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Beware of Governments Bearing Tax Gifts

Canadians should beware of governments bearing gifts in the guise of tax cuts: Tax reductions will quickly be eroded by the same stealthy mechanism that has imposed years of hidden tax increases on an unsuspecting public.

The spending cuts the Liberals will begin restoring in their upcoming 'health budget' were not the only weapon that won the war against the deficit. They have their Conservative predecessors to thank for forging another powerful armament in the form of overt and covert income tax hikes.

The visible mechanism was a 'temporary' general surtax on all taxpayers and a surtax on the affluent. The invisible mechanism was 'partial deindexation' of the tax system, a secret but potent weapon that harnesses the power of infla-

tion to stealthily steal after-tax income from Canadians' pockets.

Thanks to the magic of compound deindexation, Ottawa now collects some \$10 billion (16 percent) more than if the income tax system had remained fully protected from inflation. Provincial income tax coffers gain about half this amount.

Under partial deindexation, tax brackets and credits do not keep pace with inflation. They are increased only to the level of inflation minus three percentage points. So they decline in value year after year when measured in real (inflation-adjusted) dollars.

Through 'bracket creep,' partial deindexation has pushed 1.9 million taxpayers from the

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bottom to the middle tax bracket and 600,000 taxpayers from the middle to the top bracket. Shrinking tax credits raise taxes for all.

While no taxpayer has escaped stealth taxes, lower-income Canadians have been hit hardest. Partial deindexation has added more than a million low-income people to the tax rolls since 1988. The federal income tax threshold fell from \$10,505 in 1980 to \$7,112 in 1998.

Partial deindexation also weakens the refundable GST credit. Each year, fewer poor families and individuals qualify for the credit, and those who do get less.

The 1998 Budget offered a low-income supplement worth a grand \$85 in federal income tax savings. The general surtax was lifted from low- and middle-income taxpayers.

But the low-income supplement is fatally infected with the partial deindexation virus. Like

the other tax credits, it will lag inflation, so taxes for the working poor will resume their steady climb.

This year's Budget will slap bigger but equally flawed patches on the tax system. The general surtax could be fully eliminated, at a cost of \$1.1 billion. For another \$1.2 billion, all taxpayers could receive an \$85 increase in the personal, spousal and equivalent-to-married credits.

Eliminating the high-income surtax would cost \$650 million. Lowering marginal tax rates by just one percentage point – the most generous tax cut – would cost \$3.7 billion.

Whatever particular mix and timetable of tax reductions offered in the 1999 Budget, buyer beware: Unless full indexation is restored to the income tax system, any tax cut will be less than meets the eye. Within just five years, partial deindexation will swamp any so-called tax cut.

**Federal income tax,
single taxpayer with \$20,000 taxable income**

| | 1999 | 2003 | tax increase |
|--|---------|---------|--------------|
| status quo | \$1,809 | \$1,947 | \$138 |
| end general surtax | \$1,809 | \$1,947 | \$138 |
| end high-income surtax | \$1,809 | \$1,947 | \$138 |
| \$500 increase in personal amount | \$1,723 | \$1,906 | \$183 |
| 1% point reduction in marginal tax rates | \$1,609 | \$1,779 | \$170 |
| re-index at 1998 level | \$1,793 | \$1,793 | \$0 |

The federal government claims that restoring indexation is too expensive. Re-indexing personal credits and tax brackets would 'cost' \$610 million in 1999 and \$2.4 billion by 2002.

What this really means is that Ottawa would have to forgo a \$610 million inflation-imposed tax increase in 1999 rising to \$2.4 billion by 2002. Incidentally, this tax grab will substantially offset the cost of tax 'cuts' the Budget might announce.

It is high time to rebuild a firm foundation by restoring full indexation to the income tax system. Then – and only then – should the federal government come bearing gifts of tax cuts.

Other tax priorities also should take precedence over smoke-and-mirrors tax cuts.

Canada Pension Plan contributions are scheduled to rise substantially between 1997 and 2003 as a result of changes to the financing of the plan from 'pay as you go' to partial funding. The purpose of the shift is to secure the long-term financial health of the CPP – to have it keep pace with the growth of gray heads in the population. Contribution rates are expected to rise steadily until 2003 – when they are slated to level off.

In the long run, lower-income workers will benefit from the change. But getting there will hurt. And it will be below-average earners who will pay most for the long-term financial security of the CPP. The Budget should redesign the tax credit for CPP contributions to provide geared-to-income tax relief.

Despite recent reductions, Employment Insurance (EI) premiums are still far too high. Belt-tightening changes have shrunk the program's coverage to only 42 percent of Canada's unemployed in 1997.

The \$19 billion surplus in the EI Fund in 1998 is expected to rise to \$25 billion in 1999. Ottawa should either cut premiums further or, better still, reconstruct this decimated program.

Action on the disability front is crucial. Ottawa and all provinces (minus Quebec) recently released a 'vision paper' entitled *In Unison: A Canadian Approach to Disability Issues*. The document sets out an earnest commitment to inclusion and full citizenship for persons with disabilities.

But the federal government appears to have been struck by analysis paralysis. It has done precious little to turn the passionate words into action.

If Ottawa does nothing else, it should provide extra tax assistance for disability costs. It also should offer tax relief to employers who modify their premises for physical accessibility or purchase disability-related equipment.

It's time for substance, not stealth, in tax reform.

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