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Targeted Tax Relief

Governments are quelling their deficits mainly by reducing social spending. The cuts have fallen heaviest on the poor, who rely more than other Canadians on Employment Insurance, welfare and social services.

Tax increases also have helped vanquish deficits. There is a popular impression that middle-income taxpayers have born the brunt of tax hikes. However, a large and growing group of low-income Canadians – the working poor – are being hit hard by increases in both income and payroll taxes.

Major income tax changes initiated by the Mulroney government clobbered low-income workers. Ottawa axed the federal tax reduction for taxpayers with below-average incomes, imposed a surtax on all taxpayers (including the poor) and partially de-indexed tax brackets, exemptions and credits.

Partial de-indexation is eroding the value of tax credits and thus extending Revenue Canada's reach further below the poverty line each year. In 1980, single taxfilers paid federal income tax once their earnings exceeded $10,172 (in inflation-adjusted 1997 dollars). By 1997, the federal taxpaying threshold had sunk to $6,755 or 39 percent of the low income line. Figure 1 shows the decline in the federal taxpaying threshold.

The Tories' stealthy tax changes, left intact by the Liberals, are imposing hidden income tax increases on all taxpayers – the working poor included. Provincial income tax hikes have added to the mounting tax burden.

Although contributions to the Canada Pension Plan remained low and level from 1966 through 1986, they have since risen gradually – too gradually. So the federal and provincial

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governments have agreed to a rapid escalation of contributions over seven years, boosting employee contributions from 2.8 percent of earnings up to the average wage in 1996 to 4.95 percent from 2003 on.

Reform of CPP financing is necessary to ensure the fiscal integrity and political viability of a public pension plan that is vital to pensioners with below-average earnings. Lower-income workers will benefit most from the promise of a fixed contribution rate after 2003 as opposed to continued future increases under the old system. But the steep ramp-up in contributions, exacerbated by a freeze on the Year's Basic Exemption, will hit workers with below-average earnings harder than better-off contributors as the CPP makes the difficult transition from pay-go to partial funding. Figure 2 illustrates the increase in CPP contributions (net of income tax savings from the non-refundable credit for CPP contributions) for employees and self-employed Canadians, measured as a percent-age of earnings.

Employment Insurance will shift more of its financing burden from middle-income and well-off employees to lower-wage workers. Premiums are now levied on the first hour of employment, requiring all part-time workers to pay into the scheme. The maximum level of earnings upon which premiums are levied was lowered from $42,380 to $39,000 and will be frozen until 2000, which effectively will reduce it further. Narrowing the wage base on which premiums are charged requires a higher rate than otherwise, hurting low-income employees most.

The refundable GST credit is supposed to ease the weight of the regressive GST on low-income families and individuals. But both the credit and income threshold for maximum benefits are partially de-indexed. Each year, as inflation erodes the credit, the GST burden increases – but only for the poor.

Single workers earning $10,000 paid income and payroll taxes totalling $458 in 1980, $1,036 in 1990, $1,301 in 1997 and a projected $1,594 in 2003. Income and payroll taxes took 4.6 percent of earnings in 1980, grew to 13 percent this year and will reach an estimated 15.9 percent by 2003; Figure 3 plots the trend. After-tax income fell from $9,542 in 1980 to $8,898 in 1997 and will drop to $8,583 in 2003.

Such appalling numbers point to a grievous flaw in Canadian public policy – its unfair treatment of the working poor, whose work effort is discouraged by ever-mounting taxes. Welfare recipients who manage to find a job can end up worse off financially because their (typically) low wages are reduced by income and payroll taxes, not to mention employment-related expenses such as transportation and child care.

The federal and provincial governments are working together to dismantle one layer of the welfare wall – lower child benefits for working poor families than families on welfare – by building a National Child Benefit System that will equalize benefits for all low-income children. Governments should apply the same cooperative ingenuity to alleviating the growing tax burden on low-income Canadians. The answer is an integrated tax credit which will target tax relief to those who need it most.

An integrated tax credit would replace the current hodgepodge of varying federal and provincial credits and reductions which fail adequately to shield the poor from escalating income, payroll and consumption taxes. An integrated tax credit must be fully indexed to stem the falling income tax threshold and rising GST and income tax burden on the poor.

The new tax credit system should be a joint federal-provincial endeavour. It can be designed to reflect differences in provincial income and sales taxes, while at the same time delivering administrative savings because Ottawa would operate it on behalf of both levels of government.

Reforms such as the National Child Benefit and my proposed integrated tax credit demonstrate that governments can collaborate to solve pressing social and economic problems. The best way to save Canada is to show that federalism can work.

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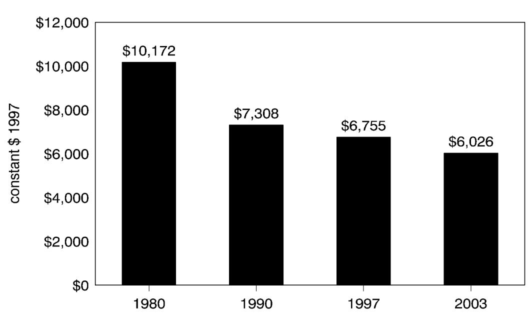
Figure 1 Federal taxpaying threshold, single workers, 1980-2003

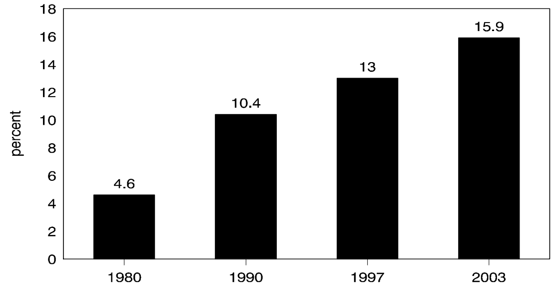


source: Caledon Institute of Social Policy

Figure 2 Increase in net (after-tax credit) CPP contributions as % of earnings, employees and self-employed, 1996/2003

source: Caledon Institute of Social Policy

Figure 3 Total income and payroll taxes as % of pay, low-income worker earning $10,000, 1980-2003



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