WORKING GROUP REPORT

Low Income Tax Relief

FAIR TAX COMMISSION • COMMISSION DE L'ÉQUITÉ FISCALE

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REPORT

December 3, 1992

The Honourable Floyd Laughren
Treasurer of Ontario and Minister of Economics
7th Floor Frost Building South
7 Queen's Park Crescent
Toronto, Ontario
M7A 1Y7

Dear Minister:

We, the members of the Low Income Tax Relief Working Group of the Fair Tax Commission, are pleased to submit our final report.

Yours truly,

Mary Pat MacKinnon
Chair
Low Income Tax Relief Working Group

PREFACE

Background

In August of 1991, the Treasurer of Ontario appointed a group of Ontario citizens to advise him on the ways to change the tax system to make it fairer for families and individuals with low incomes.

We, the volunteer members of the Low Income Tax Relief Working Group, bring a variety of perspectives to the process, including those of advocacy groups for the poor, the organized labour movement, and the academic and business sectors.

Process

In the course of our work, we formed into sub-committees to undertake specific projects, including data analysis of the impact of taxes on low-income households, an examination of the tax issues related to the working poor, a public consultation regarding our proposed directions for change and the production of our final report.

We acted independently from the Fair Tax Commission and are reporting directly to the Treasurer. Therefore, our recommendations do not necessarily reflect the views of the commission.

Consultation

In setting up the Fair Tax Commission and the working groups, the Treasurer intended to engage a broad cross-section of Ontarians in tax reform. To this end, the commission initiated a community education and consultation program to encourage the participation of groups who traditionally have not had access to tax policy development. We believe that any proposed changes to the tax system must be meaningful to the people who would be affected.

We therefore designed our consultation to elicit comments on our proposed directions for change. It involved two activities: a focus group discussion and a consultation by mail. The focus group gathered 18 low-income individuals from different regions of Ontario for a two-day discussion held on April 11 and 21, 1992 in Toronto.

In early May 1992, we sent our consultation paper to some 145 organized groups in Ontario who have an interest in the problems of low-income people. The organized groups comprised the following: social planning councils; advocacy groups for the elderly, people with disabilities, women, and children; aboriginal people's organizations; anti-poverty and housing groups; church leaders; food banks; ethno-specific social service agencies and immigrant service bureaus; and our respective organizations (See Appendix 2 for the list of organizations invited to respond to our consultation paper).

We received about 20 responses from a cross-section of the different groups. The concerns raised and the feedback obtained through this public consultation process have contributed to the enrichment of our discussions and recommendations. We greatly appreciate this input.

LOW INCOME TAX RELIEF MEMBERSHIP LIST

Michael Capotosto	Comptroller, Prime Restaurant Group
Carol Cayenne	Chair, Parents Against Poverty
Nick DiSalle	Acting Staff Representative, Ontario Public Service Employees Union
Josephine Grey	Co-Founder, Low Income Families Together
Ted Hall	Manager, Taxation, Hudson's Bay Company
Judith Harris	Partner, Tory Tory Deslauriers & Binnington
Winsome Leong	Vice President & Actuary, Royal Insurance Canada
Mary Pat MacKinnon (Chair)	Steering Committee Member, Child Poverty Action Group
Andy Mitchell	Programme Director, Social Planning Council of Metropolitan Toronto
Mona Monkman	Director, Financial Management Corporation of the City of Mississauga
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Laurell Ritchie	Member, Confederation of Canadian Unions
John Southern	Political Advocate, PUSH (Persons United for Self Help) Ontario
Colleen Stanko	Senior Economic Specialist, Dow Chemical Canada Inc.
Richard Yampolsky	Former Executive Director, FoodShare Metro Toronto

ACKNOWLEDGEMENTS

We would like to thank all the individuals who participated in our focus group sessions as well as the organizations that responded to our consultation paper. We appreciate the time, energy and thought that participants and organizations committed to the issues we addressed. We would also like to thank Bev Burke of the Doris Marshall Institute for her excellent work in facilitating the focus group consultation. Thanks are also in order to the Fair Tax Community Animators who assisted us in recruiting participants for the focus groups and in compiling lists of local organizations to receive our consultation paper.

In the course of our work we were assisted by resource people who provided us with information and analysis on relevant topics. We would like to express our appreciation to: Ken Battle, President, Caledon Institute of Social Policy (former Executive Director, National Council of Welfare), Harry Beatty, legal counsel for the Advocacy Resource Centre for the Handicapped; Amy Go, a member of the Advisory Group on New Social Assistance Legislation; Fiona Knight, an advocate for social assistance consumers; and Leon Muszynski, an independent social policy analyst.

We would also like to thank the following members of the Ontario Public Service who provided us with technical assistance and analysis: Harry Newton, Kostas Plainos, John Whitehead and Charles Whitfield, Ministry of Treasury and Economics; Harry Busse, Ministry of Revenue; David Mercer, Chandra Pala, Catherine Finlay and Angie Szuch, Ministry of Community and Social Services; Cindy Germain and Zsuzsanna Lonti, Ministry of Labour; and Agatha Garcia-Wright, Ministry of the Attorney General.

The Fair Tax Commission Secretariat provided us with the necessary research and administrative support. Thanks are due to Richard Shillington for assisting us with tax impact analysis and providing invaluable statistical data. In particular, we wish to express our appreciation to Chinn Duong, Bob Cooke and Mark Polley for their diligent work, patience and good humour throughout the working group process.

We also appreciate the faithful attendance of Commissioner Brigitte Kitchen at meetings. Brigitte played an important liaison role between the commission and our working group.

Low Income Tax Relief Working Group

REPORT

" Taxes are what we pay for civilized society..."
Oliver W. Holmes
(*Compania de Tabacos v. Collector*, 1927, p. 100)

1. INTRODUCTION

Taxes may be what we pay for civilized society, but they must be levied in a civilized way.

The Treasurer's question to us was:

> ***What changes to, or restructuring of, existing tax-delivered assistance would increase the fairness of the overall tax burden on low-income individuals and families?***

The Fair Tax Commission asked us to answer a number of supplementary questions:

> ***What is the impact of the current tax system on the poor?***
>
> ***What are the implications for low-income tax relief for family vs. individual as the defined tax unit?***
>
> ***What is the potential for the tax system to address the problem of poverty?***
>
> ***What is the interaction among the various major taxes and their impact on the poor?***

In order to answer these questions, we decided to focus on the income dimension of poverty because it was the one aspect of poverty that the tax system could address. We decided to define poverty using Statistics Canada's low income cut-off. Section 2 of this report elaborates on our reasons for this choice.

Section 3 explores the meaning of fairness in the Treasurer's question. We developed a number of principles that became, for us, standards that must be met for the tax system to be fair overall and in particular to low-income people.

The most important of these guiding principles is that the overall tax system must reflect ability to pay. Section 4 of the report demonstrates how the present tax system fails to meet this standard. In spite of various tax relief measures, the tax system loads significant burdens on people with incomes far below the poverty level. A key question for us became whether the tax system is sufficiently progressive.

Section 5 presents our recommendations for greater progressivity. However, in framing our recommendations, we became increasingly convinced that tax reform by itself can make only a modest contribution to the fight against poverty. So, while section 6 suggests some improvements to assist low-income people, section 7 points out how only a concerted anti-poverty strategy will meet the need.

The Treasurer has asked us to think about tax relief for low income people. In accepting this task, we recognize that tax relief, in various forms, exists for people at all income levels. We urge the Fair Tax Commission and the Treasurer to examine tax relief comprehensively for tax fairness purposes.

It should be noted that in carrying out our mandate, we were guided by our search for tax fairness and not by the limitations imposed by current fiscal realities and administrative concerns. A lack of time and resources prevented us from delving deeply into these areas. We did not, however, disregard the practical elements of implementation, including affordability. Practical aspects were given due consideration, but we leave the detailed aspects of implementation to the Treasurer.

In summary, in answer to the Treasurer's and the commission's questions, we found that a number of changes would increase the fairness of the tax system and reduce the heavy tax burden on the poor. Although our recommendations pertain primarily to the tax system, the need for an overall anti-poverty strategy is paramount. Taxation and other economic measures cannot be separated. Of prime importance is full employment strategy because, with adequate wages, come better health, social interaction, self-respect and dignity. We concluded that the tax system can only address the problem of poverty in concert with other far-reaching measures.

RECOMMENDATIONS

The symbol (*) indicates that different views on this recommendation are discussed in the report.

RECOMMENDATION 1:

A. *Families and individuals with inadequate incomes should not pay personal income taxes to either the federal or provincial government.*

B. *Statistics Canada's after-tax low income cut-off should at present be used by both the federal and Ontario governments as the measure of adequacy of income.*

C. *If new social assistance legislation for Ontario is enacted which uses a market basket approach to adequacy of income, this approach should be reviewed by the government of Ontario as a possible substitute for the after-tax low income cut-off.*

D. *The federal government should adopt a tax measure similar to the Ontario Tax Reduction program.*

E. *In the interim, the Ontario Tax Reduction program should be further enriched to assist families with incomes below the prevailing measure of adequacy of income. It should also be fully protected from the effects of inflation.*

RECOMMENDATION 2:

A. *The federal and Ontario governments should cooperate to reduce marginal tax rates for people with low to moderate incomes.*

B. *If the federal government will not reduce these marginal rates, Ontario should negotiate for the flexibility to set its own marginal rate structure and proceed to reduce Ontario marginal rates for low to moderate income people.*

RECOMMENDATION 3:

A. *Ontario should reduce reliance on sales taxes through successive reductions in the sales tax rate over time. (*)*

B. *The Ontario Sales Tax Credit should be increased and fully protected from inflation.*

C. *If new social assistance legislation adopts a market basket approach to adequacy of income, the amount of sales taxes paid on the items in the basket should be viewed by Ontario as a potential benchmark for the amount of the sales tax credit.*

D. *The federal Goods and Services Tax Credit should be increased and fully protected from inflation.*

RECOMMENDATION 4:

- *The Ontario government should increase the Property Tax Credit and fully protect it from the effects of inflation. (*)*

RECOMMENDATION 5:

- *People should be fully protected from the hidden effects of inflation in the personal income tax system. The federal and Ontario governments should fully index the income tax brackets, tax credit amounts and income thresholds for tax credit calculations.*

RECOMMENDATION 6:

- *The tax unit for raising revenue should continue to be based on the individual. However, the Ontario Tax Reduction program and any similar measure in the federal income tax legislation should be based on family income.*

RECOMMENDATION 7:

A. *The federal government should further publicize and promote the benefits of the short form of the income tax return and increase public awareness that refunds are now paid more quickly.*

B. *The Ontario government should inform all social assistance recipients and seniors receiving a monthly supplement (GAINS-A) that the short form may be of benefit to them.*

RECOMMENDATION 8:

A. *The federal and the provincial personal income tax systems should provide fair recognition of fundamental differences in ability to pay among various groups of taxpayers, such as those raising children and those not raising children.*

B. *The federal government should re-introduce non-refundable child tax credits. (*)*

RECOMMENDATION 9:

- *The threshold for federal and Ontario refundable tax credits (the income level at which they start to be reduced) should be set at least equal to the measure of adequacy of income. The measure of adequacy should be Statistics Canada's after-tax low income cut-off or a market basket measure if agreed on in new social assistance legislation.*

RECOMMENDATION 10:

- *The Treasurer of Ontario and the Ontario Minister of Revenue should examine the feasibility of making tax credit payments on a quarterly or annual basis, based on recipients' preferences. Where the recipient chooses an annual payment, interest should be paid as if the recipient's entitlement accrued quarterly.*

RECOMMENDATION 11:

- *The federal government should convert the deduction for child care expenses to a non-refundable tax credit.*

RECOMMENDATION 12:

- *Because the new Child Tax Benefit is inadequate, the federal government should increase funding to ensure that low-income families have adequate resources to raise children. In addition, the federal government should convert the Earned Income Supplement into a payment to all families with children having a net family income below the income threshold for the Child Tax Benefit, currently set at $25,921 for 1993. Benefits must be fully indexed against inflation.*

RECOMMENDATION 13:

A. *Family care-givers in Ontario should have access to appropriate public support services.*

B. *The Ontario government should consider exempting family care-givers from job search requirements for the purpose of determining eligibility for social assistance.*

RECOMMENDATION 14:

A. *The federal government must find ways to reduce current tax inequities experienced by persons with disabilities. In doing so, it must seek advice from persons with disabilities.*

B. *Both the federal and provincial governments should foster greater awareness of tax benefits available to persons with disabilities.*

RECOMMENDATION 15:

A. *The personal needs allowance provided to seniors in residential care facilities should be increased to $150 per month to recognize inflation since the last increase, and then be indexed to the cost of living.*

B. *Ontario should institute a property tax deferral scheme for seniors and persons with disabilities. The issue of who funds and administers the program should be reviewed as part of the broader provincial-municipal disentanglement discussion currently underway.*

RECOMMENDATION 16:

- *The Fair Tax Commission should recommend ways of reducing the high implicit marginal tax rates experienced by social assistance recipients when they have earned income.*

RECOMMENDATION 17:

- *Before designing an income supplementation program for the working poor, the federal government should seek advice from all stakeholders including provincial governments, business, labour and community groups.*

RECOMMENDATION 18:

- *To eliminate poverty, full employment at adequate income levels must be the first priority of both the federal and Ontario governments. Tax policy could be used as one of a range of policy instruments to achieve this goal.*

2. DEFINING "LOW INCOME"

We began to answer the Treasurer's question by defining "low income". The terms of reference for our group did not include a working definition of "low income" and one was needed in order to sketch a profile of the people who would be affected by the changes we recommend in this report.

2.1 "Low Income" and Poverty

Underlying our use of the expression "low income" is a concern about poverty. There are many causes of poverty such as inadequate education, ill health, disability, marital breakup, low pay and intermittent work. The consequences of poverty include hunger, homelessness, inadequate housing, unemployment and an inability to participate fully in society.

Our task was to focus on the income dimension of poverty because it is the one aspect of poverty which the tax system might be able to address. We believe that people are poor when they lack basic life necessities (e.g., shelter, food, clothing, transportation, resources for raising children, and health care), and the opportunity to move towards self-reliance and integration into the community.

2.2 Choosing a Measure of Poverty

We adopted Statistics Canada's low income cut-off (commonly referred to as the "poverty line") as a measure of poverty for the following reasons:

1. It is the most widely-used measure of economic well-being; it is constructed from data from a nation-wide survey.
2. It is adjusted for the effects of inflation; it has been published on an annual basis since the 1960s and is the only historical measure available.
3. Most importantly, it incorporates both the "absolute" and "relative" concepts of poverty.

("Measuring Poverty" in Appendix 1 provides a fuller description of the low income cut-off and other low income measures we reviewed).

2.3 Who Is Poor?

Calculations using Statistics Canada's low income cut-off indicate that, in 1990, at least one in seven Ontario households was poor (about 15% or 540,000 Ontario households).[1] Sole-support mothers were nearly three times more likely to be poor: 44% were poor. Singles fared better: 36% of those over age 64 were poor and 25% of

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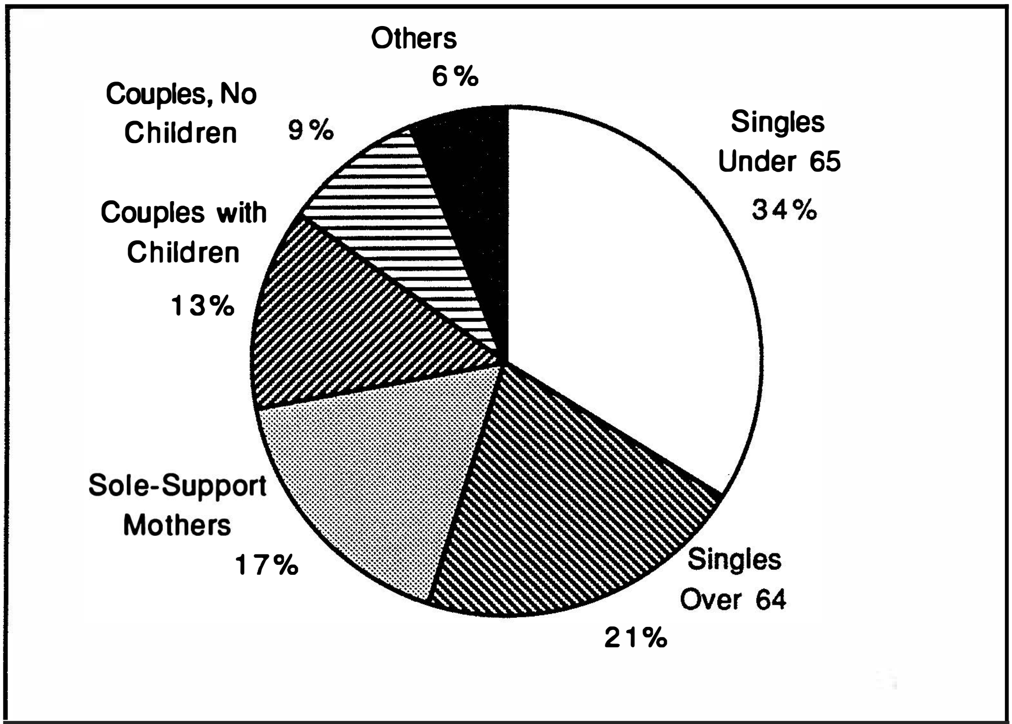
[1] Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

those under age 65 were poor. Couples had a much lower rate of poverty: 7% for couples without children, and 6% for couples with children. (This is illustrated in Figure 1 in Appendix 1).

Sole-support mothers comprised 17% of poor households in 1990 Ontario. Individuals living alone made up 55%. The composition of the population living in poverty is illustrated in Figure 1 below.

Figure 1
Poor Households In Ontario, 1990



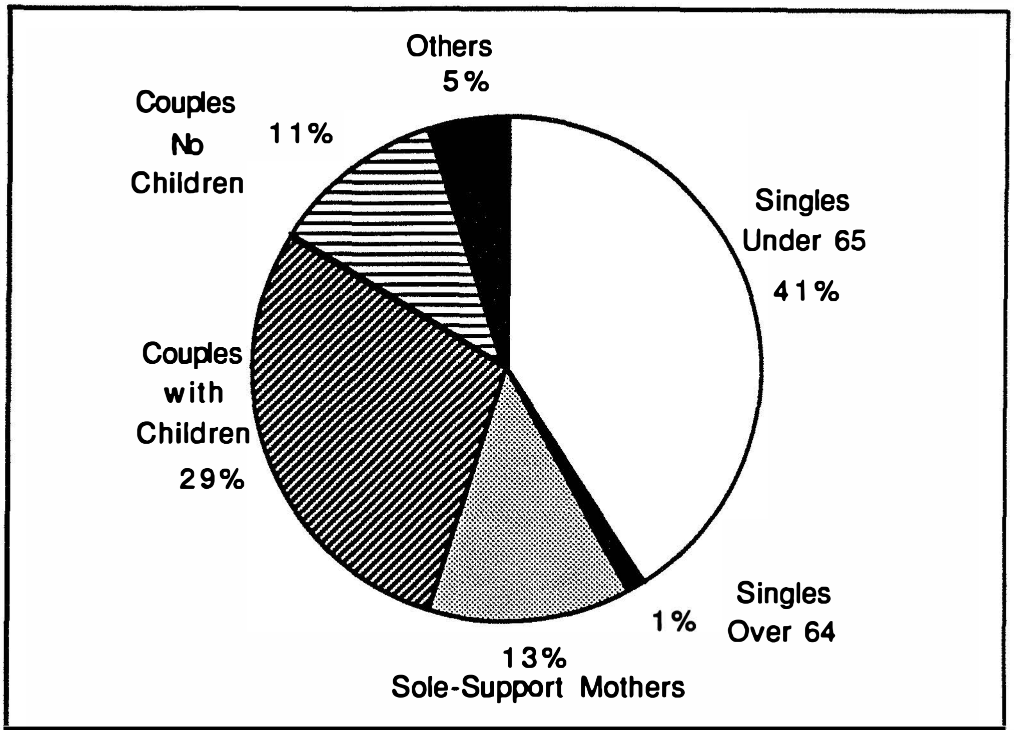
Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

Society expects most of its members to support themselves through employment. Evidence, however, shows that employment does not always shield people from poverty. This is the social phenomenon of the "working poor". Our definition of the working poor includes households whose adult members, between them, have at least 49 weeks of either full-time or part-time work during the year. Where there is only one adult in the household, the criterion requires that the person be employed full-year.

On this basis, about one Ontario household in four (24%) living below the poverty line was working poor in 1990. This represents about 140,000 households. Couples with children were at least twice as likely (54%) to constitute working poor households. (This is illustrated in Figure 2 in Appendix 1).

Figure 2 below depicts the different types of working poor households.

Figure 2
Working Poor Households In Ontario, 1990



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

While seniors living alone constituted about 21% of poor households (see Figure 1), they were virtually absent (1%) in the ranks of the working poor (see Figure 2). This reflects society's expectation that the elderly should not have to work, as evidenced by the range of income support programs devoted to them. Moreover, mandatory retirement policies do not permit many seniors to continue to work even if they chose to do so.

We are also aware that the "poverty gap", i.e., the income shortfall from the poverty line, varies among the different groups of welfare poor and working poor (recent Canadian data on poverty gaps can be found in Gunderson and Muszynski, 1990 and in National Council of Welfare, 1992). For instance, among the Ontario welfare poor in 1991, the poverty gaps amounted to $6,868 for a person who is single and employable, and $4,168 for a single parent with one child. With a poverty line at $14,951 for one person, a single employable person on welfare was thus living on income just over half (54%) of the poverty line; with a poverty line at $20,266 for three persons, the total welfare income for a single parent with one child was about four-fifths (79%) of the poverty line.[2]

2.4 Child Poverty

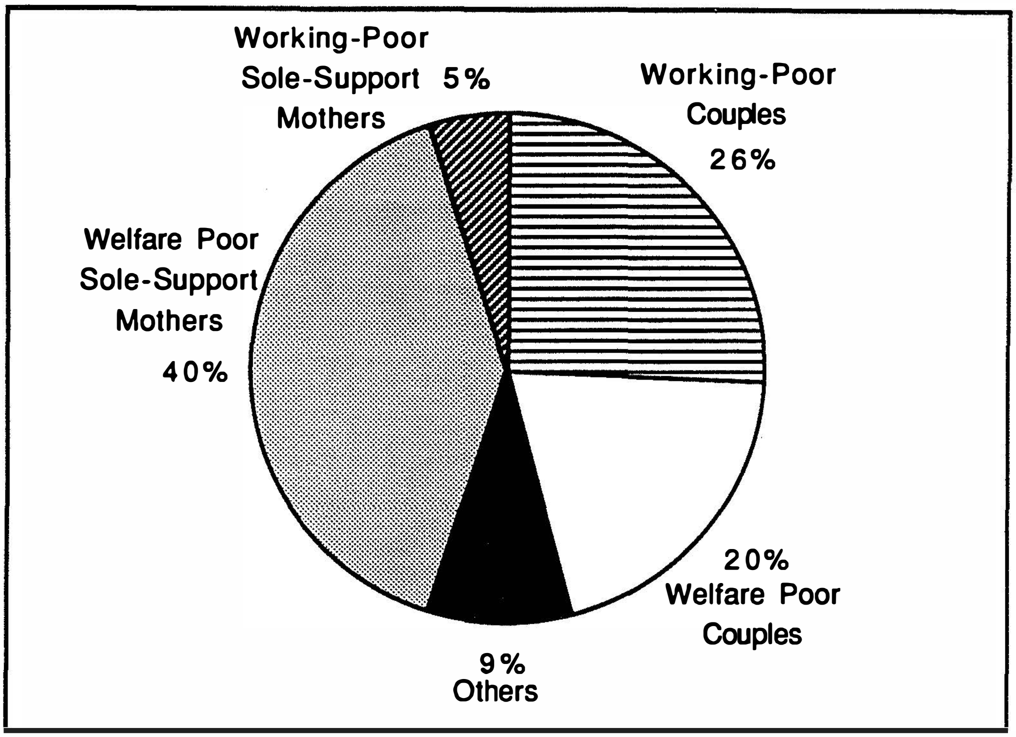
Much has been said and written about the phenomenon of child poverty in a country as wealthy as Canada (Standing Senate Committee on Social Affairs, Science and Technology, 1991; Kitchen, Mitchell, Clutterbuck & Novick, 1991; Standing Committee on Health and Welfare, Social Affairs, Seniors and the Status of Women, 1991; and Income and Employment Forum of the Social Planning Council of Ottawa-Carleton, 1991).

About 340,000 children lived in poverty in Ontario in 1990. This represented about 15% of all Ontario children under age 18. Child poverty can be found amid sole-support mothers as well as two-parent families: in 1990 about 45% of children living in poverty had sole-support mothers and about 46% lived in two-parent families.[3] Figure 3, on the following page, illustrates the distribution of child poverty by household type in Ontario.

[2] As illustrated in National Council of Welfare, 1992, Table 2, pp. 23-24.

[3] Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

Figure 3
Poor Children under Age 18 In Ontario
by Household Type, 1990



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

According to our estimates, at least 31% of children living in poverty were in working poor households, the remaining were in households relying on welfare as their primary source of income.

2.5 Dynamics of Poverty

To the extent that poverty is measured by income and that earnings are a major source of income for most people, poverty is a condition reflecting on-going changes in family structures, labour markets, and economic conditions.

A research study by the Economic Council of Canada (1992) found that the majority of families with low incomes move in and out of poverty, although nearly half the poor population remains in poverty for extended periods. One-parent families and older single adults (age 45-60) are most likely to experience continuous poverty and about a quarter of the people in both groups stayed poor over the 1982-86 five-year period, compared with about 6% of the total working-age population (Economic Council of Canada, 1992, Table 6, p.26).

Job loss, reduced hours of work, divorce, and raising children may push families into poverty. Conversely, gaining an additional earner through marriage or a common-law relationship improves the chance of escaping poverty. Overall, about one in three Canadians experience poverty at least once during their working lives (Economic Council of Canada, 1992, p. 27).

Much of the job creation in the last 15 years has occurred in the service sector: transportation, communications, utilities, business services, finance, insurance, real estate, wholesale and retail trades, personal services, health and social services, education and public administration. This represents a shift away from the goods-producing sector[4] to the service sector (Economic Council of Canada, 1990).

Moreover, while many jobs have been created, evidence points to an emerging employment structure that is polarized between "good" jobs, i.e., high-skill well-paying stable positions, and "bad" jobs, i.e., low-skill low-paid unstable positions. "Good" jobs also tend to be found in large cities. "Bad" jobs tend to be characterized by part-time employment, short-term work, temporary help agency work, and own-account self-employment—i.e., self-employed who do not themselves have employees—(Economic Council of Canada, 1990).

In the wider economic context, there is also a growing concern that Ontario and Canada face greater competition in world markets. Factors that will allow our country to keep a competitive edge include technological innovation, skilled labour, high productivity, and product quality or product uniqueness (Premier's Council, 1988). These factors will therefore have an impact on the labour market structure and the extent to which people are able to achieve economic security and escape poverty.

[4] The goods-producing sector consists of primary industries such as agriculture, fishing, forestry and mining, and of secondary industries, such as manufacturing and construction. The service, or tertiary, sector constitutes the remainder of the economy. In contrast to goods, services have the characteristics of being intangible, nontransferable and nonstorable (Economic Council of Canada, 1990).

3. GUIDING PRINCIPLES TO FAIRER TAXES

We developed principles to guide our deliberations in arriving at recommendations to the Treasurer. These nine principles are set out below with a brief discussion of each.

1. The tax system must reflect ability to pay.

Ability to pay is a principle of tax fairness under which taxpayers make a relatively equal sacrifice of well-being in paying tax. It provides the philosophical basis for progressive taxation on the assumption that the higher the income level, the greater the amount of discretionary income a person has and thus the greater her or his ability to pay tax.

2. Progressivity in the overall tax system is an important element of fairness in taxation.

A tax system is said to be progressive when, on the whole, it levies a higher percentage of tax on high-income taxpayers than on low-income taxpayers. The test of overall progressivity must include the combined impact of all taxes such as income taxes, commodity taxes, and property taxes. Progressivity in any one component such as income tax does not ensure a fair tax system overall.

3. The tax system must treat people in like circumstances the same way and those in different circumstances differently.

The ability-to-pay principle means that people who have the same capacity to pay taxes should pay the same amount of tax. Conversely, people with different abilities to pay should pay different amounts of tax. For example, the tax system should give recognition to the fact that at the same income level, a taxpayer raising children or caring for a dependent adult will have less ability to pay tax than a taxpayer with no dependants. Unfair taxation results when the same tax burden is borne by people in different circumstances.

4. The tax system must be perceived to be fair.

Unfair taxation encourages an attitude that tax evasion schemes are acceptable despite being illegal. It weakens the social consensus that supports public initiatives which improve our collective quality of life. In the face of unfair taxation, the underground economy flourishes, depriving governments of revenue needed for essential public programs and ultimately depriving citizens of important goods and services.

5. The primary objective of the tax system must be to raise revenue. The merits of using the tax system to deliver benefits to low-income people must be weighed against those of a direct transfer program outside the tax system.

Taxation is generally recognized as a means for governments to raise revenue. However, many features in our current tax system are not intended to raise revenue; they are used to encourage or discourage particular activities, or to deliver benefits. For instance, the tax system is being used to encourage individual savings for retirement through deductions for contributions to a registered retirement savings plan. And benefits such as sales tax rebates for low-income people are delivered through the Ontario Tax Credits program.

Because there is a large number of tax expenditures serving a variety of purposes, it is easy to forget that taxes have historically been levied primarily to raise revenues to support public services, and this continues to be the primary purpose for taxation. Therefore, compelling reasons must be offered for tax provisions that serve a different purpose.

6. Tax policy must be considered in conjunction with social and economic policies.

Tax policy must complement macroeconomic, labour market and social welfare policies to form an overall poverty prevention strategy. In order to be effective, the tax system must keep abreast of changing social and economic circumstances and be subject to on-going scrutiny.

7. The tax and social security systems must operate in a co-ordinated way to ensure that people's life choices are not restricted by either system.

Healthy, well-functioning and co-ordinated tax and social security systems promise a measure of economic security and stability to individuals. Taxation enables government to provide a range of important basic services. Social security programs prevent people from falling into poverty, or deeper into poverty, through such mechanisms as the Canada Pension Plan, Unemployment Insurance, Old Age Security, Medicare, social assistance, social housing, and drug and dental plans.

A tax and social security structure that is not fair or well-coordinated creates hardship for individuals and families. It can force some families apart as parents may find themselves left with more money living alone than together. Children cannot afford to care for an elderly parent at home. Education is cut short, because parents cannot afford to keep children in school. Adults with disabilities cannot afford the supports they need to allow them to work or participate fully in society. The economic anxiety created undermines the well-being of the individual and the stability of the community.

In addition, a poorly co-ordinated tax and social security system can discourage people from seeking work for fear of losing income and benefits such as affordable housing, prescription drugs, dental service, and vision care.

8. Tax policy must be developed in consultation with those affected.

We believe an important element of tax fairness is that the taxpayers affected by changes must have an opportunity for input before the changes are made. In order for this input to be meaningful, they need to be appropriately informed. People need to understand what determines how much tax they pay. Governments must be prepared to commit time and resources to enable people to participate in a meaningful way in tax policy development.

9. Changes to the tax system must not increase hardship among low-income people.

The tax system currently recognizes that people need a certain minimum amount of income to live. This is reflected in the personal exemption amount on the income tax return and by the existence of a tax threshold below which individuals are not taxed. Tax reform, either by itself or in conjunction with other policy initiatives, should not leave any low-income individual and family in Ontario with less disposable income than they now have.

4. WHO PAYS TAXES AND WHO GETS TAX RELIEF

Looking at who pays taxes and who gets tax relief led us to conclude that the current tax system places an unfair tax burden on low-income people.

We looked at the way that the overall tax burden is distributed over different income levels. We found that people living below the poverty line pay a significant amount of tax relative to their incomes. The tax system creates a disincentive to work for people on social assistance.

We also considered how the tax system attempts to provide relief to low-income people through tax reductions and tax credits. In spite of tax relief measures, the redistributive effect of the current tax system is not significant. We therefore concluded that low-income people in Ontario bear an unfair share of the tax burden relative to their incomes.

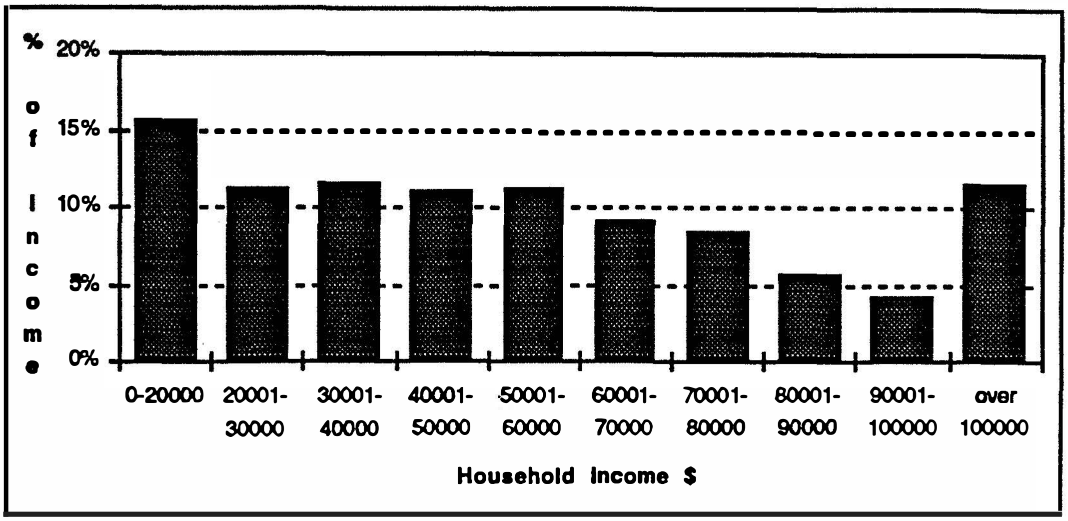
4.1 Tax Burden on Low-Income People

Tax burden is the proportion of income paid in taxes. To assess the amount of taxes borne by low-income people, we examined the range of household incomes in Ontario. We also looked at the way in which personal income tax and other taxes are levied. We calculated the total taxes Ontario households pay on average, both in dollar amounts and in proportion to their incomes. The information we obtained led us to conclude that Ontario households with low incomes bear a heavy tax burden.

4.1.1 Income of Ontario Households

Figure 4, on the next page, shows the percentage of Ontario households that can be found in a given household income range. We have estimated that one in six Ontario households has, on average, less than $20,000 income a year; one in two has, on average, less than $50,000 income a year; and about one in five (22%) has, on average, an annual income of $80,000 or more.

Figure 4
Ontario Households by Estimated Income Distribution, 1991



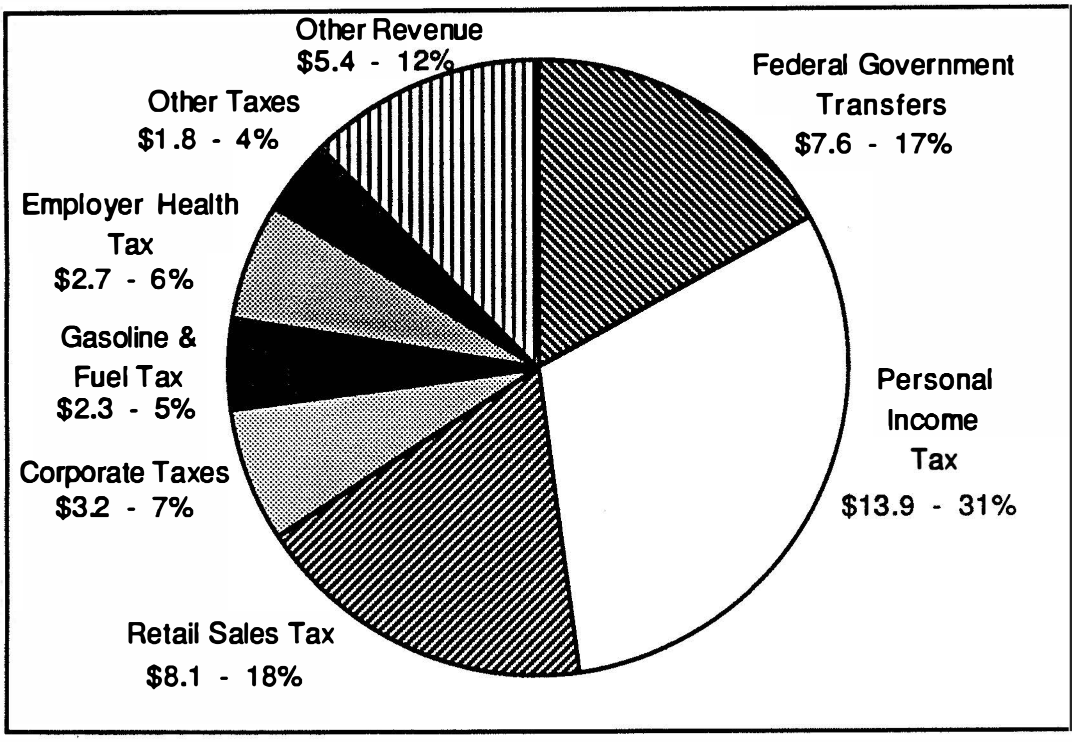
<u>Source</u>: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.
<u>Note:</u> These are estimated average amounts: they can be higher for some households and lower for others.

4.1.2 Sources and Uses of Taxes

Seventy per cent of the Ontario government's revenue comes from taxation, net of all tax expenditures, as illustrated in Figure 5a, on the following page.

Tax expenditures refer to provisions in the tax system that are in the form of credits against tax, deferrals of tax, exemptions and deductions from income, preferential tax rates and tax reductions. They are called tax expenditures because a dollar not collected from taxes is similar to a dollar spent by government. They serve a variety of policy objectives other than raising revenue, as discussed later in the section on tax-delivered assistance.

Figure 5a
Projected 1992-93 Ontario Revenue
($ Billions)



Source: 1992 Ontario Budget.

The personal income tax and the retail sales tax contribute about 70% of the tax revenue raised by Ontario. The property tax is another major source of revenue in Ontario, currently nearly $12 billion a year.

Revenues from property taxes are not included in the provincial accounts because property taxes are collected by local governments and school boards to cover their costs. The province sets the legislative framework for their collection.

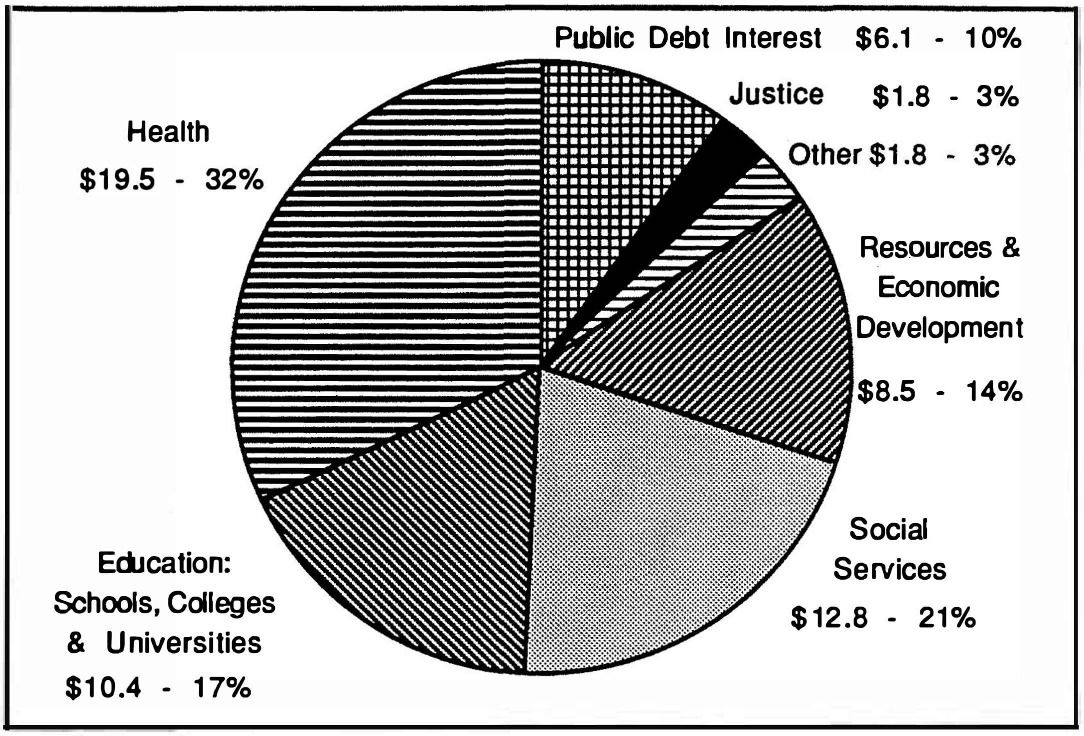
The "tax mix" that is, the proportion of revenue raised from various tax sources, changes according to economic conditions. For example, corporate tax revenue declines during hard times.

Governments also change the tax mix. They may introduce new tax sources, such as the employer health tax in 1990. They may change tax rates. For example, the retail sales tax was 3% in 1961, when the tax was first introduced. In 1966 it was increased to 5%, 7% in 1973; it has stayed at 8% since 1988.

Any changes relating to a significant tax source affects the tax mix. For example, personal income tax and retail sales tax contributed respectively 33% and 25% of total Ontario revenue in 1972-73, compared to the projected 31% and 18% for 1992-93.[5]

Each percentage point increase in the personal income tax rate currently yields about $275 million to Ontario. Each percentage point in the retail sales tax rate is currently worth about $900 million (Ministry of Treasury and Economics, 1992, p. 26).

Figure 5b
Projected 1992-93 Ontario Expenditures
($ Billions)



Source: 1992 Ontario Budget.

The Ontario government spends roughly 70% of its total revenue on health, social services and education, as illustrated in Figure 5b above. Tax revenues are also used to stimulate the economy, uphold justice and service the province's debts. Taxes are thus the price Ontarians pay for the public goods and services that are the hallmarks of a civilized society.

5 Computed from revenue figures in Ministry of Treasury, Economics and Intergovernmental Affairs, 1973,.p.114.

4.1.3 How Personal Income Tax Is Levied

Ontario has agreed to let the federal government collect the province's personal income tax on its behalf. Ontario residents complete and forward their tax returns to the federal government.

Under the federal-provincial tax collection agreement, Ontario's basic personal income tax is a fixed percentage (53% for 1991)[6] of federal tax.

The liability for federal tax is the net of "federal income tax" on taxable income less non-refundable tax credits. The federal government establishes the definition of "taxable income" and the design of non-refundable tax credits. (Selected non-refundable tax credits are highlighted in Appendix 1.)

The federal personal income tax is levied according to specified rates that apply to specified income ranges. The 1988 federal tax reform reduced the number of tax rates in the personal income tax system from ten to three. Table 1 below shows how the three statutory personal income tax rates set by the federal government for the 1991 tax year are used to calculate the federal income tax on taxable income.

Table 1
Federal Income Tax on Taxable Income
1991 Tax Year

Taxable Income	Federal Income Tax
$28,784 or less	17%
$28,784	$4,893 + 26% on next $28,784
$57,568 or more	$12,377 + 29% on remainder

Source: Revenue Canada.

Both the federal and the provincial governments impose surtaxes on their respective basic income tax. The federal government imposes a two-tier surtax, the first is 5% of basic federal tax for all taxpayers; the second is 5% of basic federal tax over $12,500.[7] The Ontario surtax of 10% is applied to basic Ontario tax over $10,000.[8]

[6] For the 1992 taxation year, the Ontario personal income tax rate will be increased by 1.5 percentage points to 54.5% of basic federal tax. For 1993 and subsequent years, the Ontario personal income tax rate will be set at 55% of basic federal tax.

[7] The federal government has announced its intention to reduce the general surtax to, eventually, 3% (4.5% for the 1992 taxation year and 3% effective January 1, 1993). The high-income surtax will remain unchanged. Taxpayers with basic federal tax over $12,500 pay both the general and the high-income surtaxes.

These surtaxes implicitly increase the number of tax brackets. A complicated measure like surtaxes attempts to restore some of the progressivity that was removed in 1988.

Surtaxes also increase the top marginal personal income tax rate beyond the highest statutory rate, as illustrated in Table 2 below. Marginal tax rates are rates that apply to each additional dollar of taxable income.

For example, a person at the $28,800 income level earning an additional $100 would pay an additional $13.78 in Ontario and an additional $27.30 in federal income tax. Thus, in this example, the additional $100 increases this person's combined federal-provincial marginal income tax rate from 26.86% to 41.08%, moving her/him from the 27% income tax bracket into the 41% income tax bracket. This does not mean that the person pays 41% of all her/his income in taxes. Because the 41% marginal tax rate only applies to the last $100 of income in this case, the effective tax rate, i.e., the actual proportion of income paid in taxes, is lower.

Table 2
Marginal Personal Income Tax Rates for 1991 Tax Year

Taxable income	Federal rate	Ontario rate	Combined
Less than $28,800	17.85%	9.01%[1]	26.86%
$28,800 to $57,600	27.30%	13.78%	41.08%
$57,600 to $62,000	30.45%	15.37%	45.82%
Federal Surtax	31.90%	15.37%	47.27%
Top Rate	31.90%	17.21%	49.11%

Source: Compiled by Tax Policy Branch, Ministry of Treasury and Economics.
Note: 1) Does not include the effects of the Ontario Tax Reduction program.

Effective tax rates are lower than marginal tax rates not only because of the progressive structure of statutory rates, but also because of the existence of tax-delivered assistance which is discussed in a later section. Table 3 below provides estimates for effective personal income tax rates at different income levels.

[8] Ontario has introduced a two-tiered surtax, effective 1992: 7% on tax between $5,500 and $10,000, and 14% on tax in excess of $10,000. For 1993 and subsequent tax years, the two-tiered surtax will be : 14% on tax between $5,500 and $8,000 and 20% on tax over $8,000.

Table 3
Effective Personal Income Tax Rates (estimates for 1991)

Total Income	Federal rate	Ontario rate	Combined
Up to $25,000	7.3%	3.4%	10.7%
$25,000 - $50,000	13.7%	6.9%	20.6%
$50,000 - $75,000	17.4%	8.8%	26.2%
$75,000 - $100,000	19.3%	9.7%	29.0%
$100,000 - $125,000	20.1%	10.2%	30.3%
Over $125,000	24.5%	13.0%	37.5%

Source: Estimated by Tax Policy Branch, Ministry of Treasury and Economics.
Note: These amounts, compiled from actual data, are averages : they can be higher for some people and lower for others.

4.1.4 Other Taxes

Besides personal income taxes, the other taxes we reviewed included property taxes, major federal and provincial commodity taxes, and "payroll taxes".

Property owners pay property taxes at a specified rate on the assessed value of their property. Some of these property taxes are passed on to tenants through their rents.

People pay provincial retail sales taxes at the rate of 8% on the listed prices at the point of sale when goods and services are bought. For goods like gasoline, fuel, tobacco and alcohol, additional provincial taxes are included in consumer prices.

The federal government levies its own goods and services tax (GST), as well as taxes on gasoline, fuel, tobacco and alcohol. It also levies air transportation tax and customs duties. Moreover, contributions to the Canada Pension Plan and to Unemployment Insurance can be viewed as "payroll taxes".

4.1.5 Amount of Taxes Paid by Ontario Households

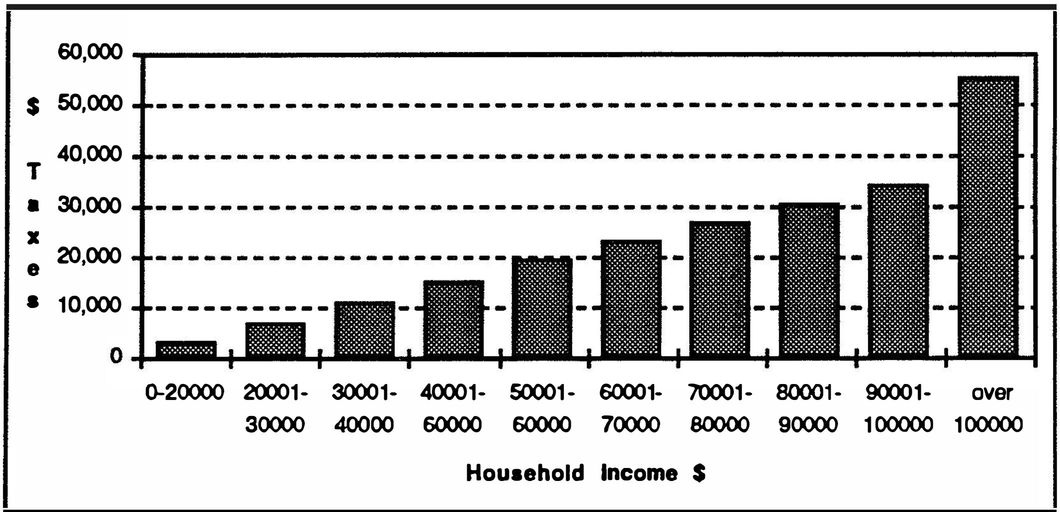
In estimating the amount of taxes Ontario households pay on average, we took into account the following taxes: property taxes; provincial and federal income taxes; major federal and provincial commodity taxes (including the provincial retail sales tax and the federal goods and service tax); and payroll taxes.

We adjusted our estimates for all deductions and credits that reduce an individual's total tax bill, including the Ontario Tax Reduction program, the Ontario Property and Sales Tax Credits (or property and sales tax grants for seniors), and the federal Goods and Services Tax Credit. As well, we have included the federal and provincial surtaxes on personal income tax. The results are depicted in Figure 6 below.

These results do not include the effects of "indirect taxation", those taxes and licensing fees paid by businesses that are passed on to individuals through increased consumer prices.

A rough estimate by the Fair Tax Commission Secretariat indicates that this type of indirect taxation is between 0% and 5% of total household income in Ontario. The extent to which this burden is passed on to consumers depends on, for example, whether Ontario businesses are able to include local taxes in their export prices, or corporate profits are passed on in the form of higher returns on investment for pensioners.

Figure 6
Average Dollar Amounts of Total Taxes Paid by Ontario Households, 1991



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.
Note: These amounts are averages: they can be higher for some households and lower for others.

The amount of tax paid increases with household income. However, absolute dollar amounts paid in taxes provide no indication of the relative share of the burden borne by households at different income levels.

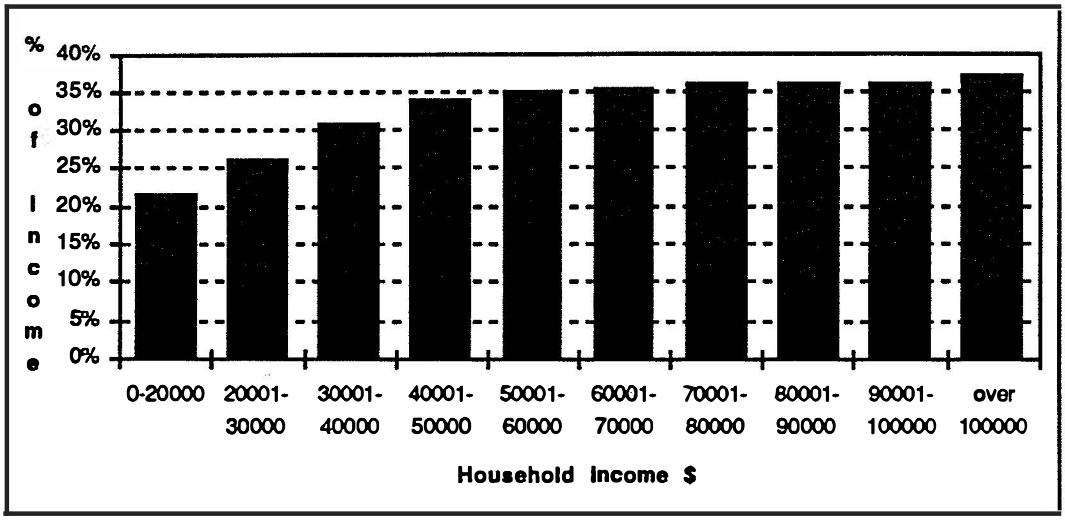
4.1.6 Overall Tax Burden

Figure 7 shows for 1991 the proportion of income paid in total taxes, i.e., the tax burden, for Ontario households at different income levels. Those with incomes below

$50,000 paid 22 to 34 cents in total taxes out of each dollar of income. For each dollar of income above $50,000 they contributed about 35 to 37 cents.

The increased Ontario surtaxes announced for 1992 and 1993 tax years will add to the tax burden of households at the high-income levels ($60,000 and over). A rough estimate by the Fair Tax Commission Secretariat shows that the increased tax burden will be one to two percentage points. Contributions to Canada Pension Plan and Unemployment Insurance as well as property taxes will likely also increase. This will add to the tax burden of households at the low to modest income levels. Thus, there will be little relative difference in the tax burdens borne by each income level.

Figure 7
Estimated Total Tax Burden for Ontario Households, 1991



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

Note: These amounts are averages: some households bear a higher tax burden, others, a lower tax burden. The taxes used in the calculations comprise the federal and provincial income taxes; contributions to Canada Pension Plan and Unemployment Insurance; the federal goods and service tax (GST); the provincial retail sales tax; federal and commodity taxes on gasoline, fuel, tobacco and alcohol (including provincial liquor board mark-ups); federal air transportation tax and customs duties; and property taxes. The tax burden is estimated after adjusting for all the surtaxes, deductions and credits for federal and provincial income tax purposes, including the Ontario Tax Reduction program, the GST Credit, and the Ontario Property and Sales Tax Credits (property and sales tax grants for seniors). It is assumed that all property taxes are passed on to tenants through their rents.

As income rises, the tax burden does not always increase significantly. For example, when the income level goes up 100% from $20,000 to $40,000, the tax burden increases by about 55%. When the income level rises again 100% from $40,000 to $80,000, the tax burden hardly changes. This indicates that there is little progressivity beyond the $40,000 income level.

This conclusion is based on, among other things, our assumption that all property taxes are passed on to tenants through their rents. Such an assumption is consistent with the Ontario Rent Review Hearings Board's practice of taking into account the landlord's property tax bill in full in determining the legally acceptable rents. However, our conclusion remains the same, even when we change our assumption to only half of the property tax being passed on to the tenant, as illustrated in Figure 5b in Appendix 1.

Our findings suggest that low-income people bear a significant tax burden and that the overall tax structure appears not to be progressive beyond the $40,000 income level.

4.2 Tax-Delivered Assistance

Not all the provisions in the personal income tax system are designed to raise revenue. Some of them, such as deductions and credits, relieve the taxpayer of some of the tax that the person would otherwise have to pay. Such provisions are what we call tax-delivered assistance.

Tax-delivered assistance exists for people at all income levels. Since our concern is with low-income individuals and families, we focus only on the major Ontario tax relief programs, the Ontario Tax Reduction program and Ontario Property and Sales Tax Credits, and on the federal GST Credit.

4.2.1 Objectives of Tax-Delivered Assistance

There are three broad objectives of tax-delivered assistance:

1) The first is to recognize ability to pay. The underlying assumption is that people need a certain amount of income to live on. Their ability to pay tax is reduced when they are supporting dependants or have special needs associated with disability. Provisions in the tax system designed to meet this objective are the following federal non-refundable tax credits: the basic personal amount, the married amount, the equivalent-to-married amount, the amounts for dependants and the disability amount. The Ontario Tax Reduction program also meets this objective by reducing the provincial income tax payable by low-income taxfilers.

2) The second objective is to encourage specific activities and subsidize specific expenditures. Examples include annual deductions such as those for contributions to registered retirement savings plans, taxable capital gains and child care expenses.

3) The third is to deliver benefits specifically to low-income families, for example, the current federal refundable Child Tax Credit and GST Credit, as well as the Ontario Property and Sales Tax Credits.

Most of the current tax-delivered assistance provisions are federal. The tax collection agreement between the federal government and Ontario allows the federal government to say what must be included in taxable income, what can be exempted from income before tax is calculated, what tax rates apply to the resulting taxable income, and under what circumstances the amount of tax owing can be reduced or offset.

Ontario can negotiate with the federal government for specific tax measures in relation to the province's own personal income tax. For example, Ontario has been allowed to levy a surtax on high-income earners, and provide its own tax relief programs to low-income individuals and families.

Thus, tax-delivered assistance objectives are met both by reducing taxes otherwise payable and by using the tax system to make direct payments to qualifying taxfilers. Both approaches have a cost. A dollar not collected costs the same as a dollar spent by government. For example, for the 1991 tax year, taxes not collected because of the Ontario Property and Sales Tax Credits cost Ontario about $404 million. Similarly, the federal tax deduction for child care expenses cost Ontario about $64 million.[9]

4.2.2 Income Tax Thresholds

The income tax structure implicitly sets an income tax threshold. This is the lowest level of personal income that is taxed. The combined effects of tax rates, tax brackets and tax-delivered assistance determine the income tax threshold.

Any change in any of these provisions alters the income tax threshold. The following section highlights the effect of the Ontario Tax Reduction (OTR) program on the Ontario income tax threshold. Other sections of our report comment on the fact that elements in this provision, and others, are not fully adjusted to reflect changes in the cost of living, with the result that income tax thresholds drop automatically over time.

The lack of full indexation depresses the income tax thresholds deeper and deeper below the poverty line. Ever more poor people are drawn into the income tax net.

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9 Estimates from Tax Policy Branch, Ministry of Treasury and Economics.

4.2.3 Ontario Tax Reduction

The Ontario Tax Reduction (OTR) program reduces or eliminates the Ontario personal income tax otherwise payable by lower income taxfilers.

For instance, in 1991 taxation year, the OTR reduced the tax of a single parent with two young children by $167 for herself, another $350 for each of her children, to a maximum total deduction of $867. If such a person's total Ontario income tax is $867 or less, she will pay no such tax. This provision is effective in reducing tax on a sliding scale until her Ontario tax payable reaches $1,300, the tax on an annual income of $22,500.

The end result of the OTR is to raise the income tax threshold chiefly by adding a range of marginal tax rates within the lowest income tax bracket, from 0% up to the first combined federal-provincial marginal rate of 26.01% for the 1991 tax year.

Table 4 shows the effect of the OTR on Ontario income tax thresholds, together with the after-tax poverty lines as benchmarks. In spite of OTR, people living below the poverty line pay both Ontario and federal personal income taxes.

Table 4
Personal Income Tax Thresholds and After-Tax Poverty Lines in 1991 Ontario

Household Type	Federal Tax Threshold[1] 1991	Ontario Tax Threshold[2] 1991	After-Tax Poverty line[3] 1991
Single, Under Age 65	$6,532	$8,477	$12,602[7]
Couple, No Children	$12,371[4]	$14,295[4]	$17,088[7]
Sole-support Mother with Children	$11,601[5]	$21,710[5]	$22,121[7]
Couple with Children	$12,028[6]	$22,136[6]	$26,020[7]

Source: Compiled by Fair Tax Commission Secretariat.

Notes:
1) Federal tax threshold is the earnings at which federal income tax (before adjusting for the federal sales tax credit and child tax credit) equals one dollar.
2) Ontario tax threshold is the earnings at which Ontario income tax, after the Ontario Tax Reduction, is one dollar. This is before the Ontario Sales Tax and Property Tax Credits.
3) Statistics Canada's 1986-based after-tax low income cut-offs for an urban residential area with a population over 500,000 are used. All other poverty lines for other residential areas with smaller population sizes are lower.
4) For a two-earner couple without children.
5) For a sole-support mother with two children.
6) For a one-earner couple with two children.
7) For households of one, two, three and four persons respectively.

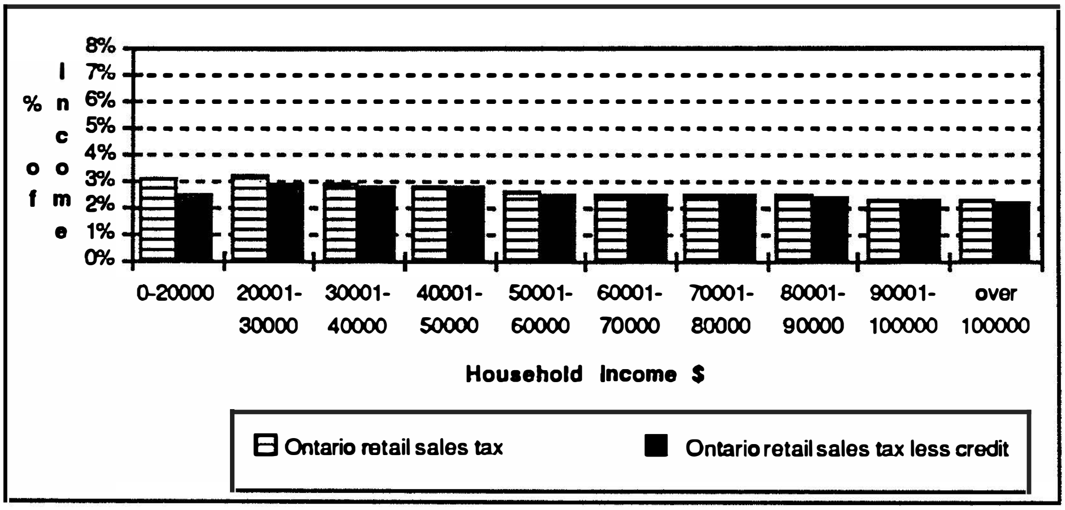
4.2.4 Ontario Property and Sales Tax Credits

The Ontario Property and Sales Tax Credits are designed to relieve the burden of these taxes on low-income individuals and families. They are administered as a single combined credit. Taxpayers calculate their entitlement to the credits separately and then combine the results to arrive at the credit. They must file an income tax return to claim the credit. The resulting federal income tax assessment acknowledges Ontario's property and sales tax credits.

Because income tax returns are filed on an annual basis and there is a time lag in processing them, it can be 12 months or more between the time that taxpayers pay sales and property taxes and the time they receive the tax relief to which they are entitled.

Figures 8 and 9 below show the extent to which these sales tax and property tax credits offset the impact of the taxes on households at various income levels.

Figure 8
Effect of Sales Tax Credit in Offsetting the Retail Sales Tax Paid by Ontario Households in 1991[10]



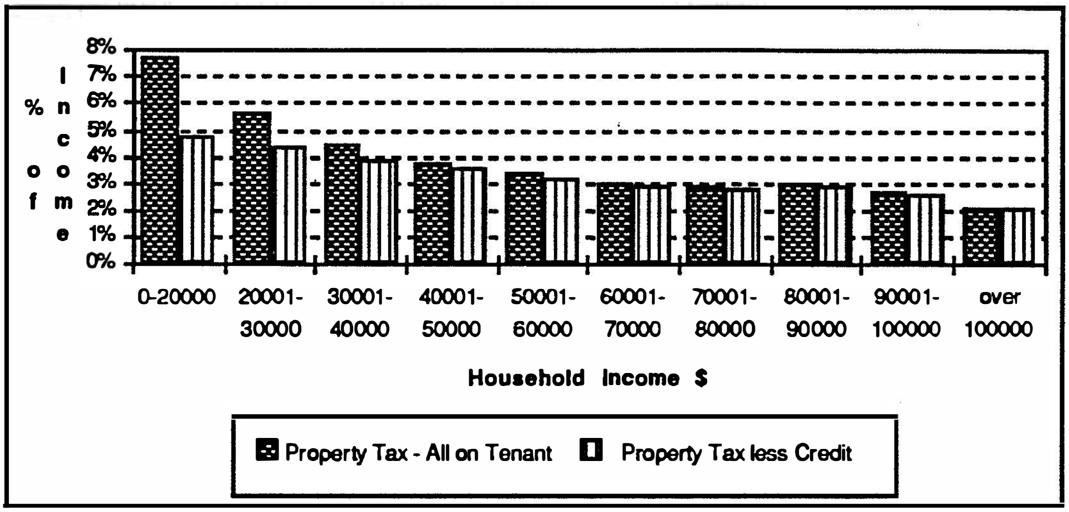
Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

10 This analysis involved estimating the part of the combined sales tax and property tax benefit received that could be attributed to each of the sales tax credit and the property tax credit respectively. This was done by first adding together the amounts reported on the income tax returns for property tax credit and sales tax credit respectively. This then enabled the calculation of the respective share of each of the reported sales tax credit and property tax credit amounts. These percentages were subsequently applied to the combined benefit amount that was paid out, to obtain separate benefit amounts for the sales tax credit and property tax credit. It should be noted that this formula was adopted here for illustration purposes, and that other allocation formulae could be used.

Figure 8 shows that the sales tax credit reduces the regressivity of the Ontario retail sales tax on households with incomes below $60,000. In contrast, households with incomes above $60,000 experience the full impact of the retail sales tax.

Low-income people spend on average a relatively higher proportion of their income on consumption than high-income people. They have to do so to purchase necessities. Among such necessities, basic groceries are exempt from the retail sales tax, but prepared foods priced over $4 are not, nor is clothing for adults.

Figure 9
Effect of Property Tax Credit in Offsetting the Property Tax Paid by Ontario Households in 1991[11]



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

As with sales tax credits, property tax credits do not fully offset the impact of property taxes on low-income households. A significant property tax burden is still borne by households with average incomes of $20,000 and less. Moreover, they are paying a greater share of their income in property taxes than high-income households, even after credits are paid.

This conclusion is based on, among other things, our assumption that all property taxes are passed on to tenants through their rents. Such an assumption is consistent with the Ontario Rent Review Hearings Board's practice of taking into account the landlord's property tax bill in full in determining the legally acceptable rents. Our conclusion remains the same even when we change our assumption to only half of the property tax being passed on to the tenant, as illustrated in Figure 5a in Appendix 1.

[11] See preceding footnote.

Shelter costs, like the costs of food and clothing, on average require the spending of a relatively higher proportion of income for low-income people compared to high-income people.

Because they all contribute to the single amount on the income tax refund cheque from the federal government, the extent to which the Ontario Tax Reduction and the Ontario Property and Sales Tax Credits contribute to an income tax refund may not be evident to the average taxpayer.

4.2.5 GST Credit

The federal goods and services tax (GST) credit, like the provincial retail sales tax credit, also tends to reduce some but not all of the regressivity of the GST on low-income households in Ontario, as illustrated in Figures 6a and 6b in Appendix 1.

4.3 Disincentives to the Working Poor

The tax system currently treats the welfare poor and the working poor differently. "Welfare poor" refers to individuals and families whose primary source of income is social assistance.

Unlike earned income, social assistance payments are not subject to income tax. For income tax purposes, the same amount of income is thus treated differently according to its source.

As a result of the 1988 federal tax reform, social assistance is now counted as part of "net family income" for the purpose of determining entitlement to certain tax credits such as the federal refundable child tax credit, the GST credit and the Ontario Property and Sales Tax Credits. This reflects a move by the federal government toward a broader definition of income.

Welfare poor who are able to work find that for each dollar they earn (above an exempt level), they must pay income tax as well as contributing to the Canada Pension Plan (CPP) and Unemployment Insurance (UI). Furthermore, for each dollar that is left, their social assistance (General Welfare, or Family Benefits) is reduced by up to 75 cents. Until 1989, benefits were reduced by as much as one dollar for every dollar earned above a certain ceiling.

The net effect for a sole-support mother with two children on Family Benefits who earns $22,000 annually now is that every dollar earned can cost her as much as 88 cents,thus giving her a great disincentive to work. The combined effect of the social assistance benefit reduction rate together with the income tax rate, CPP and UI contributions, and the loss of in-kind benefits (prescriptions drugs, dental care, eye-glasses) is often referred to as the "poverty trap". Ontario's Social Assistance Review Committee (1988) recommended the social assistance reduction rate on earnings be reduced further—to 66.66%—to help people escape the poverty trap.

The tax system thus interacts with social assistance to create barriers for the welfare poor who wish to make the transition to gainful employment. Tax benefits that are determined on the basis of taxable income assist the working poor, but not the welfare poor who have no earnings. On the other hand, the working poor must pay income tax on their earnings while social assistance payments are not taxable.

4.4 Redistributing Income through the Tax System

The effect of designing the tax system to take account of ability to pay results in redistributing income from those who have much to those who have little. However, for low-income people, the tax system plays a lesser role in income redistribution than the transfer system, as shown in Figure 10.

Figure 10 compares pre-tax "market income" with pre-tax "total income" and with the total after-tax "net income", as defined below:

(i) Pre-tax "market income" earned by all individuals in Ontario includes income earned in the market economy, such as wages and salaries, income from self employment, investment and other private sources of income. It excludes transfer payments.

(ii) Pre-tax "total income" includes market income and transfer payments of all Ontario individuals. Transfer payments include Family Allowances, Old Age Security, Guaranteed Income Supplement, Spouse's Allowance, Canada Pension Plan and Unemployment Insurance payments, refundable Child Tax Credit, federal and provincial sales tax credits and social assistance payments.

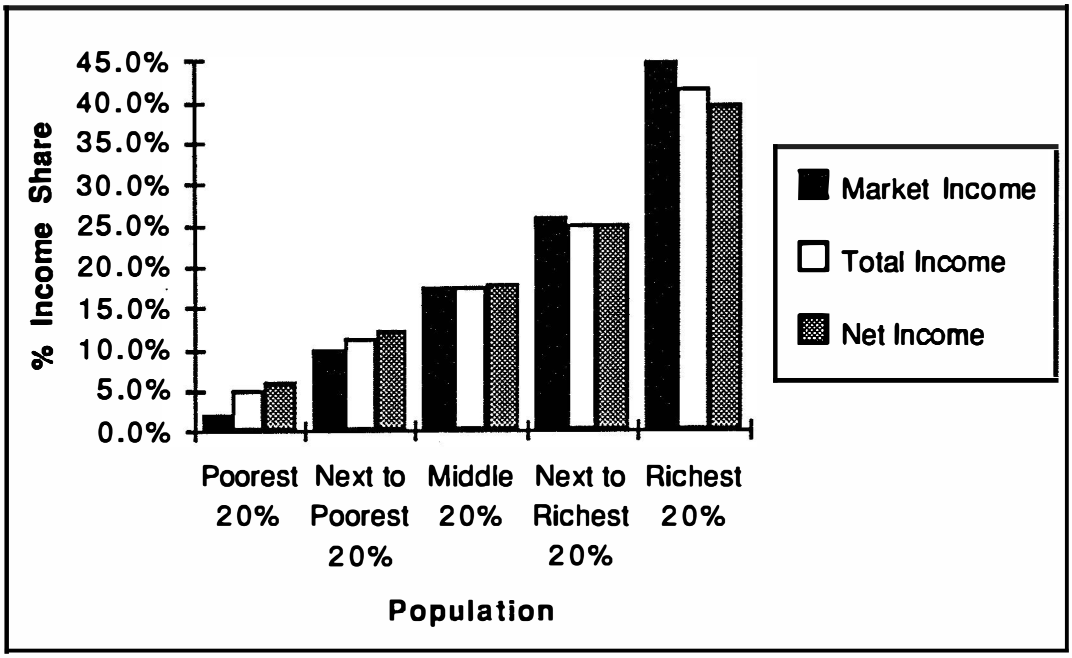
(iii) total after-tax "net income" of all Ontario individuals is market income plus transfer payments less federal and provincial income taxes.

The black bars in the figure represent "market income". The white bars represent "total income". The grey bars in the figure represent after-tax "net income".

In Figure 10, Ontario individuals have been divided into five groups or quintiles. Each quintile contains the same number of individuals and represents 20% of all Ontarians according to their levels of income, from lowest or "poorest" to highest or "richest".

If a particular group of individuals has a greater or lesser percentage of "market income" than that group's share of "total income", then the transfer system has resulted in some redistribution of income. Similarly, if a particular group's percentage of "total income" is greater or less than that group's percentage of after-tax "net income", then the tax system has resulted in some redistribution of income.

Figure 10
Income Shares of Quintiles
Ontario, 1991



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1989 Survey of Consumer Finances Micro-Data Files.

The poorest quintile of the Ontario population earned about 2.1% of the total market income in Ontario in 1991, had about 5.1% of total income (including transfer payments) and about 6% of after-tax income. The transfer system added to the low income group's share by a full three percentage points, while the tax system added only .9 percentage points. Each percentage point was worth about $1.75 billion in 1989. Conversely, the tax-transfer system removed from the richest quintile of the Ontario population a small share of their market income.

The transfer system has a more marked effect on the low-income group's share of income than the tax system. This difference between the transfer system and the tax system is not as great for the other quintiles.

Therefore, the tax system currently contributes only marginally to improving the lot of low-income people. Clearly, the system can be improved.

5. RAISING REVENUES IN A FAIR WAY

Low-income people are particularly vulnerable to unfairness in the tax structure. The tax system is unfair when it takes money from people below the poverty line, when it takes money from them when they can least afford to pay it, and when it fails to treat people in similar circumstances the same way.

5.1 Where Income Taxes Should Start

The point where federal income tax becomes payable is far below the poverty line. In fact, Canadians are expected to pay federal taxes when their income is about half the amount they need for a minimum living standard. Although the point at which Ontario income taxes are payable is still below the poverty line, it is not as unfair as the federal system.

The dilemma for us was whether we should recommend that the provincial Treasurer enrich the Ontario Tax Reduction program, knowing full well that such a move would reduce pressure on the federal government to make the national tax system fairer.

On balance, we felt that federal income taxes are assessed at income levels so far out of line with economic reality, that the focus must be on pressing the federal government to rectify this unacceptable situation. The immediate remedy would be for the federal government to introduce a measure similar to the Ontario Tax Reduction program.

We suggest that the after-tax version of Statistics Canada's low income cut off be used as an income adequacy benchmark for a personal income tax threshold. Statistics Canada produces this after-tax low income cut-off by subtracting from the normal (pre-tax) low income cut-off, the income tax which people are estimated to be paying when their income is at the cut-off level. (For a comparison between pre-tax and after-tax low income cut-offs for selected household sizes, please see "Measuring Poverty" in Appendix 1).

Two other measures of poverty are currently in the developmental stage. One is the Low Income Measure which Statistics Canada is considering as a possible substitute for the low income cut-off. The other is the market basket approach to setting social assistance rates which has been recommended to the Ontario Minister of Community and Social Services for inclusion in a new social assistance legislation. (For further details, please see "Measuring Poverty" in Appendix 1).

We urge the Treasurer to consider all approaches when setting benchmarks for personal income tax thresholds, bearing in mind fairness as the key criterion.

RECOMMENDATION 1:

A. Families and individuals with inadequate incomes should not pay personal income taxes to either the federal or provincial government.

B. Statistics Canada's after-tax low income cut-off should at present be used by both the federal and Ontario governments as the measure of adequacy of income.

C. If new social assistance legislation for Ontario is enacted which uses a market basket approach to adequacy of income, this approach should be reviewed by the government of Ontario as a possible substitute for the after-tax low income cut-off.

D. The federal government should adopt a tax measure similar to the Ontario Tax Reduction program.

E. In the interim, the Ontario Tax Reduction program should be further enriched to assist families with incomes below the prevailing measure of adequacy of income. It should also be fully protected from the effects of inflation.

5.2 A Fair Marginal Income Tax Rate for Low Income People

People with incomes just above the poverty line are currently taxed by the federal government at a marginal rate of 17%. The Ontario government's first marginal tax rate is 9% (53% of 17%), excluding the effects of the Ontario Tax Reduction. Consequently, the combined federal/provincial marginal tax rate for many low-income people is 26%.

A measure such as the Ontario Tax Reduction (OTR) program raises the provincial income tax threshold for only those with the lowest incomes. However, it phases out too quickly, and leaves many low-income people subject to taxation at high marginal rates.

The simplest solution is to restore a more graduated set of marginal tax rates. The Ontario government cannot do it alone. The federal-provincial tax collection agreement prevents Ontario from setting a marginal rate structure which deviates significantly from the federal structure. The OTR thus can never really help significant numbers of lower-income taxpayers in Ontario. Until the agreement is revised to permit Ontario to set its own marginal rate structure, the OTR's "band-aid" effect will continue.

If the federal government will not revise its marginal tax rates, Ontario must negotiate for the flexibility to set its own income tax structure.

Administering a broader range of marginal rates does not pose a significant problem. The majority of low-income people are wage-earners, whose taxes are withheld at source by the employer. Additional tax brackets should not constitute an added administrative burden for employers, regardless of whether the withholding is being done using manual payroll deduction tables (in which marginal rates are precalculated) or a computer program.

RECOMMENDATION 2:

A. The federal and Ontario governments should cooperate to reduce marginal tax rates for people with low to moderate incomes.

B. If the federal government will not reduce these marginal rates, Ontario should negotiate for the flexibility to set its own marginal rate structure and proceed to reduce Ontario marginal rates for low to moderate income people.

5.3 Reducing Reliance on Regressive Taxation

The personal income tax is inherently progressive, while retail sales and property taxes are not. Sales taxes are levied at a flat rate. Property taxes are assessed on the value of property held by individuals, some of whom may have very little income or are on fixed incomes.

To offset the burden which sales and property taxes place on low-income people, Ontario has instituted a combined property and sales tax credit. It has also exempted many items from the retail sales tax.

Sales Taxes

Poor people have to spend a greater proportion of their limited income on necessities. The province taxes fewer necessities than the federal government. The retail sales tax has a much narrower base than the federal Goods and Services Tax (GST). It does not tax most services, though many are subject to GST. It does not tax necessary items such as children's clothing, shoes $30 and under, feminine hygiene and books.

A minority of us believed that we would have a far simpler and more efficient tax system if Ontario were to eliminate sales taxes entirely and raise personal income tax rates to achieve the equivalent dollar yield. Eliminating the retail sales tax would, however, constitute an enormous change in the "tax mix". This, together with the difficult fiscal situation of the province, led a majority of us to conclude that now is not the time for such large scale changes.

It might be argued that the sales tax should remain as is, except that low-income people should be exempted from having to pay it. This would require an administrative structure to measure eligibility for exempt status and to issue some form of exemption card. Such cards would stigmatize low income people. We rejected this approach.

Another approach would be to broaden the retail sales tax base, while reducing the rate. This has been considered an interim step by some whose longer-term goal is to eliminate the retail sales tax.

Most of us felt that Ontario should in the long run reduce its reliance on sales taxes relative to income taxes. However, in the short run, the Sales Tax Credit must be increased.

The current $100 per person sales tax credit reduces a low income person's burden to zero, provided yearly purchases of taxable items do not exceed $1250. A preferable approach would be to relate the amount of the credit to a non-discretionary basket of taxable goods and services which a person might be expected to purchase in order to maintain a minimum standard of living. Statistics Canada's after-tax low income cut-off could be used as a benchmark until such time as agreement is reached on a new social assistance market basket.

Such an approach should also be applied to the federal goods and services tax credit.

RECOMMENDATION 3:

A. *Ontario should reduce reliance on sales taxes through successive reductions in the sales tax rate over time. (*)*

B. *The Ontario Sales Tax Credit should be increased and fully protected from inflation.*

C. *If new social assistance legislation adopts a market basket approach to adequacy of income, the amount of sales taxes paid on the items in the basket should be viewed by Ontario as a potential benchmark for the amount of the sales tax credit.*

D. *The federal Goods and Services Tax Credit should be increased and fully protected from inflation.*

Property Taxes

As with sales taxes, we examined the possibility of reducing reliance on property taxes and increasing reliance on income taxes for revenue-raising purposes. Even after credits are paid, property taxes appear to be more regressive than sales taxes.

We agreed that current economic conditions preclude a massive shift from one tax base to another. Since property taxes are being reviewed by another working group appointed by the Treasurer, we do not recommend specific large-scale moves to reduce overall property taxes.

Some of us argued that, since many low-income people live in rented accommodation, the Property Tax Credit is nothing more than a rental supplement. A minority would therefore prefer to replace the Property Tax Credit with some form of direct assistance such as a direct grant or more affordable housing.

The majority, however, felt that it would be a reasonable target in the short-term for the Treasurer to adjust the property tax credit to equalize the proportion of income paid in property taxes across the different income levels.

RECOMMENDATION 4:

- *The Ontario government should increase the Property Tax Credit and fully protect it from inflation. (*)*

5.4 Inflation Protection

One of the reasons Canadians far below the poverty line are paying income taxes is because people are not fully protected against the hidden effects of inflation in the personal income tax system. Within the provincial personal income tax system, tax credits and associated thresholds are raised only when the government decides to do so, not automatically in relation to increases in the cost of living.

Since 1986 , the federal government has used a formula for adjusting its tax brackets, tax credits and associated thresholds. It increases them by the percentage that the annual inflation rate exceeds 3%. The same partial indexation formula applies to the income threshold above which Old Age Security (OAS) benefits have been recovered or "clawed-back" in part or in full from higher income seniors since 1989. If inflation is more than three percent, then tax brackets, tax credits and their thresholds, and the OAS claw-back decline in value by three percent in real terms. If inflation is less than three percent, they fall by the amount of inflation.

While the lack of full indexation obviously has negative implications for all taxpayers, the effects on low-income people are most acute. It results in automatic, hidden income tax increases each year and depresses the income tax threshold deeper and deeper below the poverty line, pulling increasing numbers of poor people at ever-lower income levels into the income tax system. Over time, it erodes the value of tax credits and depresses the OAS clawback and the income thresholds at which tax credits are reduced; greater numbers of low-income seniors and families receive lesser benefit amounts.

We feel strongly that inflation protection must be restored throughout the personal income tax system. In fact, if this is not done, much of the benefit to low-income taxpayers derived from other recommendations will simply disappear over time.

RECOMMENDATION 5:

- *People should be fully protected from the hidden effects of inflation in the personal income tax system. The federal and Ontario governments should fully index the income tax brackets, tax credit amounts and income thresholds for tax credit calculations.*

5.5 Unit of Taxation: Individual vs Family

Should the personal income tax be calculated on the income of the individual, or should the income of a spouse or other family members be taken into account in some way?

The income tax in Canada is levied on the individual. However, as in the case of the Ontario Property and Sales Tax Credits, net family income is used in the calculation of tax benefits to low-income households. If this were not so, a couple might receive benefits, even though one of them had a high income.

To avoid this, we believe benefits should be calculated on a household basis. Treating the household as a single economic unit maintains harmony between the tax and the social assistance systems.

RECOMMENDATION 6:

- *The tax unit for raising revenue should continue to be based on the individual. However, the Ontario Tax Reduction program and any similar measure in the federal income tax legislation should be based on family income.*

5.6 Getting Refunds and Credits Quickly

The tax system can create significant cash flow problems for low-income people, whether they are working or on social assistance.

Employed persons have their income taxes withheld at source in amounts which are usually greater than their ultimate tax bill. They are thus eligible for a refund. Interest on refunds is paid to the taxpayer only for the time period between the due date for filing a return and the payment of the refund. There is no interest paid on the amount that was over-deducted throughout the tax year. In light of this, the government should at least process tax refunds as quickly as possible.

People on social assistance also have an interest in the speed with which their tax returns are processed as they are likely to be entitled to receive Ontario Property and Sales Tax Credits. Depending on their circumstances, these can be large relative to monthly incomes.

Given the importance of timing to low-income people, many use the services of professional firms to prepare their tax returns. Some tax preparers give their clients their anticipated refunds less a percentage. Low-income people really cannot afford to lose any part of their rebate or credit.

The federal government has moved to recognize the importance of having a tax return which is accessible to all and which can be processed quickly. To that end, the T1 short form was introduced for the 1990 tax year; it requires no calculations. Taxfilers complete the return, attach any supporting information, and mail it in. Calculations are done by federal employees and a rebate can be processed in as little as three weeks.

Unfortunately, this short form is not used extensively at present. This appears to indicate a need for more publicity concerning its merits. Both the federal and Ontario governments can play a role. Ottawa can do more direct advertising, as well as include inserts with the cheques sent as quarterly GST credits to low-income people. These inserts would remind people of the ease and simplicity of the short form system, as well as the speed of processing. Ontario could include a similar insert in its monthly cheques to social assistance recipients and seniors on GAINS-A.

RECOMMENDATION 7:

A. *The federal government should further publicize and promote the benefits of the short form of the income tax return and increase public awareness that refunds are now paid more quickly.*

B. *The Ontario government should inform all social assistance recipients and seniors receiving a monthly supplement (GAINS-A) that the short form may be of benefit to them.*

5.7 Recognizing the Cost of Raising Children

Parents of dependent children have less ability to pay taxes than those without.

The new federal Child Tax Benefit eliminates the non-refundable tax credit for dependent children. Yet, the non-refundable married tax credit is being retained for a dependent spouse. And single parents continue to benefit from the "equivalent-to-married" non-refundable tax credit in recognition of the cost of raising one child.

Some of us felt that there is no defensible rationale for recognizing economically dependent spouses in the personal income tax system for all taxpayers (i.e., including middle- and upper-income taxpayers) and not recognizing economically dependent children. Others disagreed and opted for a simpler system giving no recognition to differences in ability to pay.

Most of us in the working group preferred to retain and restore special provisions to recognize the reduced ability-to-pay among taxpayers supporting spouses and children.

RECOMMENDATION 8:

A. *The federal and the provincial personal income tax systems should provide fair recognition of fundamental differences in ability to pay among various groups of taxpayers, such as those raising children and those not raising children.*

B. *The federal government should re-introduce non-refundable child tax credits. (*)*

5.8 Tax Treatment of Social Assistance

Social assistance payments are not subject to income tax, but earnings are. This results in inequities.

To illustrate, consider a single person who worked for the first four months of the year and earned $6000, went on unemployment insurance for the next four months and received $4000 and then went to social assistance for the final four months of the year and received $2000. The total income would be $12,000, but only $10,000 of it would be considered as income for tax purposes. Another person could have worked continuously through the year and earned $12,000 and would have to declare it all as income for tax purposes.

Fears have been expressed that taxing social assistance payments to correct this unequal treatment could harm social assistance recipients. Underlying these fears is the fact that social assistance payments do not even represent a subsistence level of income.

We believe that an important element in solving this dilemma is to raise the personal income tax threshold to a suitable measure of income adequacy.

The Fair Tax Commission is studying the relationship between the tax system and social assistance system. The issue of the taxation of social assistance should be considered part of this review. In fact, such a study should examine all transfer programs providing people with the necessities of life, including housing subsidies and drug benefits.

We urge the Fair Tax Commission to make recommendations on the current tax treatment of social assistance with a view to reducing work disincentives and inequities between welfare poor and working poor.

6. USING THE TAX SYSTEM TO DELIVER BENEFITS TO LOW-INCOME PEOPLE

The benefit-delivery components of the tax system must also be fair. The point where tax benefits are paid must be harmonized with the point where taxes cease. Tax benefits should be paid when people need them the most. Tax benefits that accrue disproportionately to higher-income taxpayers are not fair.

6.1 Fairness in Refundable Tax Credits

Refundable tax credits result in direct payments or reductions of taxes otherwise payable.

Their very existence warned us that the tax system was trying to alleviate an undue burden it was causing elsewhere. Giving a sales tax credit admits that a person has been "over-taxed" throughout the year. Refundable tax credits, almost by definition, address symptoms, not underlying causes.

Should we accept the existence of tax credits as a way of making up for shortcomings in the system, or should we address the shortcomings themselves? On balance, the most practical route seemed to be one whereby credits should, in the interim, be enhanced to do their intended job of fully correcting injustices.

Refundable tax credits are generally geared to people with low income. They therefore imply an income level or threshold below which people qualify for the credit. Currently, there are a number of different thresholds in use in both the federal and the provincial tax systems. In the interests of symmetry, simplicity and fairness, we recommend that the thresholds should be same for both the imposition of tax and the generation of refundable tax credits.

RECOMMENDATION 9:

- *The threshold for federal and Ontario refundable tax credits (the income level at which they start to be reduced) should be set at least equal to the measure of adequacy of income. The measure of adequacy should be Statistics Canada's after-tax low income cut-off or a market basket measure if agreed on in new social assistance legislation.*

6.2 Timing of Tax Benefit Payments

Currently, Ontario's Property and Sales Tax Credits are paid only once a year as part of the income tax refund process. This means recipients may have to wait up to 15 months between the time they pay a property tax instalment or sales tax on a purchase, and the time they actually receive payment of the refundable tax credit. This creates a cash flow problem for low-income people.

Payment of sales and property tax credits on a quarterly basis would greatly reduce this problem. The federal government has demonstrated that the additional administrative burden is manageable by paying the GST Credit on a quarterly basis, based on prior year returns.

In our consultation sessions with low-income people, the frequency of payments was raised as an issue. Opinions varied about whether it was preferable to receive payments in single larger amounts or in instalments throughout the year. Some viewed the large payments as a form of savings which could be used to purchase more expensive necessities. Others felt it was important to get their payments as soon as possible. Many suggested the tax system should let people choose for themselves.

RECOMMENDATION 10:

- *The Treasurer of Ontario and the Ontario Minister of Revenue should examine the feasibility of making tax credit payments on a quarterly or annual basis, based on recipients' preferences. Where the recipient chooses an annual payment, interest should be paid as if the recipient's entitlement accrued quarterly.*

6.3 Child Care Expenses

Qualifying child care expenses are deductible in determining taxable income. Deductibility is based on the premise that arranging for the care of children is essential in order to allow the parents to work and earn income. In the case of a couple, the deduction may be claimed only by the spouse with the lower income.

Low-income parents often have to rely on unlicensed and informal child care arrangements. They therefore do not have the required receipts to be able to claim the deductions.

Some of us see the problem as a shortage of subsidized child care spaces and are therefore in favour of the expansion of a publicly funded child care program. Others in our group noted that Ontario is already adding another 20,000 subsidized spaces, as announced in its 1992 Budget. This represents a 40% expansion.

We all agreed that tax deductions are unfair, since they result in tax savings which increase as taxable income increases. In contrast, non-refundable tax credits reduce the amount of tax owing by the same amount at all income levels. A move to a tax credit approach would therefore provide improved equity.

RECOMMENDATION 11:

- *The federal government should convert the deduction for child care expenses to a non-refundable tax credit.*

6.4 Child Support Payments

When parents separate, a supporting parent may deduct support payments paid in accordance with a court order or separation agreement. The recipient parent must pay tax on such payments. Through our consultation sessions with low-income people, the question was raised whether this tax treatment is fair.

Some of the individuals consulted felt that it was unfair that, for example, a mother with dependent children who is struggling to get by on limited resources should have to pay tax on what might already be an inadequate amount of support payments. The highlights of our discussion on this issue are in Appendix 1.

We did not arrive at a consensus regarding changes in the tax provisions that would help low income parents. We therefore have no recommendation on this issue.

7. TOWARD A CONCERTED ANTI-POVERTY STRATEGY

Participants in our public consultation confirmed our view that meaningful tax policy must be discussed in conjunction with other anti-poverty policies. Their problems of poverty cannot be addressed by the tax system alone. At the same time, they are so close to the margin that any unfairness in the tax system is unbearable.

In summary, they told us:

1) They do not have adequate resources to raise children or care for other family members at home.
2) People with disabilities need better information about how to access support programs and take advantage of tax exemptions and benefits.
3) Elderly persons on fixed incomes worried about being able to live with dignity in their own homes.
4) Social assistance recipients were preoccupied with the way the different social support programs can interact to their disadvantage.
5) Those who want to work cannot afford work-related expenses or upgrade their skills.

Our attempts at addressing these concerns led us to explore the philosophical basis for providing assistance and relief measures outside the tax system. There are many programs which exist to address the problem of poverty. Unfortunately they are not always designed to work together efficiently. There are instances where programs are working at cross purposes.

Our assessment of the the tax burden on low-income people has led us to ponder aspects of the tax system that interact with the income security system, other social welfare programs and other policy measures in addressing the problem of poverty. It became obvious to us that a more co-ordinated design of the various programs for low-income people would contribute greatly to their overall effectiveness.

Tax policy is only one element of the complex mix of broader social and economic policies. We have concluded that without full employment at adequate income levels, we will not make fundamental progress in fighting poverty.

7.1 Philosophical Basis for Providing Public Assistance

Our discussion of the philosophical basis for providing public assistance spanned the traditional continuum between "universal" benefit programs and "targetted" benefit programs. "Universal" benefits are paid to specific categories of people regardless of their income. "Targetted" benefits are paid to people who satisfy a test to establish their need for public assistance.

Universal programs reflect values of equal rights and opportunity, social cohesion, and economic stabilization in the face of what many believe has been the failure of the market economy to meet social needs and provide economic equity. Their universality engenders broad public support. They do not stigmatize. On the other hand, universal programs are widely believed to be more costly.

Targetted programs have their historical roots in charitable relief to the poor. Today they are seen as an efficient way to allocate scarce resources to the most needy. Targetted programs are criticized because they attempt to distinguish between the deserving and the undeserving. They can also result in high implicit marginal tax rates for low-income workers.

Targetted programs can be fitted within a universality framework to curb costs with minimum violation of the concept of citizens' rights and maximum benefit where it is really needed.

There are different approaches and philosophical bases that people rely on to determine when to use universal or targetted programs, or when to use tax expenditures or direct spending programs to accomplish social objectives. Our consideration of when to use or not use the tax system to deliver benefits concluded that while there is no formula, there are key criteria to bear in mind:

- Are benefits accessible?
- Are benefits free from stigma?
- Are benefits adequate?
- Are benefits responsive to changing needs?
- Are benefits delivered in a cost-efficient manner?
- Is the program simple to administer?
- Is there accountability to the public?

If the tax system is to be an effective part of the income security system, it has to be flexible enough to recognize people's changing circumstances in a timely manner.

7.1.1 The New Federal Child Tax Benefit

In its February, 1992 Budget, the federal government announced a new Child Tax Benefit, to come into effect January 1, 1993. It will be paid monthly, usually to the mother, based on family income reported in the previous year.

The benefit will not be taxed, i.e., will not be added to the calculation of net family income for tax purposes or recovered through the tax system. It will replace three current provisions: Family Allowances, the refundable Child Tax Credit and the non-refundable tax credits for dependent children. It will also be supplemented by a new provision, the Earned Income Supplement.

The maximum basic benefit is $1,020 for each of the first two children and then $1,095 for each subsequent child. Families can receive an additional maximum amount of $213 for each child aged below seven when they are not claiming any child care expenses. These are the maximum amounts for the whole year of 1993 and will be raised only by the percentage that exceeds annual inflation rate of 3%.

Benefits are reduced at a rate of 5.0% of family income over $25,921 for families with two or more children, and at a lower rate of 2.5% for families with one child. A family with one or two children aged over seven will stop receiving the benefit when their net family income exceeds $66,721 ($87,121 and $107,521 for three and four children respectively).

The full Earned Income Supplement (EIS) will be paid only to families with earnings above $10,000 and net income below $20,921. Families with net income above $20,921 will have their EIS reduced by 10% of the excess. Families will have to earn at least $3750 per year to begin receiving the EIS. For every dollar of earnings above $3750, the EIS payment goes up by 8 cents, such that the full $500 is paid when earnings reach $10,000.

Unless they are eligible to receive the EIS, the Child Tax Benefit will be of no help to many low-income families with children. The $1020 per year figure adds to exactly the same amount as the current family allowance ($419) and refundable child tax credit ($601). As with so many other programs, partial indexation means that the benefits will erode over time.

Although we agreed that the amount of the benefits provided were inadequate to meet the real costs of raising children, we did not all agree on the design which would do this most efficiently.

Some of us who adhere to the universal approach to providing public assistance see the solution as a two-tiered national benefit composed of the following:

1) a universal payment to all families with children, regardless of income; and
2) a selective "top-up" paid to families with low incomes. Families with incomes up to the Statistics Canada's after-tax low income cut-off would receive the full top-up, with benefits gradually reduced as income goes up. Ontario would supplement the federal benefit only to the extent that the costs of raising a child in Ontario exceeds the national average.

Those of us who support a two-tiered benefit feel that having a modest amount paid universally to parents is necessary to recognize the importance of all children in Canada's future. Even though this payment would be subject to income tax, the principle of paying it to everyone is essential to its objective.

Some of us would rather not have a universal child benefit program, but would prefer to see more money dedicated to families who really need it.

The Earned Income Supplement discriminates against recipients of social assistance. We see no justification for this.

RECOMMENDATION 12:

- *Because the new Child Tax Benefit is inadequate, the federal government should increase funding to ensure that low-income families have adequate resources to raise children. In addition, the federal government should convert the Earned Income Supplement into a payment to all families with children having a net family income below the income threshold for the Child Tax Benefit, currently set at $25,921 for 1993. Benefits must be fully indexed against inflation.*

7.1.2 Care-giving Activities

The cost of caring for family members is a growing concern as the overall population ages. Family care-givers provide as much as 80-90% of the support received by elderly persons and adults with disabilities. In 1988 there were about 1 million people aged 65 and older in Ontario, representing 11.8% of the total population. That proportion will increase by at least one-third to 16.3% by the year 2001.[12]

We discussed whether family care-givers should be financially compensated. Feedback from its recent public consultation on long-term care reform has yielded the Ministry of Community and Social Services a range of public opinions on this issue.

On the one hand, payment to family care-givers is seen as a practical alternative to bringing care-givers from major centres to remote rural areas where there is no formal support services network. Also, it would provide households with additional income if the care-giver had given up employment to undertake full-time care-giving.

On the other hand, payment to family care-givers is viewed as undermining family responsibility. Such a program would be expensive and difficult to monitor. Moreover, payment to family care-givers is seen as undermining the autonomy of the care-receiver who may desire to make her/his own care arrangements.

The majority of us are of the view that the tax system is not the best way to give recognition to family care-giving activities, whether or not family care-givers are paid. Instead, we advocate an improved support system that would include information and referral services, counselling and support groups, one-on-one training in the home by nurses and other professionals, respite care and public adult day care programs.

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[12] Source: Ministry of Community and Social Services.

Moreover, we note the hardship to a low-income family when one of its members has to leave the paid workforce and become a full-time family care-giver. Such persons are considered to be employable and to be gainfully employed or searching for a job. They may therefore have difficulty obtaining social assistance.

RECOMMENDATION 13:

A. *Family care-givers in Ontario should have access to appropriate public support services.*

B. *The Ontario government should consider exempting family care-givers from job search requirements for the purpose of determining eligibility for social assistance.*

7.1.3 Taxation and Disability

The tax system has certain provisions which recognize the costs of disability. For example, taxpayers can claim the non-refundable tax credits related to disability and medical expenses. They can also apply for rebates and exemptions from the provincial retail sales tax and from the federal GST on goods and services that can be identified as related to their disabilities.

The Coalition of Provincial Organizations of the Handicapped has an extensive inventory of tax concerns and suggestions for addressing them (Beatty, 1989; Baker, 1991). We noted the following concerns in particular:

1) low-income taxpayers cannot afford to pay medical fees to obtain the Disability Tax Credit Certificate needed to claim the disability tax credit;
2) the medical expense tax credit is not designed to recognize ongoing extraordinary medical expenses associated with disabilities;
3) the full cost of a vehicle to a person with disabilities can be claimed against the Ontario retail sales tax, but only the portion of the cost which relates to the adaptations made to the vehicle can be claimed against the GST; and
4) people with disabilities have difficulty accessing information on the tax provisions that affect them.

These concerns suggest that improvements to the current tax system are needed to allow for a more appropriate recognition of the costs of disability.

RECOMMENDATION 14:

A. *The federal government must find ways to reduce current tax inequities experienced by persons with disabilities. In doing so, it must seek advice from persons with disabilities.*

B. *Both the federal and provincial governments should foster greater awareness of tax incentives available to persons with disabilities.*

7.1.4 Living with Dignity in Old Age

Seniors in Residential Care

Elderly people should have adequate incomes, whether they are residing in their own homes or in publicly funded residential care facilities. After paying for residential care, many seniors including those on minimum pension income, are left with only $112 a month for all their personal needs. This results from the Ontario government's policy of setting the fee for residential care at a monthly level $112 below the minimum seniors' income.

This personal needs allowance is expected to cover a wide range of items, including essentials such as clothing, hair care, personal toiletries, transportation and incontinent supplies. In our view, the fees paid for residential care should cover all essential care needs. We therefore urge that the residential care fee coverage be reviewed in the context of the long-term care reform currently underway in Ontario.

Also, the amount has not been raised since 1985, even though the guaranteed income of seniors (Old Age Security, Guaranteed Income Supplement, Ontario's GAINS-A) is increased every three months to reflect inflation. It is thus apparent that the $112 figure needs to be increased to reflect inflation since 1985, which would bring it to about $150. Furthermore, it should be indexed to inflation from now on.

Seniors in their Own Homes

Many seniors living in their own homes on fixed incomes have experienced significant increases in property taxes in recent years. Although we have not seen any conclusive studies, it is apparent that there is real pressure on many seniors to give up their homes for financial reasons. Not only does the overall well-being of people suffer when they are forced to sell their homes, it also places pressure on publicly-funded subsidized housing and residential care facilities. The same can be said for people with disabilities.

The Ontario government allows individual municipalities to pass by-laws permitting deferral of property tax. The deferral becomes a lien on the property. This approach does not appear to provide much encouragement to municipalities to institute such plans. New legislation should direct municipalities to state their position with respect to having local property tax deferral schemes. The possibility of the provincial government providing financial incentives should be considered in the development of this legislation.

RECOMMENDATION 15:

A. *The personal needs allowance provided to seniors in residential care facilities should be increased to $150 per month to recognize inflation since the last increase, and then be fully indexed to the cost of living.*

B. *Ontario should institute a property tax deferral scheme for seniors and persons with disabilities. The issue of who funds and administers the program should be reviewed as part of the broader provincial-municipal disentanglement discussion currently underway.*

7.2 Tax and Other Policies

Tax policies have implications far beyond fiscal concerns. They can be made to interact with other social and economic policies to yield optimal poverty alleviation and prevention.

7.2.1 Social Assistance Tax-Back Rates

People on social assistance who have earnings can face two types of "tax". First, they pay income tax on earnings—the lowest marginal income tax rate is 26%. Secondly, there is the "tax-back" on social assistance payments i.e., the rate at which payments are reduced as after-tax earnings go up.

The combination of income tax rates, social assistance tax-back rates and deductions for Canada Pension Plan and Unemployment Insurance can result in an implicit marginal tax rate of up to 88%. For every extra dollar earned, a person may be better off by only 12 cents.

Both the Ontario Social Assistance Review Committee (1988) and its successor, the Advisory Group on New Social Assistance Legislation (1992), recognized the punitive impact of this and the complications of solving it. The solution is not necessarily to reduce either the social assistance tax-back rate or the income tax rate.

Reducing the tax-back rate might lead to large numbers of people who are currently in the labour force becoming eligible for social assistance. It could ultimately affect the minimum wage and the relationship between employers and workers in a large segment of the labour force. It could depress the minimum wage as employers restructure remuneration levels and hours of work to take into account social assistance payments.

It is beyond the scope of our report to do more than recognize the problem and its complexities. The Fair Tax Commission has a study underway on this topic.

RECOMMENDATION 16:

- *The Fair Tax Commission should recommend ways of reducing the high implicit marginal tax rates experienced by social assistance recipients when they have earned income.*

7.2.2 Coordination with other Social Programs

Currently, a large number of programs provide subsidies to individuals and families for various purposes, each with different financial criteria. Examples include housing subsidies, student awards, child care, assistive devices, legal aid, handicapped children's benefits, drug benefits, dental benefits. Many of these programs are essential to keep low-income people in the work force or provide them with education and training for a job.

Low-income people are often both confused and discouraged in their efforts to obtain such subsidies. Some programs use a financial test which does not take income taxes into account. Some provide subsidies to raise income to approximate poverty lines. Some withdraw subsidies at a rapid rate; others do so in a more gradual way. Sometimes, their effect is to work at cross-purposes with tax relief policies, as well as with each other.

We recognize that an absolutely harmonious relationship these programs may never be found. However, we are convinced that a collaborative effort involving all the stakeholders can eliminate the most irrational design elements. Stakeholders would include low-income people, agencies which administer the tests and government officials.

7.2.3 Income Supplementation

Income supplementation measures are most relevant to low-wage workers. The federal Earned Income Supplement (EIS), intended to help them, will be difficult to harmonize with Ontario's social assistance program. Notably, EIS is currently part of the federal Child Tax Benefit, and not a self-contained program.

Since its Social Assistance Review Committee's report Transitions (1988), Ontario has provided earning incentives to people on social assistance through its STEP program (Supports To Employment Program). As a result, there are many people in Ontario with some earnings, receiving partial social assistance, who will now receive the $500 EIS.

It is not clear how the EIS payment should or will be treated under social assistance law. Should people be able to receive income supplementation simultaneously from two different programs, each program calculating its benefits as if the other did not exist?

Policy debates concerning this dilemma have revolved around the idea of a guaranteed annual income (Royal Commission on the Economic Union and Development Prospects for Canada, 1985; Commission of Inquiry on Unemployment Insurance, 1986; and Canadian Council on Social Development, 1987).

A typical guaranteed annual income (GAI) scheme:

1) establishes an income floor below which no citizen need fall;

2) provides income support for those unable to work and income supplementation for the working poor;
3) delivers such assistance through the income tax system by means of a negative income tax; and
4) streamlines the system by eliminating various existing programs in favour of one guaranteed income scheme for various types of recipients.

Although intuitively appealing, this GAI approach has a number of problems. We are particularly concerned with three issues.

1) Streamlining the system is not as easy as it might appear since there are many different needs to which the system is expected to respond.
2) A GAI scheme may encourage employers to keep wages low, since they may count on the government's reducing the gap between actual wages and the poverty line.
3) The GAI approach can be construed as a substitute for full-employment, deflecting attention from efforts to generate jobs and integrate more people into the mainstream of the economy.

It is primarily for the latter reason that the Social Assistance Review Committee rejected a GAI solution to the problems facing the income security system in Ontario.

The issue of income supplementation is far too important for governments to attempt to address in isolation. If both the federal and Ontario governments intend to operate programs of this type, the programs must fit together.

RECOMMENDATION 17:
- *Before designing an income supplementation program for the working poor, the federal government should seek advice from all stakeholders including provincial governments, business, labour and community groups.*

7.2.4 Employment as First-Line of Defence against Poverty

Society expects most people to support themselves through work. However, the market economy does not protect people from poverty resulting from such causes as job loss, low wages, injury or disability.

Most current social programs to buffer people from such exigencies were enacted at a time when unemployment was much lower than it is today. The economy was expanding and wages were rising. The average unemployment rate was about 3% in the 1960s but has steadily increased. In 1991, the average unemployment rate in Ontario was 9.6% (Statistics Canada, 1992, p. 270). In addition the average length of time people are unemployed has been steadily increasing since the early 1980s.

It is now evident that the economy is restructuring. The service sector is growing, the manufacturing sector is declining, and the field of technology and communications is expanding.

Economic restructuring has resulted in serious social and economic problems: a rising displacement of workers, rapid changes in the skill requirements of jobs, growth in the relative proportion of low-skill, low-paid, unstable jobs, and sharper inequalities in earnings due to the erosion of middle-income jobs (Wien, 1991). Changing economic realities create new needs which social welfare and income security systems are having to address. There has been a dramatic increase in the number of people on social assistance in Ontario in the 1980s. At present, about one in seven non-aged Ontarian receives social assistance payments.[13]

The Ontario government faces the dilemma of having to raise more taxes from a smaller number of taxpayers while having to provide more relief and assistance to a growing number of low-income individuals and families.

It is unreasonable to expect income security and other social programs to address the fundamental economic problems which we face today. There are limits to what social policy can do. Nor can we expect tax policy to do the job alone.

What is needed is a concerted full employment strategy that weaves together economic policy and social policy to focus on employment creation and improved jobs. In short, we believe that employment must become the first-line defence against poverty.

A full employment strategy requires the commitment and collaboration of governments, business, labour, communities and individuals. Policies must complement and not thwart full employment objectives. Tax policy must encourage, not discourage job creation.

Designing a full employment strategy is beyond our mandate. It would require examining not only tax policy, but also monetary policy and policies on education and training, income security, child care, labour relations, pay and employment equity, research and development, and industrial development.

Our message is simple: everyone needs a good job, so that we can all pay our fair share of taxes to support the public goods and services that we feel are important.

RECOMMENDATION 18:

- *To eliminate poverty, full employment at adequate income levels must be the first priority of both the federal and Ontario governments. Tax policy could be used as one of a range of policy instruments to achieve this goal.*

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13 Monthly caseload data for the 1980s ending in October, 1992. Source: Income Maintenance Branch, Ministry of Community and Social Services.

8. CONCLUDING REMARKS

Low-income individuals and families in Ontario carry an unfair tax burden. It must be reduced. Ontario has the power to effect some of our recommendations. Others require either federal-provincial collaboration or unilateral federal moves.

We have suggested changes to Ontario's own tax-delivered assistance programs to alleviate the tax burden on low-income Ontarians. But tinkering with tax-delivered assistance either at the provincial or federal level can only provide short-term relief. In our view, fairer taxation requires greater progressivity in the overall tax system.

To achieve this goal, structural changes which require federal-provincial collaboration are called for. Measures we have suggested include the following:

1) raising the personal income tax threshold, i.e., the income level at which low-income people start to pay federal and provincial income taxes;
2) restructuring the schedule of income tax rates, and hence the income tax brackets, to lighten the taxes on low- and modest-income people;
3) full indexation of the personal income tax system; and
4) reducing the reliance on regressive taxes, namely sales and other commodity taxes.

Our report has indicated the pervasiveness of poverty in Ontario. People are poor not only because they have to pay taxes, but also because they have limited access to the market economy. Throughout our discussions, we kept asking ourselves: How do we limit ourselves to studying one rather modest tool to fight poverty, namely the tax system, when we believe a comprehensive strategy is needed to be effective?

APPENDIX 1

Additional Notes and Charts

- Measuring Poverty
- Social Policy Simulation Database/Model (SPSD/M)
- Selected Non-Refundable Tax Credits
- Design of a Refundable Tax Credit
- Child Support Payments
- Additional Charts

Measuring Poverty

The Low Income Tax Relief Working Group reviewed several well-known measures of poverty as described below.

Relative vs. Absolute Poverty

A **relative** measure of poverty reflects the relative deprivation encountered by people lacking the resources to access goods and services which are available to most other people. It has been argued that this approach invites an analysis of the unequal distribution of income and other resources in society (Muszynski, 1992).

An **absolute** measure of poverty stresses the minimum necessary for mere physical survival. Absolute standards, because of their tendency to reflect minimum physical subsistence levels, are assumed or stipulated to be more or less unchanged over time regardless of changes in average income; this contrasts with relative standards (Leadbeater, 1992). It is, however, possible to specify a basket of goods and services intended not just for people's physiological needs but also for their social functioning. This has been done, for instance, in the *Guides for Family Budgeting* developed by the Social Planning Council of Metropolitan Toronto (1991).

Statistics Canada's Low Income Cut-Off

Statistics Canada's low income cut-off is the most widely used "poverty line" in Canada although it was not intended to be a measure of poverty. Published annually since the 1960s, it is the only historical measure available.

When Jenny Poduluk first produced the low income cut-off, she argued that low-income families were those in income groups "in which, on average, most of the income received must be spent upon essentials such as food, clothing and shelter" (Poduluk, 1968, p.185). Based on data from a 1959 family expenditures survey, she found that family expenditures on food, shelter, and clothing averaged about half of family income.

She then added another 20 percentage points and made the assumption that when families had to spend 70% or more of their incomes on food, shelter and clothing, they would have little income left for anything else. In her view these families, in relation to other families, would have very little discretionary income. In other words, the low income cut-off incorporates both the absolute and the relative concepts of poverty.

Over the years, Statistics Canada has been revising the 70% ratio downwards in line with the fact that families are spending less and less of their income on food, shelter and clothing. In the last revision, the ratio was reduced to 56.2%, based on Statistics Canada's 1986 Family Expenditure Survey data.

Adjustments to the low income cut-off have also been made over time, which take into account family size and the population size of the area of residence. In this manner, a set of 35 low income cut-offs is generated (seven different family sizes for each of the five different population sizes). These low income cut-offs are adjusted for inflation each year although family expenditure surveys have only been conducted periodically.

The working group used the after-tax version of the low income cut-off as a benchmark of income adequacy in its recommendations. The after-tax low income cut-off is the normal (pre-tax) low income cut-off net of personal income taxes. Figures for the 1990 low income cut-off and after-tax low income cut-off for different family sizes are compared below:

Statistics Canada's Low Income Cut-Off and After-Tax Low Income Cut-Off
Urban Area with Population of 500,000 and over, 1990

Family Size	Low Income Cut-Off (1)	After-Tax Low Income Cut-Off (2)
1 person	$14,155	$12,002
2 persons	$19,187	$16,275
3 persons	$24,389	$21,068
4 persons	$28,081	$24,781
5 persons	$30,680	$26,961
6 persons	$33,303	$28,819
7 persons	$35,818	$30,637

(1) 1986-based low income cut-offs for urban area with population of 500,000 and over. Source: Statistics Canada (1991a, Text Table V, p. 35).

(2) 1986-based low income cut-offs for urban area with population of 500,000 and over. Source: Statistics Canada (1991b, Appendix Table 1, pp. 96-98).

Statistics Canada's Low Income Measure

Starting in 1992, Statistics Canada also publishes a new measure of low income called the Low Income Measure. This measure is calculated at one-half of the "adjusted" median family income, meaning that the Low Income Measure takes into consideration family needs. In other words, the Low Income Measure is a relative measure of poverty.

Based on the precept that family needs increase with family size, the first adult is counted as one person, each additional adult is assumed to increase the family size by 40% and each child's needs are assumed to be 30% of that first adult. Thus, different median "adjusted" family incomes can be calculated for different 'adjusted' family sizes. For each year, Low Income Measures can therefore be updated with the latest annual income figures.

It should be noted that the Low Income Measure leaves the overall poverty rate virtually unchanged, compare to the low income cut-off. However, since the Low Income Measure does not vary by city size, as does the low income cut-off, there are some changes in poverty rates in different local regions. Statistics Canada has proposed the Low Income Measure be used for a two-year trial period. Following this trial period and feedback from users, the Low Income Measure may replace the low income cut-off.

The Canadian Council on Social Development's Income Guidelines

The Canadian Council on Social Development's income guideline for a family of three is set at one-half of the average family income in Canada. The individual line is set at 50% of the three-person line and a two-person line at 83%. For families with more than three people, an additional 16.7% is added to the base figure for each additional member. The Council updates its income guidelines periodically.

The Senate Committee's Poverty Lines

The Senate Committee on Poverty reported in 1971 its own two sets of poverty lines: a poverty line and a minimum income guarantee, which formed the basis of the Committee's guaranteed annual income program. The guarantee was designed to provide basic necessities and was set at 70% of the poverty line. The late Senator David Croll had been updating the Committee's poverty lines in accordance with changes in total disposable income and rising living standards.

The Social Planning Council of Metropolitan Toronto's Guides to Family Budgeting

These budget guides have been developed for modest income households in the Metropolitan Toronto area. These budget guides are based on a basket of goods and services aimed at reflecting broader social norms of consumption beyond the three basic necessities of food, shelter and clothing. The intention is to ensure a modest but adequate standard of living to preserve "social and physical well-being". The Council updates its budget guides periodically.

Provincial Social Assistance Rates

Arguments have been made that the existence of income support programs itself suggests that there exists a socially sanctioned minimum level of consumption and that social assistance rates should reflect those values.

Currently, social assistance allowances are adjusted on an adhoc basis in Ontario. The Advisory Group on New Social Assistance Legislation (1992) recommended to the Ontario Minister of Community and Social Services a market basket approach to setting social assistance rates. This market basket would ten broad categories of items, including food, clothing, personal care, communication, transportation, communication, transportation, home furnishing and equipment, household operation, school needs, insurance and recreation. It would be adjusted for changes in the cost of living annually and reviewed every five years.

The Montreal Diet Dispensary Guidelines

These guidelines, although based on a basket of goods similar to the one used by the Social Planning Council of Metropolitan Toronto, are however intended for what can be purchased within social assistance levels only.

Summary of Different Poverty Lines (1990 Dollars)

Family Size	Statistics Canada's Low Income Cut-Off (1)	Statistics Canada's Low Income Measure (2)	Canadian Council on Social Development (3)	Senate Committee (4)
1 person	$14,155	$11,388	$12,360	$11,939
2 persons	$19,187	$16,573	$20,599	$19,921
3 persons	$24,389	$21,308	$24,719	$23,901
4 persons	$28,081	$26,044	$28,839	$27,881
5 persons	$30,680	$30,779	$32,959	$31,856
6 persons	$33,303	$35,514	$37,080	$35,840
7 persons	$35,818	-	$41,200	$39,820

(1) 1986-based low income cut-offs for urban area with population of 500,000 and over.
Source: Statistics Canada (1991a, Text Table V, p. 35).

(2) Low Income Measures for adults only.
Source: Statistics Canada (1991, Appendix Table 1, pp. 176-177).

(3) 1989 figures adjusted by writer to reflect increases in the cost of living to 1990.
Source: Canadian Council on Social Development as cited in Ross, D.P. & Shillington, R. (1989, Table 2.2, p. 9).

(4) 1987 figures adjusted by writer to reflect increases in the cost of living to 1990.
Source: Office of Senator David Croll.

Summary of Budget Guidelines and Social Assistance Rates (1990 Dollars)

Household Type	Social Planning Council of Metropolitan Toronto (1)	Montreal Diet Dispensary (2)	Social Assistance (3)
Single Employable	$17,136	$8,229	$7,195
Mother, 2 Children	$22,670	$13,333	$13,253
Couple, 2 Children	$31,563	$16,665	$17,389

(1) 1987 figures adjusted by writer to reflect increases in the cost of living to 1990.
Source: Social Planning Council of Metropolitan Toronto (1987).

(2) Source: Montreal Diet Dispensary (1990).

(3) Source: as cited in National Council of Welfare (1988, Table 5, pp. 39-40).

Social Policy Simulation Data/Model (SPSD/M)

The SPSD/M is a micro-computer based product designed to analyze the financial interactions between governments and the household sector in Canada.[14] Made available by Statistics Canada, the SPSD/M can assess the cost implications or income redistributive effects of changes in the personal taxation and cash transfer system. The SPSD/M consists of two integrated parts: a database and a model.

The database is comprised of approximately 100,000 individuals in families. They are statistically representative of the Canadian population. Each observation contains enough information on each individual to compute taxes paid to and transfers received from federal and provincial governments. The database has been constructed from various statistical and administrative micro-data files for the year 1986. Parameters are supplied to modify the database to represent any year from 1984 to 1991.

The model is composed of static accounting algorithms which calculate taxes and transfers using legislated or proposed programs on each individual and family in the database. The model calculates both the personal income taxes and the sales and excise taxes associated with each individual or household. The sales and excise tax parameters used by the model are estimated by a separate static Input-Output model.

[14] This description was adapted from Bordt, M., Cameron, G. J., Gribble, S. F., Murphy, B. D., Rowe, G. T. & Wolfson, C. (1990).

Selected Non-Refundable Tax Credits

A non-refundable tax credit can be used only to reduce a taxpayer's income tax liability to zero. Any unused portion of a non-refundable tax credit is not refunded to the taxfiler.

Although non-refundable tax credits are federal programs, they result in credits against the Ontario personal income tax as well. This is because the provincial income tax is levied at a fixed percentage of basic federal tax.

Selected Non-Refundable Tax Credits, 1991 Tax Year

	Base amounts	Converted to federal credits (17% of base amounts)	Converted to Ontario credits (53% of federal credits)
Personal	$6,280	$1,067.60	$565.82
Married and Equivalent-to-married	$5,233	$889.61	$471.49
Dependant under age 19:			
-each of first two	$406	$69.02	$36.58
-each additional	$812	$138.04	$73.16
Disabled dependant age 19 or over	$1,540	$261.80	$138.75
Disability	$4,118	$700.06	$371.03
Age 65 or over	$3,387	$575.79	$305.16

Most non-refundable tax credits are structured with a fixed base amount; some however, have a variable base amount such as the case with the credit related to medical expenses. A fixed base amount structure implies that people need a certain amount to live on which should not be taxed away. In contrast, the medical expenses credit is structured in such a way that people have to pay their own medical expenses up to 3% of their "net income" for tax purposes before using the balance of their eligible medical bill as base amount.

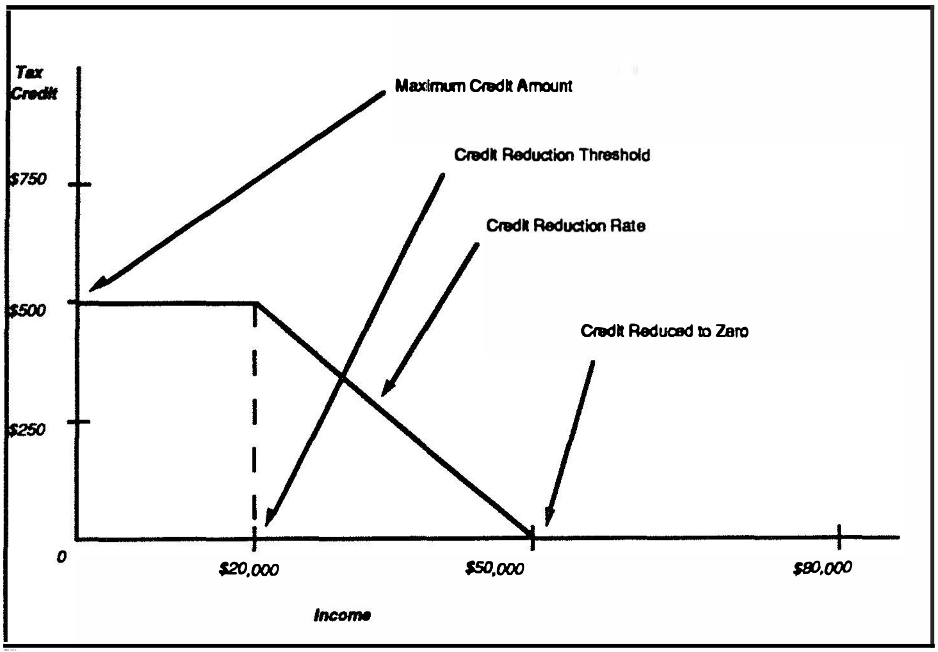
Design of a Refundable Tax Credit

Design Elements

A refundable tax credit is a tax credit that is payable to a taxfiler regardless of whether she or he is required to pay any tax.

A tax credit program usually has a base credit amount, an income level above which the credit amount will be reduced (credit reduction threshold), and some formula for reducing the credit amount. These three elements together determine the income at which the credit is reduced to zero, which varies for taxfilers according to their individual circumstances.

These three design elements also determine the total cost of the program. In particular, the reduction formula determines how abruptly or how gradually the tax benefit is being reduced to zero. A more gradual phasing-out of the tax benefit will add to the program cost as people at higher incomes still get some benefit. A more abrupt cut-off will help contain program costs, but creates hardship for people with incomes just above the threshold.



Refundable Tax Credits

These include the federal refundable Child Tax Credit, Goods and Services Tax (GST) credit, the Ontario Sales and Property Tax Credit, and the Ontario Tax Credits for Seniors. Effective January 1, 1993, the refundable Child Tax Credit, together with the non-refundable child tax credits and Family Allowances, will be replaced by the new Child Tax Benefit. The Ontario tax credits for seniors were introduced with the Ontario 1992 Budget to replace the Ontario tax grants for seniors.

Eligibility for these credits is based on an income measure which includes the tax-filer's income, the income of the taxfiler's spouse, and the income of an "other supporting person".[15] Also included in this income measure are social assistance and workers' compensation payments as well as net federal supplements, although they are not taxable incomes. (The amounts shown below are for the 1991 tax year, unless indicated otherwise.)

- *Child Tax Credit*

The person eligible for Family Allowances claims this credit.

Maximum credit amount per child	$585
Credit reduction threshold	$25,215
Credit reduction rate	5%

Example: A mother receiving Family Allowances on behalf of her child, all other things being equal, will theoretically have her child tax credit reduced to zero at an income of $36,915.

An additional $207 credit per child for children under age 7 can be claimed; but it is reduced by 25% of all child care expenses claimed as a tax deduction on behalf of the child.

- *GST Credit*

Maximum amount for self	$190
Maximum amount for dependent spouse	$190
Child claimed as equivalent-to-married	$190
Child claimed as a dependent	$100
Credit reduction threshold	$25,215
Credit reduction rate	5%

[15] Other supporting persons include: a common-law spouse with whom the taxfiler is residing and who is the parent of the taxfiler's child, and any person (other than the taxfiler's spouse) who claimed a personal amount for that child.

Example: A sole-support mother claiming the GST credit for herself and her child as equivalent-to-married, all other things being equal, will theoretically have her GST credit reduced to zero at an income of $32,815. If she can claim her child only as a dependant, her GST credit will be reduced to zero at an income of $31,015, all other things being equal.

•Ontario Property and Sales Tax Credits

Maximum combined credit	$1,000
Credit reduction threshold	$4,000
Credit reduction rate	2% of the difference between combined net income and $4,000

While delivered as a combined credit, taxfilers actually calculate their property tax credits and sales tax credits separately before adding them together. The maximum property tax credit is $250 plus either 2 per cent of rent or 10 per cent of property tax paid. The maximum sales tax credit is equal to the sum of $100, plus $100 for a spouse or other supporting person, plus $50 for each dependent child.

Over 1.8 million Ontario taxfilers will receive an estimated $420 million in property and sales tax relief in respect of the 1992 taxation year.[16]

•Ontario Tax Credits for Seniors

This program comes into effect in the 1992 taxation year (the amounts shown below are therefore for the 1992 tax year).

Maximum combined credit	$1,000
Credit reduction threshold	$22,000
Credit reduction rate	4% of the difference between combined net income and $22,000

While delivered as a combined credit, seniors actually calculate their property tax credits and sales tax credits separately before adding them together. The maximum property tax credit is $500 plus either 2 per cent of rent or 10 per cent of property tax paid. The maximum sales tax credit is equal to the sum of $100, plus $100 for a spouse or other supporting person, plus $50 for each dependent child.

Over 600,000 senior households will receive an estimated $440 million in tax credits in respect of the 1992 taxation year.[17]

[16] Source: Tax Policy Branch, Ministry of Treasury and Economics.

[17] Source: Tax Policy Branch, Ministry of Treasury and Economics.

Full Indexation

Neither the provincial nor the federal refundable tax credits offer full protection against inflation (full indexation). In the case of the province, credit amounts and credit reduction thresholds are raised only when the Ontario government decides to do so. The federal refundable tax credits are adjusted for inflation on a formula basis. But the formula calls for only partial increases which do not recognize the first three per cent of inflation. If inflation is more than three percent, then refundable tax credits and their thresholds decline in value by three percent in real terms; if inflation is less than three percent, they fall by the amount of inflation.

Delivery Issues

Tax-delivered vs Tax-triggered

Both the federal refundable Child Tax Credit and the Ontario Tax Credits (for seniors and non-seniors) are delivered through the personal income tax system. They are both an integral part of the final amount of income tax refund or income tax due.

In contrast, the federal GST credit comes in a separate cheque. Its calculation is "triggered" by the data collected from the filing of the income tax return.

Frequency of Payments

- Lump-sum payment, once a year: Ontario Property and Sales Tax Credits.
- One prepayment: the federal child tax credit, for taxpayers with three or more eligible children when previous year's net combined income is below the threshold of $25,215, and for taxpayers with fewer than three children when previous year's net combined income is less than two-thirds of the threshold.
- Quarterly payment: the GST credit (July, October, January, and April).

The New Federal Child Tax Benefit

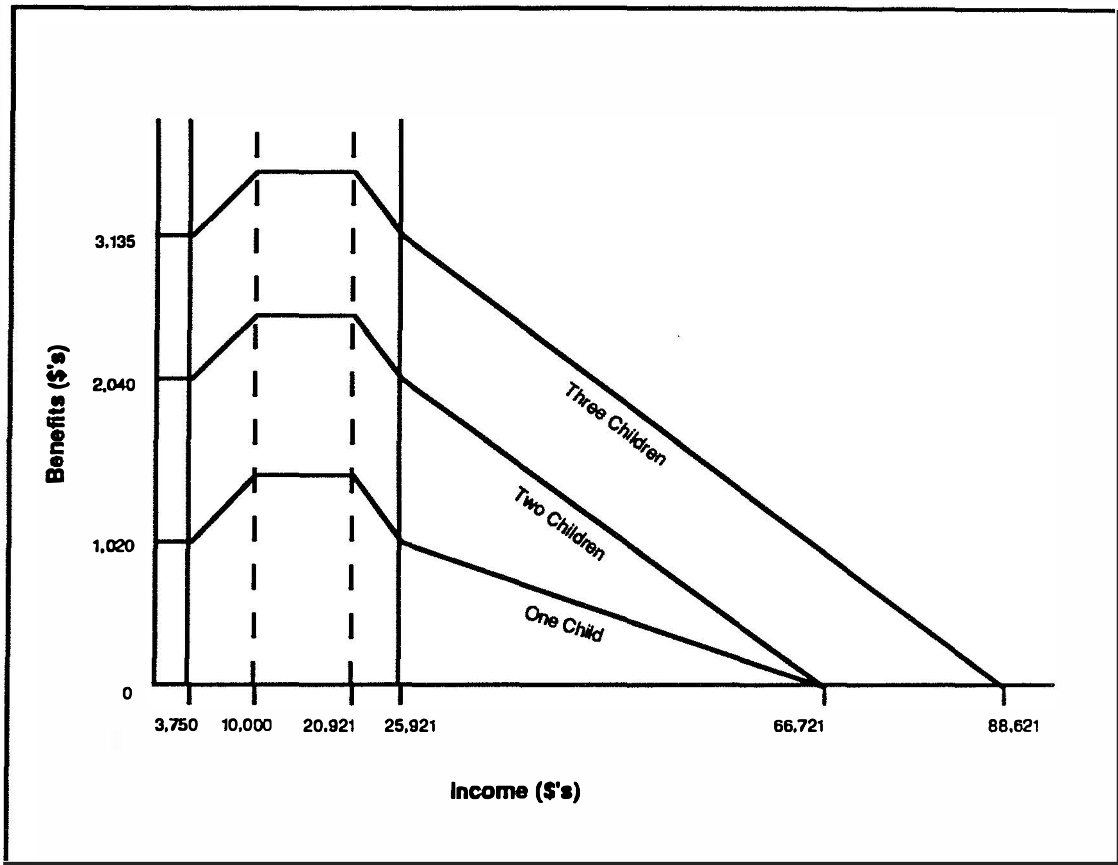
The new federal Child Tax Benefit resembles a large refundable tax credit in design, although the benefit is not taxed, or recovered through the tax system or intended to be used to reduce a person's tax bill. It is also subject to partial indexation which does not take into account the first three percent of inflation. The annual amounts for 1993 are shown below:

Maximum basic amount	$1,020 for each of the two first children $1,095 for each subsequent child
Benefit reduction threshold	$25,921
Benefit reduction rate	5.0% for families with two or more children 2.5% for families with one child

Families can receive an additional maximum amount of $213 for each child aged below seven when they are not claiming any child care expenses.

The benefit is supplemented by a new provision, the Earned Income Supplement (EIS). Families will have to earn at least $3750 per year to begin receiving the EIS. For every dollar of earnings above $3750, the EIS payment goes up by 8 cents, such that the full $500 is paid when earnings reach $10,000. Families with earnings above $20,921 will have their EIS reduced by 10% of the excess. The EIS amount does not vary with the number of children.

Design of the New Child Tax Benefit (including the Earned Income Supplement)



Note: The above illustrates the design of the program in broad strokes. It omits the $213 supplement for each child under age seven parents can have if they do not claim child care expenses. The Earned Income Supplement phases in with earned income and phases out with "net family income" which includes, among other things, social assistance, worker's compensation, Unemployment insurance and Canada Pension Plan payments. The actual amounts of Child Tax Benefit received by each family will thus depend on individual circumstances.

Child Support Payments

Under the current tax system, the "supporting" parent may claim a tax deduction for support payments, and the "recipient" parent must include such payments in income for tax purposes, where the support payments are made under a court order or written separation agreement. The recipient parent, as the custodial parent, is usually allowed to claim the "equivalent-to-married" tax credit with respect to one child, and, beginning in 1993, will be entitled to receive an amount under the new federal child tax benefit program with respect to any additional children.

If child support payments are made informally, that is, not made under a court order or a written agreement, there is no tax deduction allowed for the supporting parent and no income inclusion required for the recipient. If support payments required under an agreement or court order are, in fact, not made by the supporting parent, there is no tax deduction allowed for the supporting parent and no income inclusion required for the recipient.

The supporting parent is usually the father and the recipient parent the mother. In most cases, the supporting parent is earning more income than the recipient and may therefore be subject to income tax at a higher rate than the recipient. The recipient's tax rate may, in effect, be even lower than the rate that applies to the supporting parent because of the recipient's entitlement to claim the "equivalent-to-married" tax credit for one child. The result is that income that would otherwise have been taxed at a higher rate applicable to the supporting parent is taxed at a lower applicable to the recipient. Less tax is paid overall than if the support payments had not been deducted by the supporting parent and taxed in the hands of the recipient. This makes more after-tax income available to pay for the needs of the supporting parent and the recipient.

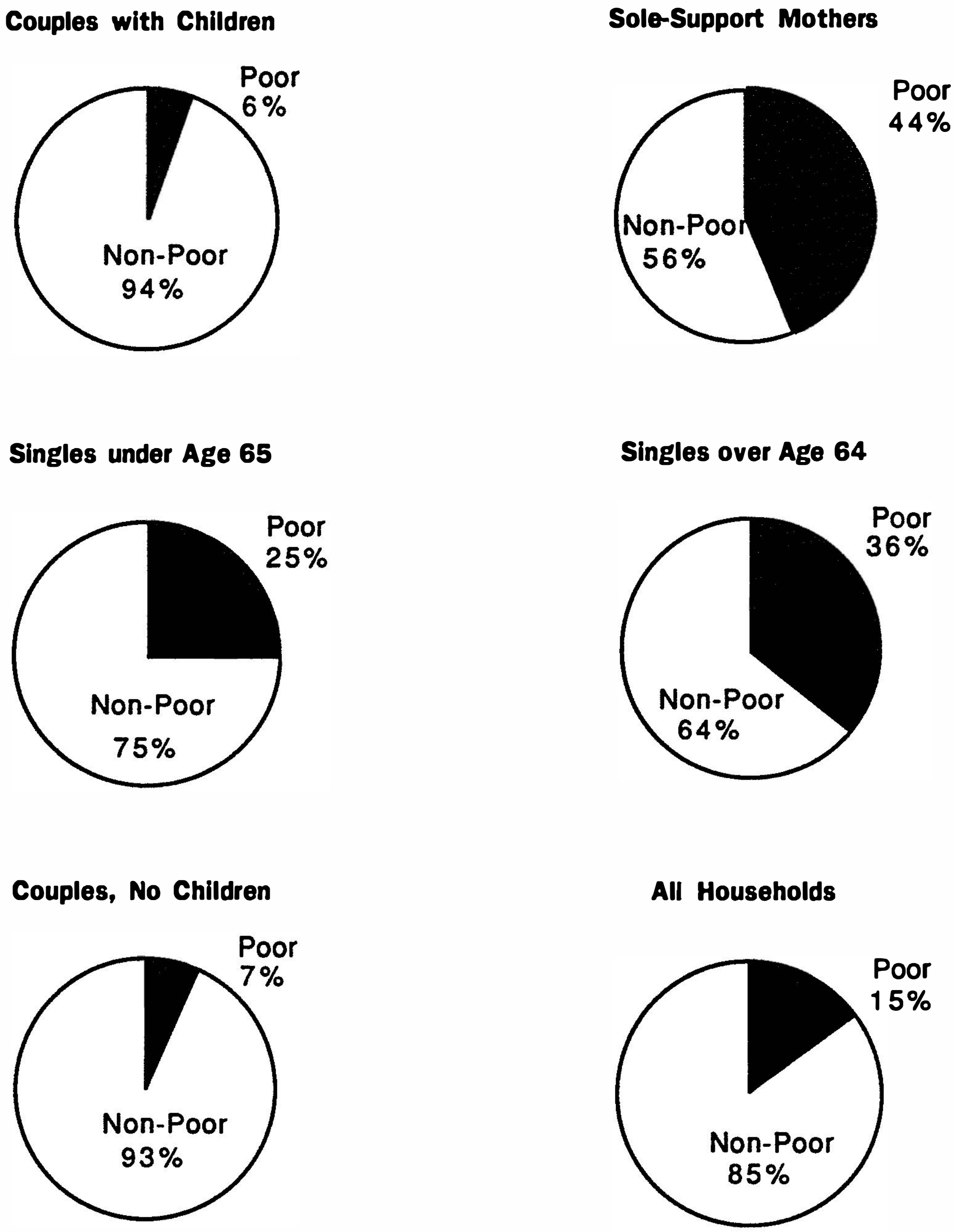
The principle of requiring the recipient spouse to include support payments in income and allowing the supporting spouse to deduct such payments is a long-standing one—it was incorporated into the Income War Tax Act in the early 1940s and has been carried through to the current income tax system. Accordingly, it is routinely taken into account in most separation agreements and court orders in determining the amount of support payments required.

A majority of the members of the working group thought that allowing the supporting parent a tax deduction for support payments is consistent with the principle of taking into account a taxpayer's ability to pay in imposing tax, because it recognizes the increased burden on the supporting parent of contributing to the support of two households where before there was one. Also, these members thought that the current system is consistent with the principle of horizontal equity in that it places the recipient parent in the same position as a taxpayer that supports his or her children solely by means of his or her own earnings rather than with an equivalent amount of support payments. These members concluded that no changes should be made to the way that the tax system currently deals with child support payments.

A minority of us took a different approach to the issue and felt that the courts should treat child support payments as intra-familial transfers outside the purview of the tax system. Courts should be be primarily concerned with the child's welfare, that is, striving for child support payments that maintain the child's material well-being as it was prior to the separation or divorce. Thus the minority view was that courts should award child support payments using the after tax income of the supporting parent. Child support payments would neither be deducted from the supporting parent's income nor included in the income of the recipient parent.

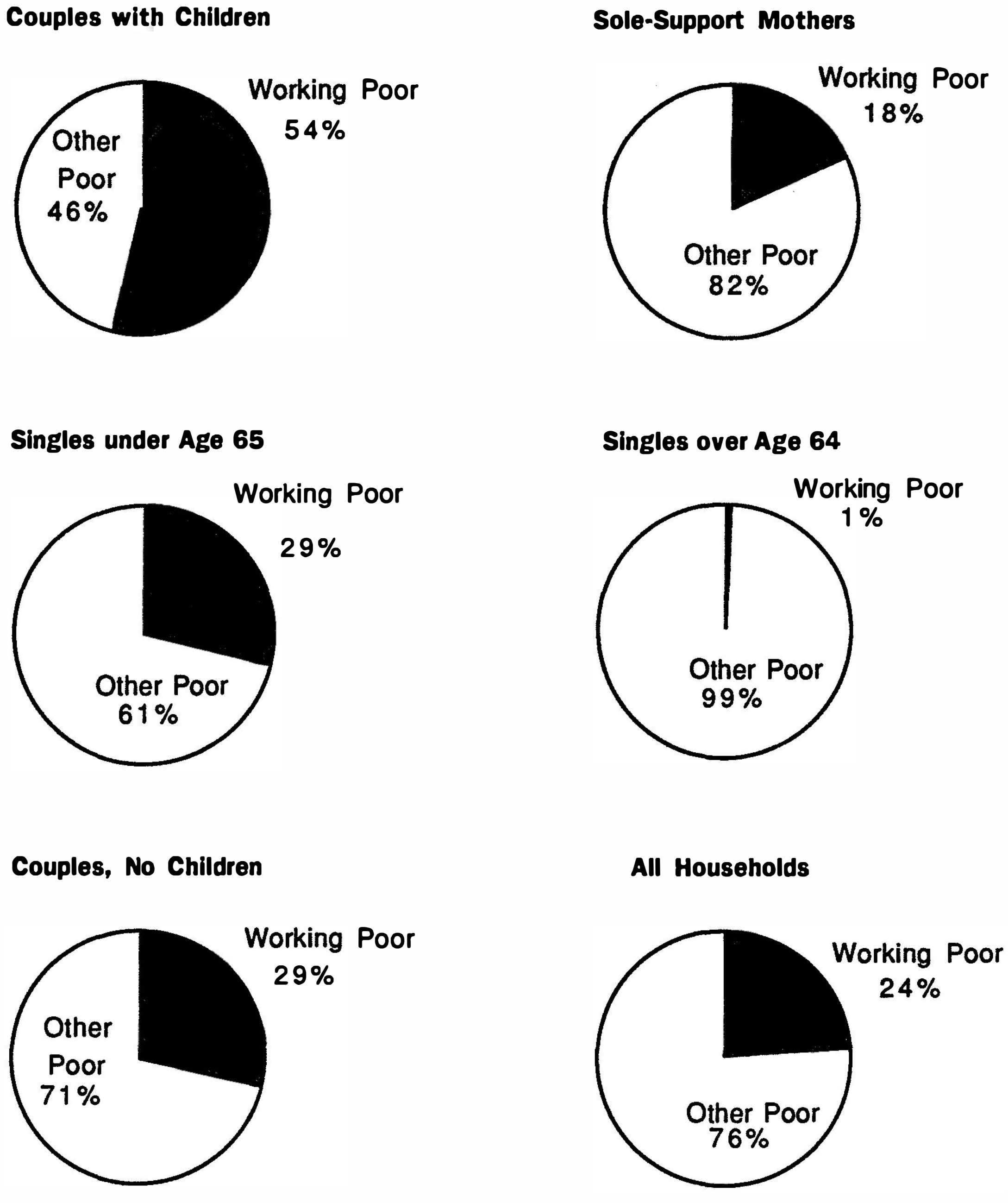
Additional Charts

Figure 1
Poor and Non-Poor in Ontario, by Household Types, 1990



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files; Statistics Canada's 1986-based low-income cut-off for urban area with population of 500,000 and over is used as the "poverty line".

Figure 2
Proportions of Working Poor Among the Poor in Ontario, by Household Types, 1990

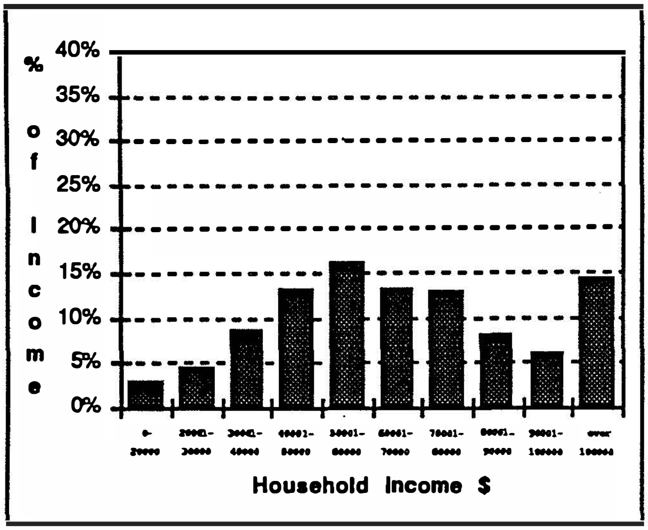


Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's 1990 Survey of Consumer Finances Micro-Data Files.

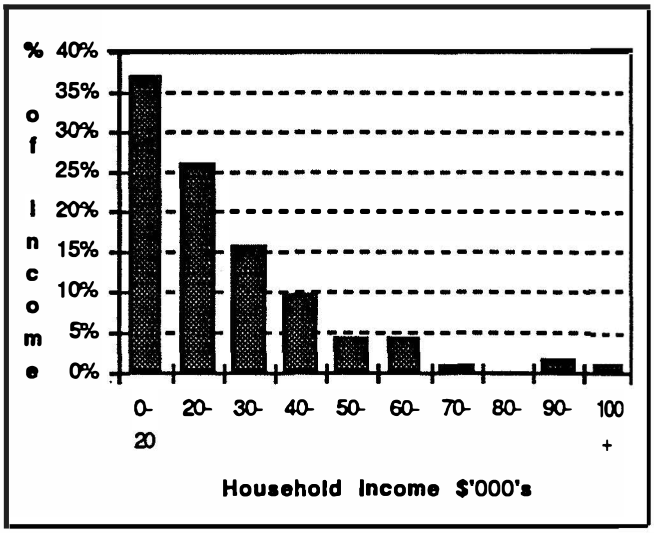
A working poor household is a household whose adult members, between them, have at least 49 weeks of either full-time or part-time work during the year and yet live below the poverty line.

Figure 3
Ontario Households by Estimated Distribution and Household Type

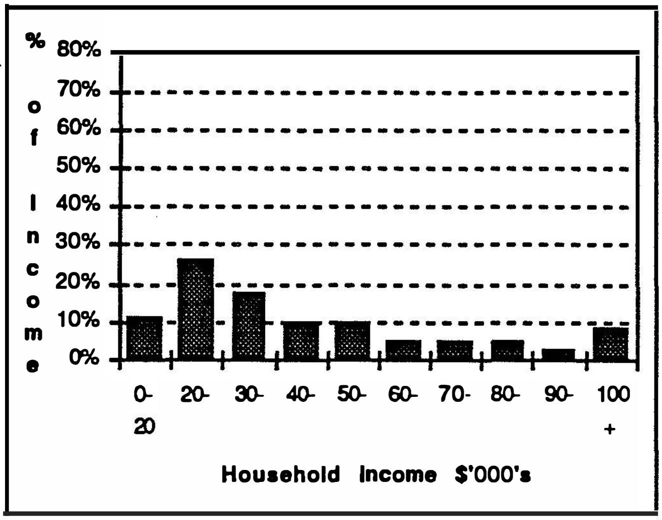
Couples with Children



Sole-Support Mothers



Elderly Couples



Singles over Age 65

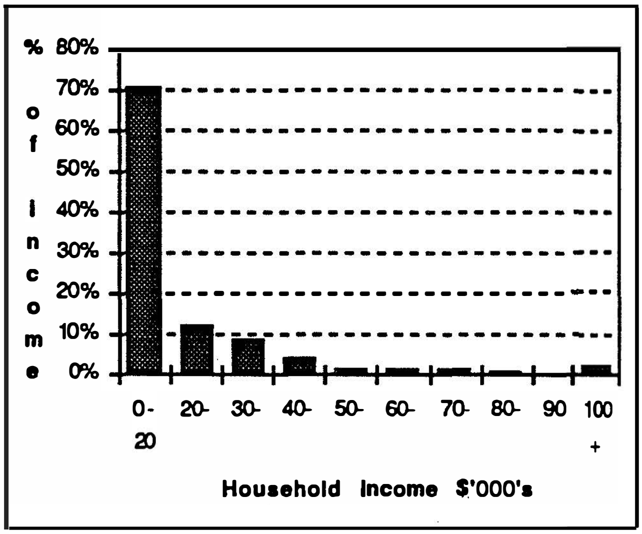
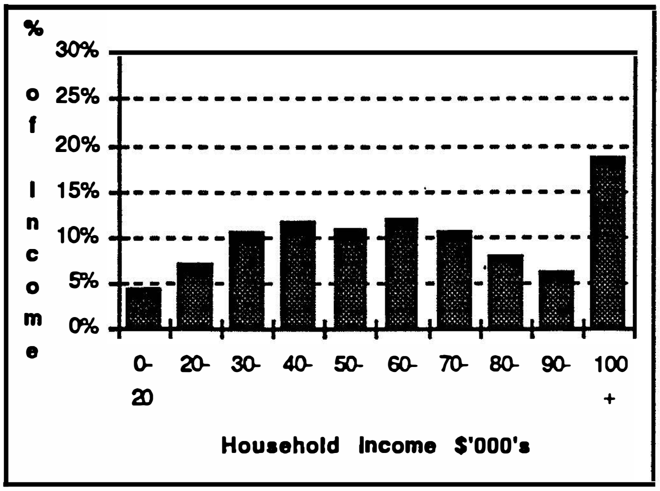
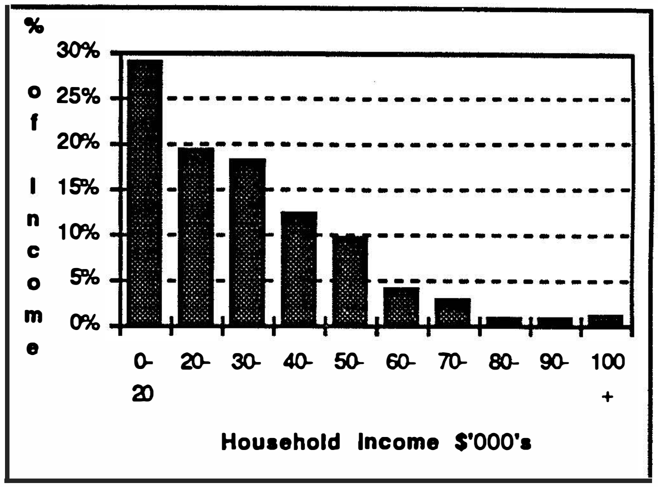


Figure 3 (cont'd)
Ontario Households by Estimated Distribution and Household Type

Couples, No Children



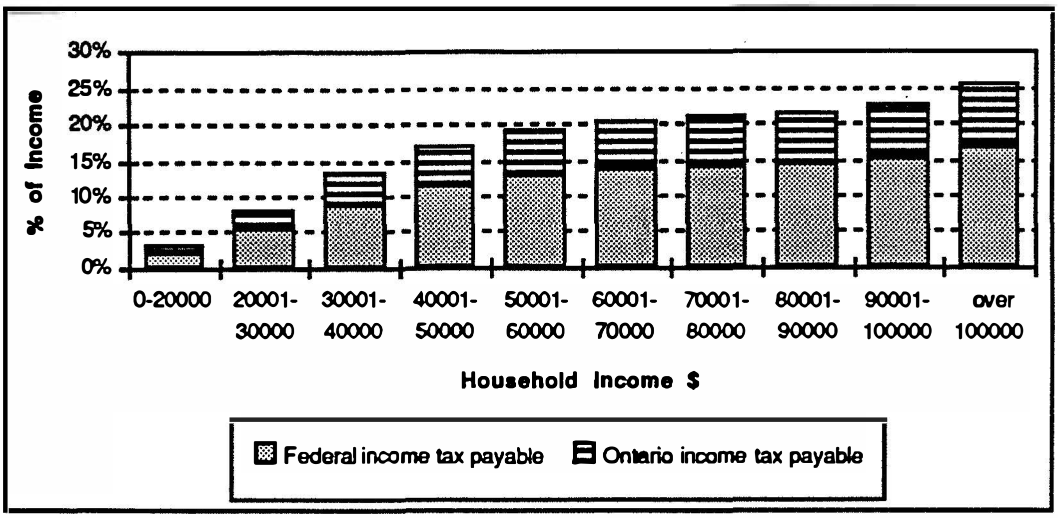
Singles under Age 65



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

Figure 4
Estimated Tax Burden from Various Taxes on Households in Ontario, 1991

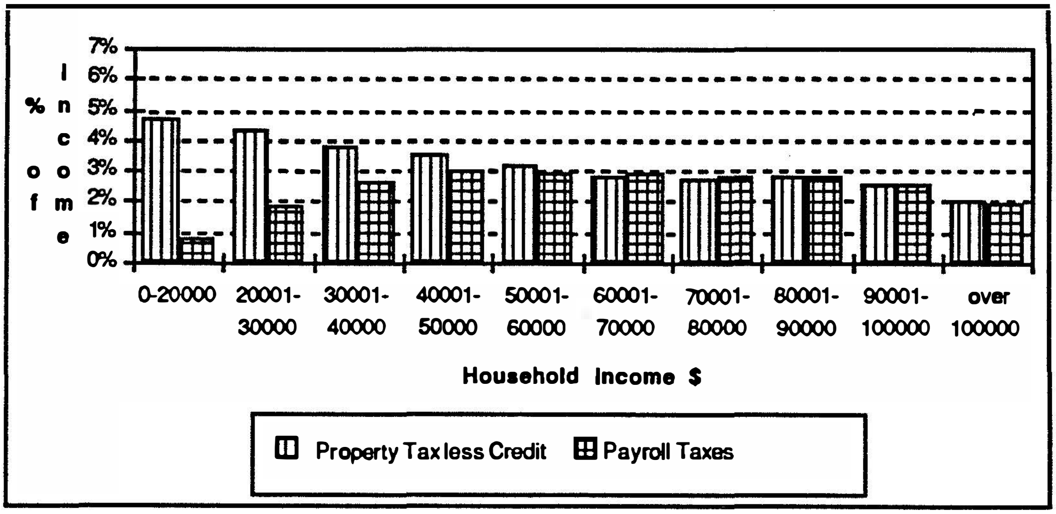
Income Taxes



Federal income tax payable is arrived at the same way as the "Net Federal Tax" is calculated for the income tax return, i.e., after taking into account the basic federal tax, the federal surtax, and federal tax deductions and credits (the Child Tax Credit and the GST Credit are therefore not included).

Ontario income tax payable is calculated at the regulated percentage of basic federal tax and takes into account the Ontario Tax Reduction program as well.

Property Taxes and Payroll Taxes

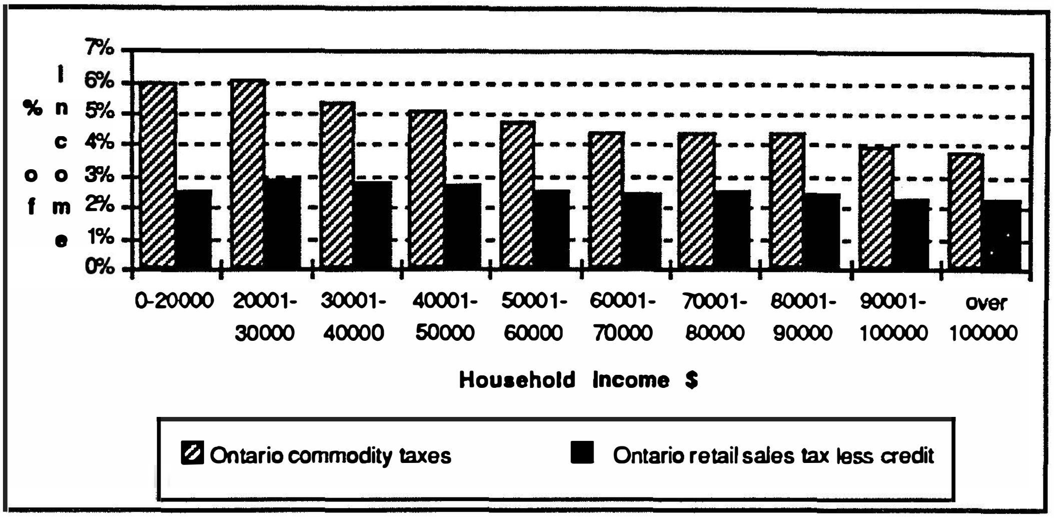


Property tax less credit, i.e., less the Ontario Property Tax Credit for people under age 65 or the Ontario Property Tax Grant for people over age 65. It is assumed that the property tax is passed onto the tenant in full.

Payroll taxes are contributions to Canada Pension Plan and Unemployment Insurance.

Figure 4 (cont'd)
Estimated Tax Burden from Various Taxes on Households in Ontario, 1991

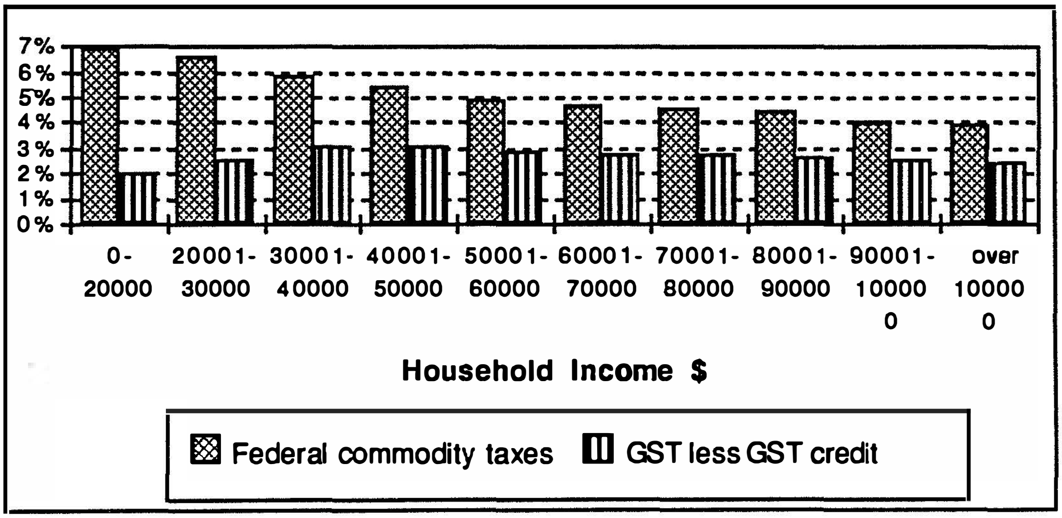
Ontario Consumption Taxes



Ontario commodity taxes include the provincial retail sales taxes, taxes on gasoline, fuel and tobacco, and liquor board mark-ups.

Ontario retail sales tax less credit, i.e., less the Ontario Sales Tax Credit for people under age 65, or the Ontario Sales Tax Grant for people over age 65.

Federal Consumption Taxes

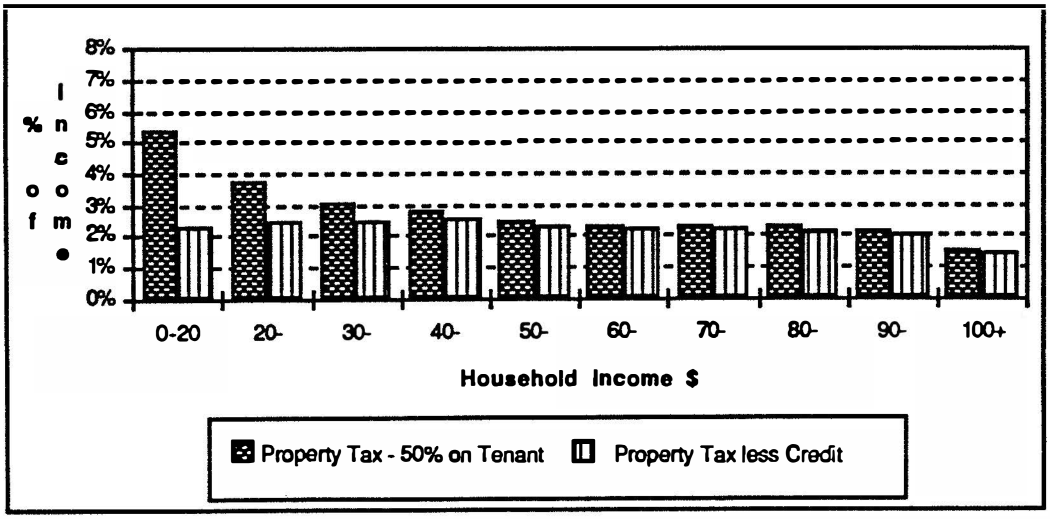


Federal commodity taxes include the goods and services tax (GST) and taxes on tobacco, gasoline, alcohol, air transportation and energy use , as well as customs duties.

GST less credit, i.e., less the GST Credit.

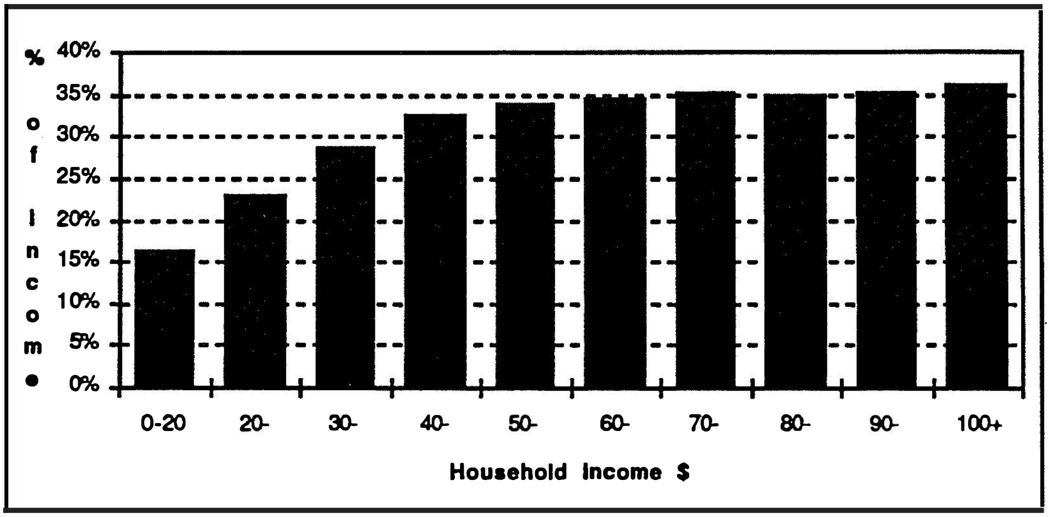
Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

Figure 5a
Estimated Property Tax Burden (50% on Tenants) in Ontario, 1991



Property tax less credit, i.e., less the Ontario Property Tax Credit for people under age 65 or the Ontario Property Tax Grant for people over age 65. It is assumed that only half the property tax is passed onto the tenant.

Figure 5b
Estimated Total Tax Burden (50% Property Tax on Tenants) in Ontario, 1991



Note: These amounts are averages: some households bear a higher tax burden, others, a lower tax burden. The taxes used in the calculations comprise the federal and provincial income taxes; contributions to Canada Pension Plan and Unemployment Insurance; the federal goods and service tax (GST); the provincial retail sales tax; federal and commodity taxes on gasoline, fuel, tobacco and alcohol (including provincial liquor board mark-ups); federal air transportation tax and customs duties; and property taxes. The tax burden is estimated after adjusting for all the surtaxes, deductions and credits for federal and provincial income tax purposes, including the Ontario Tax Reduction program, the GST Credit, and the Ontario Property and Sales Tax Credits (property and sales tax grants for seniors). It is assumed that only half the property taxes are passed on to tenants through their rents.

Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

Figure 6a
Effects of GST Credit in Offsetting the Goods and Services Tax Paid by Ontario Households in 1991

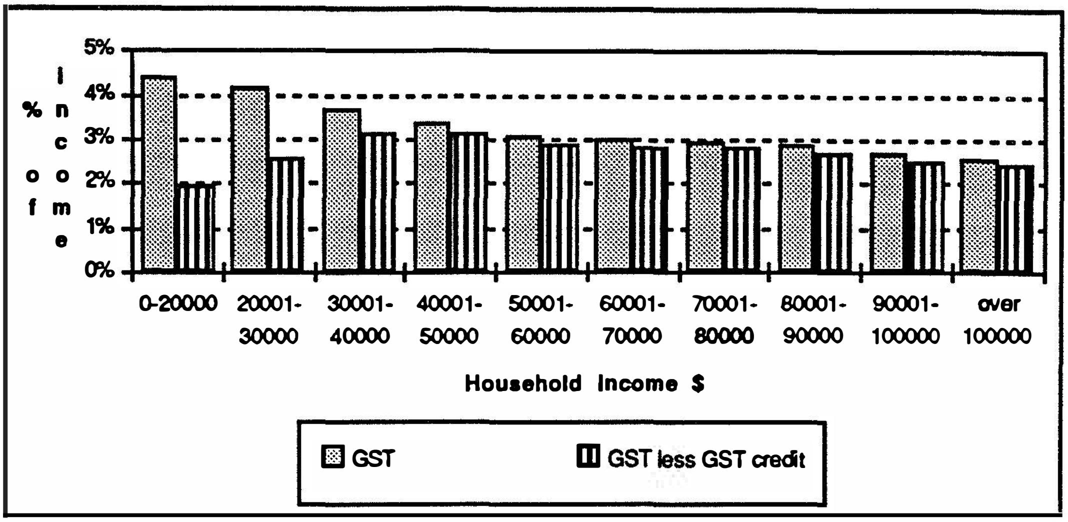
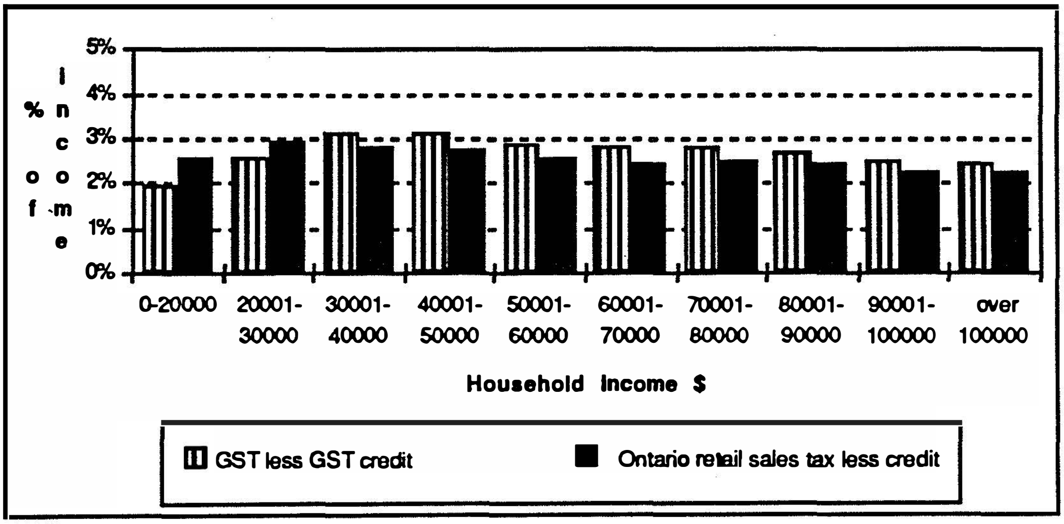


Figure 6b
Net Impact of GST and Provincial Retail Sales Tax on Ontario Households in 1991



Source: Compiled by Fair Tax Commission Secretariat, using Statistics Canada's SPSD/M model.

APPENDIX 2

Organizations Invited to Respond to Consultation Paper

Action logement (Vanier)
Advisory Group on New Social Assistance Legislation
Advocacy Centre for the Elderly
Advocacy Resource Centre for the Handicapped
Amherstburg Social Planning Council
Association canadienne-française de l'Ontario
Association multiculturelle des francophones de l'Ontario
Association of Jewish Seniors
Association of Municipalities of Ontario
BOOST
BASIC Poverty Action Group
Belleville Community Development Council
Bernard Betel Centre for Creative Living
Black Secretariat
Brant Community Social Planning Council
Bread and Roses Credit Union
Caledon Institute of Social Policy
Cambridge Social Planning Council
Canadian Co-Operative Association Ontario Region Office
Canadian Council on Social Development
Canadian Pensioners Concerned Ontario Division
Catholic Immigrant Services (Ottawa)
Central Neighbourhood House
Centre de ressources de la Basse-Ville
Centre des services communautaires de Vanier
Centre familial Caldwell (Ottawa)
Centre for Equality, Rights and Accommodation
Centre for Independent Living
Centre for Spanish Speaking Peoples
Centre for Women's Health
Centre francophone de Sault-Sainte-Marie
Centretown Coalition (Ottawa)
Child Care Providers Association (Ottawa)
Child Poverty Action Group (Toronto)
Child Poverty Action Group (Ottawa)
Children's Aid Society (Ottawa)
Citizens' Advisory Committee (Ottawa)
City of Mississauga
City of York Community and Agency Social Planning Council
Coalition of Visible Minority Women
Community Enterprise Centre (Ottawa)
Community Services Council (Newmarket)
Confederation of Canadian Unions
COSTI-IIAS Immigrant Services
Credit Union Central of Canada
Cross Cultural Communication Centre
Daily Bread Food Bank
Disabled Women's Network Canada
Dow Canada Inc.
Downtown Churchworkers' Association
East York Community Development Council
Eastern Ontario Rural Poverty Advocacy Group (Williamsburg)
Entraide budgétaire (Ottawa)
Etobicoke Social Planning Council
Focus on Future Schools
FoodShare Metro Toronto
Guelph United Way Social Planning Council
Halton Social Planning Council
Hamilton Against Poverty Committee
Hamilton Social Planning Council
Handicapped Action Group Inc. (Thunder Bay)
Hastings and Prince Edward Legal Services
Hispanic Council of Metropolitan Toronto
Hudson's Bay Company
Human Services of Scarborough
Independent Living Centre (Thunder Bay)
Indian Friendship Centre (Sault Ste. Marie)
International Ladies' Garment Workers' Union Ontario District Council
Jane-Finch Community and Family Centre
Kingston Social Planning Council
Kitchener Social Planning Council
Lakehead Social Planning Council - Community Information and Referral Centre

Lawrence Heights Community Centre
Learning Disabilities Association
Le collectif des femmes francophones du nord-est ontarien
LIFT (Low Income Families Together)
London Union of Unemployed Workers
Low Income People Involved (North Bay)
Low Vision Association Ontario
Metro Toronto Chinese & Southeast Asian Legal Clinic
Mississauga Board of Trade
Mothers and Others Making Change (Kitchener)
National Council of Welfare
Native Women's Resource Centre
North York Inter-Agency and Community Council
N'Swakamok Native Friendship Centre (Sudbury)
Odawa Native Friendship Centre (Ottawa)
Older Women's Network -Metro and Area Council
One Voice Seniors Network
Ontario Advisory Council on Disabled and Seniors Issues
Ontario Advocacy Council on Women's Issues
Ontario Association for Community Living
Ontario Association of Interval/Transition Homes
Ontario Association of Professional Social Workers
Ontario Coalition Against Poverty
Ontario Coalition for Better Day Care
Ontario Coalition of Senior Citizens' Organizations
Ontario Council of Agencies Serving Immigrants
Ontario Federation of Indian Friendship Centres
Ontario Federation of Labour
Ontario Literacy Coalition
Ontario Métis and Aboriginal Association (Sault Ste-Marie)
Ontario Municipal Social Services Association
Ontario Native Women's Association
Ontario Non-Profit Housing Association
Ontario Public Service Employees Union
Ontario Restaurant Association
Ontario Social Development Council
Ottawa-Carleton Coalition for Literacy
Ottawa-Carleton Immigrant Services Organization
Ottawa-Carleton Low Income Support Services
Ottawa/Carleton Social Planning Council
Peel Social Planning Council
Persons United for Self-Help in Ontario
Peterborough Social Planning Council
Pinecrest-Queensway Health and Community Services (Ottawa)
Regent Park Sole-Support Mothers
Riverdale Immigrant Women's Centre
Royal Insurance Canada
Sandy Hill Community Health Centre
Sault Ste-Marie Social Planning Council
Social Development Council of Ajax-Pickering
Social Planning Council of Metropolitan Toronto
Social Planning Council, Niagara Falls
Social Planning Council, Sudbury Region
Social Service and Advisory Group (Sudbury)
Somerset West Health & Community Services (Ottawa)
South Essex Community Council
St. Catharines and Thorold Social Planning Council
St. Christopher House
Sudbury & District Labour Council
Superannuated Teachers of Ontario
Toronto Organization for Domestic Workers' Rights
Tory Tory DesLauriers & Binnington
Union of Ontario Indians (North Bay)
United Tenants of Ontario
United Way of London
Vermillion Bay Social Planning Council
Windsor Refugee Office
Women for Social Change (Windsor)
Women Working with Immigrant Women
Women's Centre (Sudbury)
Woodgreen Community Centre

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