growing income share of the top 1 percent. On the one hand, market factors might predominate—for example, technological changes, globalization, and economies of scale that increase the skill premium for the top earners. Alternatively, institutional factors might be responsible—for example, bargaining power or the ability to extract rents by top earners such as chief executives, financial sector workers, and superstars. These alternative explanations have implications for tax policy. If top incomes are largely driven by rent-seeking behaviour, taxing them might both be warranted and have limited economic consequences. On the other hand, if market factors are important, taxing them at high rates could have significant disincentive and efficiency consequences.

Thomas Lemieux and W. Craig Riddell use Canadian census master-file data to get a detailed picture of the top 1 percent. Their results are quite revealing relative to what one could infer using less detailed data sources, such as tax files. They find that labour earnings have been a much larger share of top income earners than of other income groups, and that the share has been relatively constant over time. Top earners, most of whom are men, also work substantially longer hours than others.

The probability of an individual being in the top 1 percent increases with working age and education level. A medical degree is particularly important, but that credential has recently lost ground along with other health-related degrees. Commerce, management, and business degrees have grown in importance in recent years. Those with engineering and applied science degrees are disproportionately represented in the top 1 percent, but their share has not increased much over time.
The share of top earners from mathematics and computer science increased greatly a few decades ago, but has since declined.

Industry of employment and occupation have been especially important. A growing share of top earners work in finance, insurance, and business services and in oil, gas, and mining, but the share of top earners in manufacturing has declined. The share of senior management among top earners has increased considerably, especially in finance and insurance. There has also been growth in the natural and applied science professions.

Lemieux and Riddell conclude that executives and persons working in finance and business services and in oil and gas are the most important drivers of the top 1 percent. More persons in the natural and applied sciences and in computer science are also represented in the top 1 percent, but their increase has been less than the above categories. There are more computer scientists in the top 1 percent, but still a modest number, while the share of health-sector persons has declined. The authors conclude that their detailed results are more consistent with rent extraction than with market-based explanations, though both play a role. To the extent that this is true, some support could be given for increasing the top income tax rates.


Several provinces have recently increased their tax rates on top incomes, while the federal top tax rate had not changed until the 2016 budget. Kevin Milligan and Michael Smart evaluate the effects of provincial increases in tax rates by 5 percentage points for the top 1 percent. The analysis is based on their estimates of the elasticity of taxable income with respect to the marginal tax rate. Changes in taxable income resulting from changes in marginal tax rates can reflect not only changes in real behaviour, but also the shifting of income into sheltered forms or out of the taxing jurisdiction.

The authors describe the evolution of top marginal tax rates by the provinces since 2000, highlighting increases in recent years in some provinces. They trace the increases in the share of income of the top 1 percent over provinces; these data form the basis for their empirical analysis, which regresses the top income share against the top net-of-tax earnings rate (that is, 1 minus the top marginal tax rate). This calculation leads to an elasticity of taxable income of 0.664, which is comparable to estimates found in other Canadian studies. Thus, a 10 percent increase in the marginal tax rate causes taxable income to fall by 6.64 percent, thereby eroding the expected revenue gain. The authors show that this elasticity increases the higher up the income distribution scale one goes.

They use these estimates to simulate an increase in the tax rate paid by the top 1 percent by 5 percentage points for each of the provinces. They assess the effect of
such a change on the progressivity of the tax system in each province and on the tax revenue generated. Both effects vary considerably across provinces. Moreover, such a change would have only a modest effect on inequality, since it applies to only a small proportion of income earned by the top 1 percent. In addition, provincial top tax rate increases would spill over to federal tax revenues, since the federal income tax base would also be reduced.

Lars Osberg, *How Much Income Tax Could Canada’s Top 1% Pay?* (Ottawa: Canadian Centre for Policy Alternatives, 2015), 48 pages

Lars Osberg begins by reviewing some evidence on top marginal tax rates. He points out that the top rate in Canada is relatively low by OECD standards and is below the estimated revenue-maximizing rate. The current rate of about 50 percent is lower than the historical average of close to 70 percent. Top tax rates by province are generally lower in Canada than in US states: the highest rates are in New York and California and the lowest are in Alberta and Newfoundland and Labrador.

Estimates of revenue-maximizing top rates rely heavily on labour supply effects, and Osberg ingeniously points out a deficiency in the assumption underlying many of these estimates. He argues that because the time available for work is fixed, if work effort increases with the after-tax wage rate, leisure falls and marginal value—and the so-called income effect—rises. Eventually, the income effect must outweigh the substitution effect, leading to a backward-bending labour supply curve (as empirical studies have found).

Existing estimates of the elasticity of taxable income at the top typically assume a fixed elasticity of labour supply, which is not plausible. In fact, given the very wide range of incomes in the top 1 percent, a fixed elasticity of labour supply would have to be extremely low to prevent maximum labour supply from being reached. This outcome is inconsistent with estimates of the elasticity of taxable income, which suggest high elasticities of labour supply. Thus, high estimates of the responsiveness of work effort are inherently implausible. Osberg recognizes that there are other margins of response to tax rate increases, such as changes in the form of income, bargaining for rents, evasion, and migration. But induced lower bargaining from higher marginal tax rates just shifts the income to other taxpayers who pay the tax, and increased avoidance is an argument for tightening administration. Osberg claims that labour supply elasticity is the socially relevant response to tax rate changes.

He addresses a number of other considerations in evaluating the top tax rate. First, income from capital makes up a third of top 1 percent income, and inheritances are increasing components of wealth, so the focus on earnings is undermined. Second, high incomes are partly due to luck, and progressive income tax is a form of insurance. A reasonable amount of risk aversion can increase marginal top rates
substantially, assuming that some of them represent luck rather than effort. Third, higher after-tax income is spent largely on status goods that influence social ranking. The cost of raising top rates is small if ranking is not affected. Fourth, the alleged threat of migration of top earners due to higher Canadian taxes is not supported by evidence. Finally, tax avoidance and evasion are facilitated to the extent that enforcement is weak and penalties are low. Moreover, whistleblowers or informants could be used to reduce evasion as they are in other countries, and as the Canada Revenue Agency (CRA) now does for international tax reporting under the offshore tax informant program. (On this topic, see the review of Bethmann and Kvasnicka, International Tax Evasion, State Purchases of Confidential Bank Data and Voluntary Disclosures, below.)

Osberg finishes by arguing that there is scope for both higher top tax rates and tougher tax administration. For example, he calculates that increasing the marginal tax rate to 65 percent for those with taxable incomes above $205,000 would increase revenues by $15.8 billion—enough to abolish post-secondary tuition fees and double the guaranteed income supplement for seniors.

R.B.


This year’s report contains all the usual material on the cost of special tax measures, plus interesting analyses of the working income tax benefit and the charitable tax credit.

The working income tax benefit is a refundable tax credit that supplements the earnings of 1.5 million low-income workers at a cost of $1.2 billion, with the purpose of increasing the returns to work and encouraging participation in the labour force.8 The benefit is particularly important for people who would otherwise be on social assistance, since the loss of social assistance on entering the labour force presents a “welfare wall” that reduces the labour supply. The study does not directly measure this labour supply effect, but instead provides interesting statistical data on the nature of recipients.

The most striking statistical relationship is the one between the method of filing the personal income tax return and the take-up rate for the benefit: people who file a paper return have a take-up rate of only 49 percent, as compared with 86 percent for people who file their own returns using tax software and 94 percent for people who file their returns through an agent.9 The non-claimants represent 13 percent of

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7 At 36.
8 At 285.
9 At 289, table 2. The figures are for the 2012 taxation year.
all of those eligible for the benefit, so the group is not small.\textsuperscript{10} Further, people who file a paper return still have a low take-up rate (51 percent) even if the amount of the annual benefit is $600 or more.\textsuperscript{11} A $600 benefit is quite significant for the low-income workers who are eligible for the benefit, given that the maximum net income for recipients of the benefit is less than $28,000.\textsuperscript{12}

The source of this take-up problem is that claimants have to complete schedule 6. The CRA cannot determine eligibility unless this schedule is filled out because certain amounts, such as income earned on a reserve, are not available elsewhere on the return. The report is silent on the topic of whether the CRA makes any effort to contact benefit-eligible non-claimants. With respect to the possibility that a taxpayer is ineligible because of income earned on a reserve, one would think that the CRA could use the taxpayer’s address (which would show whether he or she was living on a reserve) to identify and contact eligible non-claimants.

The structure of the working income tax benefit is that of a flat-topped pyramid—a range of incomes over which the benefit is being phased in, a range of incomes in which the maximum benefit is paid, and a range of incomes over which the benefit is being phased out. However, the phase-in is based on working income, while the phase-out is based on net income. This results in the curious situation in which 6 percent of claimants are simultaneously in the phase-in and phase-out portions of the benefit schedule.\textsuperscript{13} This result can occur because of significant income from sources that are part of net income but not part of working income.

The main focus of the report’s analysis of the working income tax benefit is in the persistence of claims: do workers claim the benefit once, because of a year with temporarily low income, or is the benefit generally going to workers who experience low income on a recurring basis? For 2009 claimants, 63 percent also made a claim in the subsequent three years, while 20 percent made a claim in all of those years.\textsuperscript{14} Thus, there is an element of truth in both stories.

The second study in the report concerns the response of individuals to changes in what economists call the price of charitable donations—the after-tax cost of donating $1.\textsuperscript{15} This response is a function of both federal and provincial tax credits for donations and the capital gains tax exemption for donating certain assets that have appreciated in value (most notably, publicly traded securities). On average (both mean and median), this after-tax cost is 67 cents—that is, the government is paying

\begin{itemize}
  \item \textsuperscript{10} At 289.
  \item \textsuperscript{11} At 289, table 3.
  \item \textsuperscript{12} At 287, charts 1 and 2.
  \item \textsuperscript{13} At 293.
  \item \textsuperscript{14} At 299, table 14.
  \item \textsuperscript{15} This publication is a follow-up to a broader government report on charitable donations: see Canada, Department of Finance, \textit{Tax Expenditures and Evaluations 2014} (Ottawa: Department of Finance, 2014). See this feature (2015) 63:3 \textit{Canadian Tax Journal} 885-904, at 890-92.
\end{itemize}
about one-third of the cost of donations.\footnote[16]{At 308, table 4. Individuals who earned less than $40,000 of adjusted income over the sample period (1997-2012) were excluded from the analysis in order to have a fair test of responsiveness to tax incentives. The problem is that charitable donations of non-taxable individuals are generally not included in the data because the tax credit is non-refundable.} This cost is highest in British Columbia—about 70 cents (because of the relatively low provincial tax credit rate of 5 percent for donations below the $200 threshold). It is the lowest in Quebec, about 62 cents, where there is a high tax credit rate for both those above and those below the $200 threshold.\footnote[17]{At 309, chart 2.}

Overall, the study found an elasticity with respect to the after-tax price of \(-1.1.\)\footnote[18]{At 311, table 5.} In other words, a 1 percent reduction in the after-tax price of giving is expected to increase charitable donations by 1.1 percent. As the report notes, the argument for providing tax incentives for charitable donations is stronger where taxpayers are highly responsive to tax incentives. The report draws no conclusions about where an elasticity of the estimated magnitude falls on this spectrum, but it seems impossible to avoid the conclusion that the argument in support of incentives has been shown to be weak. After all, the government could just give the money to charities directly instead of using a tax incentive; an elasticity of \(-1.1\) implies that the tax incentive increases donations by just 10 percent above this direct-donation standard.

The above estimate is an average response for various types of donors, and thus the study does not attempt to discover whether there is more responsiveness among higher-income donors or those donors eligible for the capital gains exemption on donation. This omission is unfortunate, particularly in the latter case, because the argument for the special incentive for those donors is based on a hypothesis of greater responsiveness. However, the report mentions some interesting statistical data relevant to this issue: the non-taxation of capital gains accounts for 2 percent of overall tax assistance for donations by individuals\footnote[19]{At 303.} and, for those donations, only about 20 percent of the tax assistance arises from the capital gains preference.\footnote[20]{Ibid. The 20 percent is my inference, derived by dividing the 2 percent mentioned above from the report’s figure that 9 percent of overall tax assistance is for donations eligible for the capital gains tax exemption.} On the other hand, the figures are for 2012, and they might be higher in a time of higher price appreciation on the stock market.

The study notes in passing that total charitable donations have declined by about 6 percent in real (inflation-adjusted) terms since the 2007 peak.\footnote[21]{At 304.} The report minimizes the importance of this decline, noting that most of the decline took place during the last economic recession, and that a similar decline in donations occurred in the economic slowdown of the early 2000s. The implication appears to be that
no change in policy is needed; donations will increase again when the economy recovers.

One other noteworthy aspect of the report is that footnotes disclose the names of the authors of the two studies. This information has never before been given by the Tax Policy Branch of the Department of Finance. Does this disclosure reflect a desire on the part of the government to distance itself from the opinions expressed (they could be said to be just the opinions of the authors and not those of the government), or does it reflect a general desire by the new government to allow civil service scientists to present their findings to the public without applying a political filter?

A.M.


Paying whistleblowers for information, as the CRA has recently begun to do under its offshore tax informant program, is controversial wherever it is practised in the world. Perhaps such payment is un-Canadian, as some say. Nevertheless, the evidence seems to suggest that it is an effective strategy.

Germany’s most populous federal state, North-Rhine Westphalia (NRW), has been particularly active in this regard, buying confidential bank data offered for sale by whistleblowers. On ten occasions since 2010, it has bought data on unreported income in Swiss bank accounts. Although the amount paid appears to be unknown, it is no doubt small relative to the rewards—the NRW government estimates that the purchases have led to additional tax revenue of €2 billion from the named tax evaders.22

The discussion paper shows that the data purchases are also profitable on a second dimension—their effect on voluntary disclosures by other taxpayers, who are presumably taking advantage of the immunity from prosecution for tax fraud provided to those who so disclose in advance of an investigation being started. The NRW government discloses the timing and content of data acquisitions, and it provides data on monthly disclosures by NRW residents involving Swiss banks. The statistical analysis in the discussion paper shows that the number of voluntary disclosures increases by 254 percent in the first month after a new data acquisition emerges, compared with the number that would have occurred had no such purchase taken place. The effect declines only slightly in the second month to 212 percent, and does not disappear until the fifth month.23

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22 At 2.

23 At 9.