Fair Taxation in a Changing World

FAIR TAX COMMISSION • COMMISSION DE L'ÉQUITÉ FISCALE

Report of the Ontario Fair Tax Commission

FAIR TAX COMMISSION • COMMISSION DE L'ÉQUITÉ FISCALE

1075 Bay Street
6th Floor
Toronto, Ontario
M5S 2B1

1075, rue Bay
6e étage
Toronto (Ontario)
M5S 2B1

Tel: (416) 325-8222
Fax: (416) 325-8235

Téléphone: (416) 325-8222
Facsimile: (416) 325-8235

December 1, 1993

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

Dear Minister:

We are pleased to submit to you the report of the Fair Tax Commission.

In our report, we have addressed the issues referred to us by the Lieutenant Governor in Council, together with other issues of tax fairness which arose in the course of our own work. We are particularly indebted to the hundreds of people across Ontario who participated in our work and played a central role in defining the tax fairness issues with which we deal.

We have appreciated our involvement in this process and we hope that our report and recommendations will be of use to the Province as it considers its future options for tax reform.

Yours sincerely,

Monica Townson, Chair

Neil Brooks, Vice-Chair

Robert Couzin, Vice-Chair

Jayne Berman

W.R.C. Blundell

Susan Giampietri

Brigitte Kitchen

Gérard Lafrenière

Fiona Nelson

Satya Poddar

Fair Taxation in a Changing World

Fair Taxation in a Changing World

Report of the Ontario Fair Tax Commission

Published by University of Toronto Press in cooperation with the Ontario Fair Tax Commission

UNIVERSITY OF TORONTO PRESS

Toronto Buffalo London

Printed in Canada

ISBN 0-8020-7572-X

Printed on recycled paper

Canadian Cataloguing in Publication Data

Ontario. Fair Tax Commission
Fair taxation in a changing world: report of the Ontario Fair Tax Commission

Co-published by the Ontario Fair Tax Commission.
Issued also in French under title: Une fiscalité équitable dans un monde en perpétuel changement.
ISBN 0-8020-7572-X

1. Taxation - Ontario. I. Title.

HJ2460.O5O5 1993 336.2'009713 C94-930173-6

The French edition, *Une fiscalité équitable dans un monde en perpétuel changement* (ISBN 0-7778-1957-0), is available through:

Publications Ontario, 880 Bay Street, Toronto
Telephone (416) 326-5320

Contents

* *Detailed contents for chapters appear at the beginning of each part.*

Figures and Tables

FIGURES

TABLES

The Commission

Monica Townson *
Chair
Monica Townson is a Toronto-based economic consultant and financial journalist, specializing in personal finance.

Neil Brooks *
Vice-Chair
Neil Brooks is a professor of law at Osgoode Hall Law School, York University, focusing on tax law and policy.

Robert Couzin *
Vice-Chair
Robert Couzin, former senior partner with the law firm of Stikeman, Elliott in Toronto, currently heads its Paris associated office.

Jayne Berman †
Commissioner
Jayne Berman is founder and president of The Golden Plug Limited, Toronto, a firm which leases home electronics, appliances, and furnishings.

W.R.C. (William) Blundell ° †
Commissioner
William Blundell served as chairman and CEO of General Electric Canada, Toronto, until his recent retirement.

Susan Giampietri °
Commissioner
Susan Giampietri is a vice-president of the Public Service Alliance of Canada, and a vice-president of the Canadian Labour Congress, Ottawa.

Brigitte Kitchen * †
Commissioner
Brigitte Kitchen is an associate professor with the School of Social Work at York University, teaching social policy.

Gérard Lafrenière °
Commissioner
Gérard Lafrenière is director, Northeast Region for Contact North, Sudbury, a distance education network.

Fiona Nelson °
Commissioner
Fiona Nelson is a long-time trustee with the Toronto Board of Education.

Satya Poddar *
Commissioner
Satya Poddar is a tax partner with Ernst & Young, Toronto.

* Research Subcommittee
° Consultation Subcommittee
† Working Groups Subcommittee

Acknowledgements

This report would never have been possible without the inestimable contribution of the many people who wrote to the commission, appeared at our public hearings, served as special advisers, and took the time to participate in special consultations. The names of everyone who participated in the work of the Fair Tax Commission are listed in the appendices to this report. Our apologies to anyone we may have missed.

We would like to extend our thanks to all those who participated in our work – those who gave their time to attend meetings and write reports. Volunteers across the province organized workshops and community forums; others organized tax forces to meet and discuss tax reform so they could make an effective, informed contribution to our public hearings.

People who participated in the commission's eight working groups and two technical advisory groups deserve special mention. Their persistence and hard work provided us with an invaluable resource. These groups sparked a public debate about tax issues in the communities where we focused our consultation efforts.

We are grateful for the dedication and commitment of these volunteers, as well as the participation by people in the Ontario public service who shared their knowledge and their time with us.

People from the Ministry of Finance, the Ministry of Municipal Affairs, the Ministry of Education and Training, and the Ministry of Agriculture and Food worked closely with us, both at the secretariat and in communities across the province during our public consultation program. Their participation was integral to our work, as was the cooperation of their ministries in providing the public with information about our work.

Under the guidance of Allan Maslove, our research director, the consultants who worked with us in our research program leave a valuable legacy of studies, data, and other information designed to contribute to the tax policy process well beyond the conclusion of the commission.

We also want to extend our sincere appreciation to the staff, who provided support, information, and resources both to the working groups and to the commission itself. In particular, we thank Hugh Mackenzie, whose vision and leadership as executive director shaped our work and was essential to the smooth functioning of the commission. We are also grateful to Bob Cooke, our director of administration; Barbara Ostroff, who directed the public consultation program; and our director of communications, Dianna Rienstra.

To support this multi-faceted exercise, we employed dozens of people for varying lengths of time in many different tasks, from organizing meetings of tax forces to ensuring that materials for meetings were distributed to the hundreds of volunteers engaged in working groups.

Our successes in these endeavours have been due in large part to the efforts of dedicated staff. We would like to acknowledge the contribution of the staff who, in the final months of intensive work of the commission as we held our hearings and prepared our final report, responded efficiently and effectively to the many and varied demands placed on them and exhibited both flexibility and grace under pressure. In particular, we would like to thank the writers and data analysts, Matthew Akman, Sheila Block, John Bossons, Sarah Bradshaw, Grant Cameron, David Duff, Chinn Duong, Morley English, Ana Ferraro, Moira Hutchinson, Dagny Mofid, Leon Muszynski, Linda Perry, Mark Polley, Elaine Rowe, Richard Shillington, Lesley Silver, Bob Spencer, Almos Tassonyi, Michael Teversham, and Susan Van Der Hout; the editorial staff, Dan Liebman, Marguerite Martindale, Mary McDougall Maude, and Rosemary Shipton; our internal publishing team, Don DesRoches, Jan Dutton, Mary Liston, Christine Avery Nuñez, and David Sharp; and the administrative support people who kept us going throughout, James Allicock, Lynette Bunsee, Raj Jadon, Mary Rampersad, and Theresa Wojtasiewicz. We would like as well to acknowledge the assistance of Helen Katz, Ann McGowan, and the staff of the Ministry of Finance Library.

We also wish to express our appreciation to the minister of finance, Floyd Laughren, for his belief that a review of the fairness of Ontario's tax system was long overdue. We would like to thank him particularly for his conviction that tax fairness should be discussed by the people it affects the most – taxpayers across the province who are normally not involved in the development of tax policy.

Finally, on a personal note, I would like to thank all the commissioners for their hard work and dedication to the project.

Monica Townson
Chair

1 December 1993

Introduction

1 Paying for What We Value

Decisions about taxation – about how we spread the costs of public services among individuals in a democratic society – are decisions that shape a society. How much we tax reflects the role that we as a society have decided to assign to government. How we share the costs of government goods and services reflects the most basic of values – what we think of as fair. The way we make those decisions reflects our views about how the democratic process itself should function.

The search for fairness in the sharing of the costs of collective activities, for fairness in taxation, is an enduring quest. That quest endures, not just because we try and fail in our attempts to achieve fairness, but also because our ideas of fairness evolve over time and we have to re-evaluate continually the tension between what is desirable and what is possible.

The search for tax fairness should be an ongoing preoccupation of our political process. Regrettably, it is not. It often gets lost in budget-making processes, in which ad hoc solutions are devised in response to the specific problems of the day. Governments create commissions periodically to bring tax fairness out of the background of annual budget making and to focus the attention of the public and eventually of the legislature on tax fairness issues. The work of each such commission is influenced by the issues current at the time it was created, by the economic and political environment in which it operated, and by the specific terms under which it was established.

The mandate given to us by the government is noteworthy both for its emphasis on tax fairness and for its requirement that we involve in our process people who are not traditionally part of public discussions and debate about taxation policy. Through our process, we have attempted to focus public attention on tax fairness and to identify the fairness issues of greatest concern to the people of this province. In our report, we explore those issues and develop responses we believe are consistent with basic ideas of tax fairness and the limits we face, both as a province in a federal political structure, and as a small, open economy in an increasingly integrated international environment.

Tax Reform for the 1990s

The context within which the Fair Tax Commission is considering tax reform options in the early 1990s is dramatically different from that encountered by the last major inquiry into taxation in Ontario, the Ontario Committee on Taxation (the Smith Committee) in the 1960s. The economy was then in the middle of a period of rapid growth that had continued largely uninterrupted since the late 1930s. The Canadian economy was thriving as a branch plant operation behind trade barriers. Ontario's vehicle manufacturing industry was beginning its adjustment to the Auto Pact, then Canada's major trade agreement with the United States. The integrated international capital market of today was in its infancy. The international exchange system was still on the gold/dollar standard. The price of gold was US$35 an ounce.

Governments generally, and provincial governments in particular, were much smaller relative to the size of the total economy in the 1960s than they are in the 1990s. Before medicare, health care made up a much smaller proportion of public spending than it does today, and the rapid growth in public spending on education that accompanied the maturing of the baby-boom generation was just beginning. Public finances generally were much less constrained. Canada had not experienced rapid inflation since the 1920s. The era of "cooperative federalism," in which the federal government played the role of banker and equalizer for provincial governments facing increasing spending responsibilities with vastly different economic resources, reached its apex in the late 1960s and early 1970s. The provincial-local relationship was undergoing rapid change. The education system had been transformed by the consolidation of school boards and by significant increases in provincial funding. Rapid growth in urban areas was creating pressure for municipal reorganization. An antiquated local tax system was straining under the pressures of the rapid development that took place in the 1950s and 1960s.

Public finances were quite different in the 1960s as well. Income taxation was dominated by the federal government. The role of provincial governments in income taxation was clearly that of the junior partner. New federal-provincial agreements on income tax collection introduced in 1962 allowed provincial governments to determine their own income tax as a percentage of federal income tax, but the rates of provincial tax were relatively low and provincial policy flexibility was very limited. The federal government still accounted for 75 to 80 per cent of personal income tax revenues in most provinces. At the same time, sales taxation was largely a provincial domain. Although the federal government levied a sales tax on manufacturers, the tax was hidden in the prices of manufactured goods and the rate of tax was relatively low.

We have been asked to address issues of tax fairness in a very different context. Canada's closest economic relationship continues to be with the United States. But free trade has undermined the basis of the branch plant economy, forcing dramatic structural changes in the economy and increasing Ontario's exposure to international influences. Integration of national economies and capital markets poses a threat to the efforts of national governments either to sustain distinct systems for the taxation of capital or to resist downward pressures on revenues and tax rates created by actual or threatened capital mobility.

The philosophy of revenue sharing and interprovincial equalization that characterized the cooperative federalism of the late 1960s and early 1970s has been replaced by a determination on the part of the federal government to share its fiscal problems with provincial governments through reduced transfers. The provincial government, in turn, has passed on a share of its fiscal problem to local governments.

Federal-provincial and provincial-local public finances have also been transformed. Provincial reliance on income taxes has increased to the point where provincial governments are now responsible for raising nearly 40 per cent of the income tax collected in Canada. At the same time, the federal government, through the Goods and Services Tax, plays a major role in sales taxation. In the provincial-local sphere, more than 100 provincial-local conditional grants programs in the municipal sector as well as the complex mixture of joint provincial-local funding, provincial policy control, and local democracy in education have all blurred the lines between provincial and local responsibilities.

In addition to these changes in the economic and political environment, the taxation policy environment itself has changed. Concern about the impact of tax rates on the behaviour of individuals and corporations has become much more prominent in tax system design. As a result, rates of tax on the highest income earners have come down in many countries, including Canada. Top corporate income tax rates have been reduced in response to concerns about capital mobility. At the same time, tax bases have been broadened, particularly the corporate income tax base. Many of the incentives that had been built into the corporate tax system in the 1960s and 1970s were eliminated. The emphasis in discussions of tax fairness for individuals has shifted from making the tax system more progressive to broadening tax bases to address the uneven treatment of individuals in similar circumstances. Despite this new emphasis, however, federal budgets in the 1980s created new categories of special treatment for income from capital gains and maintained the preferred tax status of other forms of personal income from capital. In addition, the expansion in the number of self-employed individuals in Canada and the growth of the underground economy have widened the gap between the taxes paid by those who earn their income from employment and those whose income derives from other sources.

Concern about the impact of the tax system on individual decisions about work, investment, and savings has given rise to a trend in the academic literature on taxation to favour taxes on consumption over taxes on income. Although this trend in academic thinking has not had a significant impact on tax system designs generally[1] in recent years, some countries, most notably Denmark and New Zealand, have increased their reliance on consumption taxation.

---

[1] In most countries in the Organisation for Economic Co-operation and Development (OECD), taxes on consumption have not increased substantially as a proportion of gross domestic product (GDP) since the 1970s.

The tax system is being relied on more heavily and more explicitly in other areas of public policy. In areas as diverse as research and development, child care, retirement income, services for people with disabilities, energy conservation, and the prevention of smoking, the tax system is a major instrument of public policy.

Property taxes are now higher as a proportion of education costs than they were in 1967, when the Smith Committee recommended that their share be substantially reduced. Despite several attempts at reform, the property assessment system is more chaotic today than it was when the provincial government took over the assessment function from municipalities in 1970.

Mandate of the Fair Tax Commission

The Fair Tax Commission was established by the Ontario minister of finance in March 1991 with a mandate to review the Ontario tax system and to make recommendations to improve its fairness.[2] The commission was asked by the government to provide advice concerning the design and implementation of a more equitable tax system in the province. At the same time as it emphasized fairness as an objective, the government stressed the need for the commission to develop workable options for reform, given the constraints faced by Ontario as a subnational jurisdiction in an open economy undergoing significant structural change. The commission was also given a mandate to broaden public participation in discussions of tax issues beyond the experts who often dominate such debates.

We involved the public in our work in a number of ways. In response to the direction of the minister, working groups of volunteers were established to study and report to the minister on specific issues of tax fairness. We also worked intensively with people in many communities with the objective of enriching the debate on tax fairness issues in our public hearings. We published educational material on taxation at the beginning of our mandate and issued a discussion paper on tax fairness issues prior to our public hearings. We held hearings in 17 communities around the province over a

---

[2] The orders in council passed in December 1990 and January 1991 authorizing the minister to establish the commission are reproduced in full in appendix A to this report.

period of nearly three months. We also encouraged and received thousands of letters and submissions from individuals and organizations throughout Ontario.

Lessons from the Public

In our interactions with the public throughout our mandate, we found that the principles and ideals that formed the basis for the recommendations of the federal Royal Commission on Taxation (the Carter Commission) in the 1960s have been remarkably durable. Ontarians believe in progressive taxation. While they disagree about the extent to which the tax system should be made more progressive, they hold that people should contribute proportionally more to support public services as the resources available to them increase.

Similarly, the idea that people in similar circumstances should pay similar amounts of tax is firmly rooted in our political culture. People compare themselves to their neighbours. They believe it is unfair that someone whose living standard is similar to theirs should be able to get away with paying less tax because their consumption patterns differ, because their incomes receive preferential tax treatment, because they have more opportunities to avoid paying tax, or because they are able to escape detection of tax fraud.

The concepts of horizontal equity and vertical equity – equal treatment of equals and appropriately unequal treatment of unequals – are widely accepted as the principal criteria of fairness against which the tax system should be measured.

Concerns about property taxes and the appropriateness of using local property taxes to pay for education dominated our public hearings. People complained about the current residential property assessment system and questioned the fairness of market value reassessment as a response to the chaos of that system. A common theme was that services like elementary and secondary education, which are seen as entitlements in a liberal democratic society, should be funded from taxes related to ability to pay. People argued against the use of property taxes for the funding of education on the grounds that the residential property tax is not related to ability to pay.

Despite this general acceptance of ability to pay as a measure of fairness in taxation, the constrained economic circumstances faced by individuals and by governments in the 1990s have had a profound impact on their views of how tax fairness can be realized. In the

1990s, people are very conscious of how their taxes compare with those in other jurisdictions, particularly those in the United States. They are prepared to pay higher taxes if, in return, they receive public services that contribute to a better quality of life. They strenuously oppose higher taxes if they think that the money is wasted. In fact, people believe that no tax can be seen as fair if the money raised from it is wasted. This concern led many hearing participants to suggest greater reliance on such measures as specific fees tied to the use of some public services, particularly where environmental impact should be considered, and earmarking of revenues raised from some taxes for the provision of identified public services. These issues are addressed specifically in our report.

People are also well aware of the factors in the economic and political world that limit our ability to deliver a tax system fully consistent with fairness principles. These concerns came out most clearly in discussions of tax changes that might affect the ability of Ontario to attract and retain investment in a world where investors have choices unrestricted by national policies.

Finally, we found that people are not prepared to accept as fair a tax they do not understand. In our report, we emphasize the need to open up the taxation policy process to make it clearer to and more easily understood by taxpayers.

Our General Perspective

Our judgment, based on the fairness issues raised by the public and on our assessment of the evidence with respect to the impact of the tax system on economic behaviour, is that a renewed emphasis on progressive taxation in Ontario tax policy is both desirable and feasible. We also believe there is considerable scope for making the tax system more even-handed in its treatment of people in similar economic circumstances. In writing our report, we took into account concerns about the impact of the tax system on the economic behaviour of individuals and on the performance of the economy. Those concerns had a significant impact on our recommendations in a number of areas. In keeping with our fairness mandate, however, we saw our task as one of finding an appropriate balance between the goal of tax fairness and these other concerns.

In our search for that balance, we were influenced by those who participated in our public consultations. The involvement of people who do not normally participate in discussions of tax reform gave a different weight to the constraints on fairness in our work than might have been the case in a more traditional exercise. We noted that the concerns that have dominated the public finance literature over the past 20 years, about the impact of taxes on behaviour and therefore on the well-being of individuals, are not always the issues about which people in Ontario are most worried.

At the same time, we recognize that Ontario faces practical limits on its ability to increase the progressivity of its tax system. The mobility of corporations and, to some extent, of high-income individuals made possible by the integration of the international economy does not support the single-minded pursuit of tax fairness by individual nations, much less by provinces. Levels of taxation in excess of international norms in these areas are difficult to sustain. We believe, however, that Ontario cannot afford to allow passive acceptance of international trends to undermine the capacity of government to provide the public services that Ontarians and Canadians want and to pay for them in a way that is consistent with broadly accepted public standards of fairness. Ontario and Canada should push against those limits, adopting policies that achieve the fairest possible tax system and strengthen Canada's ability to resist pressures towards an international lowest common denominator in the taxation of income from capital.

In developing recommendations, we addressed issues in the design of individual taxes as well as the role of each individual tax in the tax system as a whole. For individual taxes, we deal with issues that arise from basic structure as well as from the use of the tax to support other public policy objectives and its impact on tax fairness. Our report raises questions about the extent to which the tax system is used to deliver subsidies to individual and corporate taxpayers. We note that the decision-making process that leads to the implementation of many such tax provisions is flawed; that accountability for the costs of and benefits from these provisions is almost non-existent, and that the widespread use of the tax system to deliver subsidies to individual taxpayers is a major contributor to perceptions that the tax system itself is unfair. While we do not recommend that the tax system not be used to deliver subsidies at all, we recommend that the government introduce much tighter accountability for tax expenditures as a permanent feature of the tax policy process. We recommend that some tax expenditures be taken out of the tax system and delivered through direct spending programs, and that others be redesigned to be more effective in achieving their objectives.

Ontario levies a variety of different taxes, some of which are progressive, others, regressive, and still others that bear no systematic relationship to ability to pay because they are designed to achieve other public policy purposes. We believe that it is appropriate and advisable for Ontario to levy a variety of different taxes and that it is not necessary for every tax to satisfy a specific ability-to-pay criterion. With a variety of different types of taxes, however, the extent to which Ontario relies on each of the major taxes becomes critical in determining the fairness of the system as a whole. In fact, changes in tax mix will have a far greater impact on the fairness of the tax system than would the redesign of any individual tax. In our recommendations, the most important step Ontario can take to improve the relationship between taxes and the ability to pay of taxpayers is to reduce this province's dependence on local property taxes as a source of funding for education and to replace the revenue forgone by increasing rates in more progressive taxes.

Taxes not intended to be related to ability to pay should be limited to areas in which their use is appropriate on general fairness principles. Thus, we recommend that user charges be limited to such services as sewer and water supply and garbage collection and disposal, and not be imposed in areas such as health care. We also recommend that taxes such as environmental taxes, which are intended to achieve objectives other than the raising of revenue, be designed carefully to focus on those other objectives.

It is important to emphasize, however, that we are proposing a change in direction, not a revolution. The limits that Ontario and Canada face in the taxation of sources of income that are mobile, such as capital, are real and cannot be ignored. As a result, while making recommendations that, taken together, constitute an endorsement of a more progressive tax system, we have been careful to put together a set of recommendations that we believe can reasonably be enacted in Ontario, given all the constraints this province faces.

Major Themes

Our recommendations are as wide-ranging as the issues put before us by the public. However, many of them can be summarized under a few dominant themes.

Ontario's tax system should be made more progressive overall.

Our report endorses progressive taxation, recommending action to eliminate special tax provisions that favour income from capital over income from employment, a more progressive rate structure in the Ontario income tax, and the adoption of a national tax on wealth transfers similar in revenue-raising capability to that in effect in the United States. All these changes will make the tax system a more effective instrument for income and wealth redistribution. The report recommends a significant change in the mix of taxes used to support public services in Ontario, a shift away from the regressive residential property tax and towards the progressive income tax. It also cautions against significant increases in payroll and other taxes where the base is limited to employment income.

The tax system should be even-handed in its treatment of individuals in similar economic circumstances.

We question provisions in the personal income tax which, while apparently gender neutral, have a different impact on women than on men. We recommend that tax provisions based strictly on marital status be eliminated and that assistance to families delivered through the tax system be linked to income and focused more on families with children. We also recommend that the deduction for child support payments be eliminated and that such payments be tax exempt for recipients.

We recommend that the base for the retail sales tax be broadened to include the same general range of goods and services currently subject to the federal Goods and Services Tax (GST). This will make the amount of sales tax paid by an individual less dependent on his or her consumption patterns.

We are concerned about the impact on tax fairness of tax evasion through the growth in the underground economy. We believe the most unfair tax is one that most people pay and some people can choose not to pay. We recommend that the government take a much tougher and more aggressive approach to the enforcement of tax laws on behalf of the vast majority of people who pay their taxes and thus foot the bill for those who do not.

Taxes should be linked to services only where such links support tax fairness objectives.

We do not believe that the current link between property taxes and education spending can be supported on fairness principles. The current system for funding education is unfair both to students and to taxpayers. The quality of education available to students in Ontario depends on where the student lives and what school he or she attends; the tax we pay to support elementary and secondary education depends on the community we live in. We recommend a complete overhaul of the education funding system. To ensure that funds for education are allocated where they are needed from the perspective of students, funding would be granted according to a formula based on student characteristics and needs and on local costs. Education would be removed from the residential property tax base, except for a limited local levy to permit the system to respond to local needs. The required revenue would be raised at the provincial level, primarily through the personal income tax. Local non-residential property taxes for education would be eliminated and replaced by a provincial commercial and industrial property tax.

The property tax would be redesigned as a tax to pay for benefits received from local services. We recommend new systems for assessment for both residential and non-residential property that would bring consistency to the current non-system and would better reflect benefits from local services than market value. We also recommend that the separate business occupancy tax be eliminated.

We recommend significantly increased reliance on user charges to fund sewer, water, and garbage services; a major reduction in provincial grants for local services such as transportation, sewer and water supply, and waste collection and disposal; a significant reduction in the scope of exemptions from local property taxes; and a broadening of local powers to set tax rates.

Ontario's tax system should be better structured to resist international trends that undermine tax fairness and to raise revenue more efficiently.

Canadians have chosen to deliver services through the public sector to a greater extent than have people in some other jurisdictions. Our analysis shows that more than 90 per cent of the difference in the size of the public sector between Canada and the United States can be explained by differences in the extent of public funding for education and health and the value of transfers to people, most notably pensions. Our more generous system has to be paid for, through higher taxes. To protect the tax bases needed to support Ontario's public services, we suggest that Ontario explore the potential for changes in the division of taxing powers between the federal and provincial governments. The goals would be to simplify the tax system and to ensure that tax bases most vulnerable to tax avoidance are administered by the government in the best position to deal with problems of avoidance.

We address specifically the problems faced by Ontario, and indeed by the federal government, in taxing capital and income from capital. Our report recommends that, to the extent possible, the tax system be organized to maximize the effectiveness in taxing mobile tax bases, such as corporate income and wealth. We recommend the elimination of Ontario-only corporate tax provisions and the development of a national approach to corporate income taxation that minimizes opportunities for avoidance and establishes minimum rates of corporate tax at the provincial level. While we conclude that Ontario's system of corporate taxation is comparable at present to those in other jurisdictions, we recommend that Ontario maintain a reasonable relationship between its tax rates and those in other jurisdictions. We also recommend a new national tax on wealth transfers at a level comparable with those applicable in the United States and in the European Community.

We recommend that Ontario seek a new tax collection agreement with the federal government that gives the province more influence over its own income tax policy while maintaining the current unified national administrative structure. We also recommend that Ontario work towards an agreement with the federal government and the provinces for a unified national sales tax structure based on a modification of the Goods and Services Tax.

The tax system should be well coordinated with other public policies.

We recommend replacement of Ontario's complex array of tax credits with a simplified system of credits for adults and children that could be readily integrated with proposed reforms in Ontario's social assistance system. We recommend that support for child care and for persons with disabilities be delivered directly rather than through the tax system. We also recommend reducing the maximum subsidies available for retirement savings for higher-income individuals.

Our report raises questions about the effectiveness of tax measures as instruments of economic policy. We propose the elimination of tax preferences for most capital gains and call for a federal-provincial review of the effectiveness of the dividend tax credit. We question in particular those features in the Ontario corporate income tax system that offer incentives beyond those provided in the federal corporate income tax.

Our report endorses the use of the tax system as a policy instrument for environmental change. It recommends a comprehensive carbon tax, a refundable food and beverage container tax, and increased reliance on environmental taxes as a way to force consumers and businesses to take full environmental costs into account in their consumption and production decisions.

Tax policy and administration should be open, democratic, transparent, and accountable.

We conclude in our report that the tax policy process is unnecessarily secretive and that subsidies delivered through the tax system should be subject to public disclosure and accountability on the same basis as other government spending programs. We make a series of recommendations to open up the tax policy process and to require governments to account fully for the revenue forgone when the tax system is used to deliver subsidies.

We identify serious problems of transparency in the property tax system, with its chaotic mixture of different assessment systems and its intermingled taxation and assessment policies. We recommend assessment and taxation policy changes that would recognize residential and non-residential property taxes as different taxes, put the assessment base for each tax on a consistent basis across the province, and draw a clear distinction between assessment policy and taxation policy. These changes would enable taxpayers to compare taxation policies in different jurisdictions and on different types of property.

Organization of the Report

Parts one to three of this report set out the bases on which we formulated our recommendations. Part one discusses the principles that underlie the design of a tax system. Part two reviews the context for tax reform, with particular emphasis on those characteristics that are pertinent to a provincial government undertaking tax reform within a federal structure and in an open economy. Part three summarizes the major features of the revenue generation and public expenditure system in Ontario and presents the results of our analysis of the impact of the provincial and local tax systems on individuals.

Parts four to thirteen present an analysis of key issues in tax fairness and our recommendations for reform, and the concluding part provides an analysis of the impact and implications of our recommendations. The analysis and recommendations in this report are not intended to resolve every issue that a government would need to deal with in designing a fair tax system from scratch. They are intended to provide information, analysis, and policy direction on major issues of tax fairness in Ontario in the early 1990s as identified by the commission and by the public. This focus on the issues of fairness in taxation, rather than on an analysis of the tax system, has led us to organize our report to reflect the themes and areas of interest raised by those involved in our consultation process.

Part four deals with the process of making and administering tax policy: formulating tax policy, accounting for subsidies delivered through the tax system rather than through the expenditure system, earmarking tax revenues for particular purposes, administering the tax system, and dividing income tax responsibilities between Ontario and the federal government.

Part five presents our findings on income tax issues as they relate to the economic equality of women and men: specifically, the unit of taxation, the marital credit, and the tax treatment of child support payments.

Part six deals with the role of the tax system in social policy. It presents our recommendations with respect to tax credits for low-income adults and children, the tax treatment of seniors and people with disabilities, and the retirement savings and child care deductions from taxable income.

Part seven focuses on tax changes to enhance the progressivity of the tax system. It deals with income tax provisions that are of particular benefit to high-income earners, the personal income tax rate structure, and wealth taxation.

Part eight addresses issues in the taxation of business, including corporate income tax, payroll tax, and resource tax, and the taxation of small business and cooperatives.

Part nine sets out our findings on the issues of sales taxation, whether there should be a single sales tax system in Canada to replace the Goods and Services Tax and the provincial sales taxes, and the potential role for special sales taxes on luxury consumer goods and services.

Part ten presents recommendations for using the tax system as an instrument of environmental policy.

Part eleven provides an analysis of the issues in financing local government and puts forward recommendations dealing with the financing of education, social and environmental services, property assessment reform, and broader issues in the role of local government in tax policy.

Part twelve deals with the fundamental question of the mix of taxes to support public services in Ontario, and the extent to which Ontario should be relying on revenue from different taxes.

Part thirteen presents our proposal for a new relationship between aboriginal people and Ontario in the area of taxation.

The concluding part reviews the impact and implications of our recommendations and addresses questions flowing from their implementation.

2 Enhancing Participation in Tax Policy

To be effective, a commission investigating any area of public policy must be more than a vehicle for the expression of the views of those appointed to it, as informed by expert knowledge in the field. It must also provide an opportunity for the public to be informed about the important issues at stake, to express their views on those issues, and to influence the decisions of commissioners as reflected in the commission's report. As we began our work in the spring of 1991, we were encouraged to take our role in encouraging public participation in taxation policy very seriously. Our mandate made specific reference to our involving people and organizations not normally consulted about tax policy.

The membership of the commission itself reflected that desire for broad consultation. Three of us are acknowledged experts in taxation, each with a different perspective. Two of us are business executives, one from a large corporation and one from a small business. One of us is a labour leader. Four of us are involved in education and communications: one an academic and communications specialist with a background in the cooperative movement, one an educator with an extensive background in local government, one an academic and activist in social policy, and one an economist with a background in public finance and social policy.

Our initial interest in encouraging broad public participation was reinforced by the input we received from individuals and organizations. From across the spectrum, people whose advice we sought stressed the importance of stimulating an informed public debate on tax fairness issues. Finally, as we reviewed information gathered by others about public attitudes towards taxation in Ontario, it became clear that the widespread feeling among people that their views did not matter in determining taxation policies influenced their views of the fairness of the system.

As a result, our work plan included a number of initiatives of participatory democracy to complement our research and policy development activities. In response to the specific terms of our mandate, we established working groups that included a broad cross-section of people representative of organizations with an interest in the topic under consideration. We encouraged working group members to consult and share information with others. To complement the working groups, we developed an innovative community-based consultation process, through which "tax forces" of volunteers became involved in our search for fairness. We published and distributed broadly two publications designed to inform and to stimulate debate about tax reform issues and written to be accessible to the interested public. We made our hearings as informal and as open as possible. We engaged hundreds of volunteers directly in our process on an ongoing basis. We knew when we started that we could not involve everyone in Ontario who might be interested in issues of fair taxation, but we strove within the limits of the resources available to us to attract a more representative group of Ontarians to our process than would have been possible through a consultation limited to formal public hearings.

In designing the process, we also recognized the need to ensure that the people whose volunteer time we used so freely would see the results of their hard work in our report. The people and organizations that took part through working groups, tax forces, public hearings, or formal submissions and correspondence played a major role in helping us to set our agenda of tax fairness issues. We asked them to bring forward the issues as they saw them; we made a commitment to them that those issues would be reflected in our report – not that we would agree with the conclusions they reached, but that we would address the issues seriously.

Working Groups

In September 1991 the Ontario minister of finance (then the minister of treasury and economics) appointed eight working groups to study and make practical recommendations on specific tax issues. These groups were supported by commission staff, but independent of the commission, reporting directly to the minister of finance. The working groups studied fairness issues in corporate minimum tax, taxation of real estate gains, the relationship between the Ontario retail sales tax and the goods and services tax, taxation and the environment, women and tax, low-income tax relief, property tax, and wealth tax.

The working groups brought together more than 200 people, including business executives, representatives of trade unions, farmers, educators, municipal officials, activists in social action groups, tax professionals, environmentalists, academics, and members of the public not affiliated with an organization which had a direct interest in the tax system.

These groups were made up of volunteers representing a broad cross-section of interests in the specific tax reform issues under consideration. The Low Income Tax Relief Working Group, for example, included advocates for low-income people, community analysts with expertise in social policy issues, a social work professor, a municipal director of finance, a number of business people, a tax lawyer, a chartered accountant, and two people employed by trade unions.

Each working group was assigned two commission staff and was supported by a number of policy analysts from ministries with an interest in the topic being studied. This structure provided the working group with access to expertise within the Ontario government and enabled policy analysts to learn how a broadly representative group thinks its way through fairness issues in developing tax policy recommendations.

Working groups were required to produce reports reflecting their particular response to questions put to them by the minister of finance. Although they all established their own work plans, they followed a similar process of familiarizing themselves with their mandate, identifying the issues they felt were important to address, developing an understanding of what various people in the group thought about the issues and how that influenced their views about tax reform, coming to an agreement on areas for tax reform, examining different tax design options, developing their conclusions, and signing off on a final report. Three of the groups submitted final reports to the minister in March and April 1992, four in November and December 1992, and one in March 1993.

Although the working groups were appointed independently to advise the minister, their reports contributed to the commission in a number of ways:

- the diverse perspectives on tax issues reflected in the working group reports provided us with valuable insights into the views of a broad cross-section of people, some of whom had never been involved in policy discussions on tax reform;
- research provided to working groups was an important part of our own analysis of tax fairness issues;
- the policy directions in working group reports assisted us in identifying areas on which to focus;
- our substantive recommendations in a number of areas are direct extensions of the logic and conclusions of working group reports; and
- working group reports and summaries were distributed across the province and were used in our community consultation program to inform public debate about tax reform.

Community Consultation Program

To complement the working groups, we introduced an innovative consultation program to involve people who were representative of the broader public. Our community consultation program involved hundreds of Ontarians in 13 communities (Cobourg, Grey-Bruce, Hamilton, Kenora, London, Ottawa, Peterborough, Sault Ste Marie, Sudbury, Thunder Bay, Timmins, Toronto, Windsor). They identified tax fairness issues of particular concern to them as individuals, to the organizations with which they are connected, or to the communities where they live and work.

We hired community animators to work with individuals in existing groups to identify tax issues of local concern and stimulate public discussion. Animators also brought together a number of people to work together at the community level. These volunteer "tax forces" were encouraged to develop work plans appropriate to their community, which would stimulate learning and debate about tax fairness and tax reform among people who traditionally have not had the opportunity to participate in public policy discussions. Each tax force organized a variety of activities, from public forums, debates, and seminars to radio and television open-line shows. They produced and distributed material on issues of local concern and reflected back to us tax issues that were raised by members of their community.

Tax fairness issues and reform options identified at the community level were shared with commissioners in a variety of ways: when tax force members from across the province met with commissioners; during public community forums sponsored by tax force members which commissioners attended in the fall of 1992; and in written reports submitted to the commission throughout the process. Tax forces contributed to the work of the commission by helping people who have traditionally been excluded from the process of making tax policy become more informed and confident about their ability to debate tax reform options at community events. The inclusion of these perspectives is reflected in the commission report in the agenda of issues addressed and in the arguments about reform options.

As a result of the work of the tax forces and the public consultation program, there is substantially more knowledge about taxation at the community level, and people are better equipped to participate in public debate about tax reform. The information distributed during the life of the commission will continue to be used to inform public debate about the tax system. Moreover, having participated in tax policy discussions, the public will expect to be included in developing tax policy in the future.

Public Input

Commissioners and staff met informally with hundreds of individuals and groups to explain the work of the commission, to receive presentations on technical issues, and to seek input on issues of particular concern to the individuals and groups affected. We attracted a large number of submissions from organizations and individuals on an extremely wide range of issues. A total of 2350 submissions and letters were received by us during our term.

We recognized that part of our mandate was to encourage informed debate in communities among people who might never before have thought about tax reform, other than in the sense of "I pay too much tax" and "Other people don't pay their fair share." To this end, we made a conscious effort to distribute accessible materials designed to inform and to stimulate debate. We produced a basic primer on tax issues in the fall of 1991 and our discussion paper, *Searching for Fairness*, was released prior to the public hearings. This paper highlighted the major issues we proposed to deal with and presented data and analysis relevant to those issues. Working group reports were distributed by tax forces and helped to inform the public debate that took place in communities. We also produced seven newsletters that were mailed to our database of 15,500 individuals and organizations.

In the more formal part of our consultative work, 21 days of public hearings were held in 17 communities across the province involving more than 1000 individuals and organizations.Those who registered and appeared at our hearings are listed in appendix F. The hearings were designed to encourage the participation of people who might have been intimidated by a traditional hearing format. Registration involved completing a simple form that asked participants to identify the tax fairness issue they wished to discuss with the commissioners. Formal briefs were not required. When a number of people indicated an interest in addressing a similar topic, a roundtable format allowed for discussion among participants and commissioners. Each hearing also included open periods when members of the public who had not registered had an opportunity to address the commissioners. The hearings were recorded, and summaries of submissions received are part of the record of the commission and will be available to the public through the Legislative Library.

Research Program

The research program was designed to support the deliberations of the commission. However, the commission also wanted to ensure that research and public input did not operate in isolation from each other, but, rather, informed each other. Tax fairness issues and reform options raised by the public were reviewed and discussed by us throughout our term, and that influenced the research we requested. We were determined to report the research results in a manner that would be accessible to non-expert readers, and to make the results of the research studies available.

At the outset of our work, the research program was guided by a research subcommittee made up of five commissioners, generally those most knowledgeable about taxation and/or research methodologies. An outline of the proposed research program was developed in consultation with a number of public finance specialists and circulated widely to the academic and professional tax communities. Specific research projects were identified. The research director determined staff availability to undertake specific projects and advised the research committee on work to be contracted to outside researchers. Proposals were solicited from researchers with established reputations in the area. In addition, researchers who initiated contact with the commission, many in response to the program outline, were invited to submit proposals. The research committee then examined these proposals and determined which researcher or group of researchers would undertake the accepted projects.

Approximately 50 formal studies were conducted for the commission, most by external researchers, but some by commission staff. To make the most of the available research budget, the committee decided not to undertake work in areas where the commission could draw on extensive and recent research already in the public domain. It also determined not to undertake studies on topics where it was unlikely that another article would settle outstanding debates in the public finance literature. The studies sponsored by the commission were a combination of original research (most often involving the development and analysis of new databases), reviews, and distillations of the outstanding work in a particular field.

The research studies, for the most part, were in three broad areas. First, a number of studies addressed the question of "where we are," by examining aspects of the current Ontario tax system, its distribution and economic effects. A second issue explored was "where would we like to be," that is, what properties would we ideally wish to see embedded in a reformed tax system with respect to fairness and other concerns. The third issue was "what intervenes" to affect the ability of the government to reform the tax system to achieve the desired structure. The work in this area focused on economic or market factors such as increasing globalization and mobility of capital, goods, and, to a lesser extent, labour. It also examined institutional factors such as the way the Canadian federal structure affects provincial tax design.

Most of the studies are to be published by the University of Toronto Press. The remainder are available through the Ministry of Finance Library. A list of these studies appears in appendix G at the end of this report.

The databases we developed are an important part of our work. One project used a wealth database constructed by the accounting firm Ernst & Young, as well as other information, to construct a data set that could be used to estimate the revenue yields and distributional impact of several wealth tax models. The commission assisted the provincial Ministry of Finance with the development of an Ontario corporate tax database, and analytical results from those data were made available to us. Commission work also led to the development for the first time of a model of the Ontario mining tax. Results from this model were used in the analysis of the impact of various options for cash flow taxation in the mining sector.

To make it possible to analyse the local government finance system, we developed a database that integrated information about the municipal finance system drawn from the Ministry of Municipal Affairs' Municipal Analysis and Retrieval System (MARS) and various administrative databases in the Ministry of Education. Related databases for particular analyses were developed integrating census data, Revenue Canada income tax data, and data from the Ministry of Education and the Ministry of Municipal Affairs.

In addition, our research program made extensive use of a number of research models. The Social Policy Simulation Database and Model (SPSD/M) developed by the Analytical Studies Branch of Statistics Canada was the main tool used to analyse the distribution of the existing tax system among the people of Ontario as well as the impact of alternative reform proposals. Aggregate economic projections and the impact of various reform options were analysed using the FOCUS and FOCUS-ONTARIO models of the Institute for Policy Analysis at the University of Toronto. The Caledon Institute of Social Policy, under contract to the commission, developed the Caledon Tax/Transfer Model to analyse the impact of the tax and social assistance systems, and alternatives to them, on a wide range of family units.

Bringing It All Together

This commission differs from other commissions studying tax reform in a number of ways: the range of perspectives and expertise we brought to bear on the task as commissioners, the emphasis on including those traditionally excluded from tax policy development in our process, and our commitment to integrating our consultation efforts with our research and policy development work.

In coming to our conclusions, we had to consider the tax fairness issues of concern to the people of Ontario, the ideas and recommendations presented in working group reports, the existing body of research, and the results of new research we commissioned. We looked for a balance among conflicting views on tax issues and preferred options for reform. With all this information at hand, we worked intensively to respond in ways that were consistent with principles of tax fairness, at the same time taking into account the unavoidable economic and institutional constraints. As with our other published work, we have maintained our commitment to accessibility, so that our reasoning and recommendations for tax reform are clear to all.

OVERVIEW OF THE TAX SYSTEM

Part One
Principles of the Tax System

3 Purposes of the Tax System

Most of us think of the tax system without reference to either the benefits we receive from public services or the other purposes for which taxes are levied. This separation of taxes from the services for which they pay is reinforced by the language we use to describe the impact of taxes on people. We refer to tax burdens as if taxes were unrelated to any benefit; we would never refer to the price of a car or a stereo system in such a way. Often the public debate on taxation reinforces the distinction. Contrived media events like "tax freedom day" perpetuate the impression that the taxes we pay have nothing to do with the benefits we receive from public services. Tax cuts, deficit reduction, and the need to maintain public services are often debated as if they have nothing whatsoever to do with each other. Not surprisingly, public opinion surveys often reveal that significant majorities support both reductions in taxes and increases in levels of service in all major areas of public spending.

This separation of taxes and public services emerged in our public consultations as well. Many of the arguments put to us about tax fairness were actually complaints about taxes generally being too high in Canada or in Ontario, particularly in comparison with levels of taxation in the United States. These arguments imply that Canadians have decided on the basis of some perverse and inexplicable logic to have high taxes and could easily decide to lower them. In fact, what Canadians have decided to do is to provide more services through the public sector than Americans have.

Linking taxes to the services for which they pay is important in distinguishing issues of the role of government from issues of tax fairness. In addition, for some services and for some taxes, improving the link between taxes and services can contribute directly to greater fairness in the tax system.

Relationship between Taxation and Democracy

For society in general, taxation depends on choices made collectively about what goods and services should be provided through government, what proportion of the income of society should be redistributed among its members, how the revenue needed to provide those goods and services should be raised, and how the tax system should be used to influence the decisions of individuals and corporations. These choices reflect fundamental ideas about the kind of society we want. The decisions are political, and in a democracy they should reflect broadly accepted social values. The democratic process tests those values constantly and measures the performance of our institutions of government against those values.

Although taxation is currently the chief method by which governments obtain resources, it is not the only way to provide for public goods and services, nor has it always been the principal way for governments to obtain resources.[1] Conceptually, and perhaps historically, the first method of providing for public goods and services involved voluntary transfers. In a world without any government, individuals might voluntarily agree among themselves to provide collectively for such common needs as a system for self-defence.

As communities increase in size and complexity, however, this sort of arrangement becomes inefficient and unstable. Since it is impossible to exclude non-paying individuals from the benefits provided by public goods and services, all individuals would have an incentive to "free ride" on others by contributing less than they would actually be willing to pay. As a result, the quantity of public goods and services would almost certainly be less than individuals would prefer, and the stability of even this diminished public sector would be highly uncertain. In addition, since individuals might be

---

[1] An excellent summary of alternatives to taxation appears in the Carter Report (1966, vol. 2, 1–5).

unwilling to make payments for redistributive purposes, it is arguable that voluntary taxation would be unfair as well as inefficient. In fact, it is likely that a successful system of voluntary taxation can function only in small, tightly knit communities, where social bonds function to ensure adequate contributions by all individuals. One could imagine, for example, closely knit and isolated tribal societies in which social bonds are so strong that collective activity can thrive, based on voluntary contributions by individuals, or family groupings of labour and resources. In large and diverse societies like a modern nation-state or in a province like Ontario, it is inconceivable that voluntary transfers alone could constitute a fair and efficient means of public finance.

Compulsory transfers of human and physical resources were the most prominent sources of revenue for the earliest governments. By expropriating land and agricultural output and especially by conscripting labour, early governments obtained the resources to conduct many of their activities, including waging war. Expropriation without compensation of the property of their own citizens is rare in modern societies and, where it does take place, it is usually carried out in the context of a political revolution rather than as a method for financing ongoing government activities. Conscription of citizens' labour is also rare, except in times of war or national crisis. Neither has been a prominent feature of the system of public finance in Canada.

Although compulsory transfers are more stable than voluntary contributions, their efficiency and fairness are questionable as primary methods for governments to obtain resources. By requiring contributions in kind instead of in monetary form, physical and human resources may be transferred from higher-valued private uses to lower-valued public uses, with considerable efficiency losses as a result. Further, by falling disproportionately on those who are unfortunate enough to possess the particular physical or human resources sought by the government at a particular time, or who lack the power in the society to resist or avoid compulsory transfers, such transfers produce an arbitrary and inequitable distribution of the costs of providing public goods and services. Not surprisingly, this method of transferring resources from private to public use corresponds more closely to societies without a well-developed monetary economy than to societies in which exchanges are typically conducted through monetary transactions. Indeed, the development of an integrated monetary economy is probably essential to the emergence of a general system of taxation.

The line between compulsory transfers and taxes cannot be drawn solely with reference to such factors as the presence of a monetary economy or the form of the tax/transfer relationship between the citizen and the government. For example, it would be difficult to draw a firm distinction between taxes levied by a conquering power on the citizens of a subject state and the more straightforward exacting of tribute by force. The individual citizen of one of the Roman provinces would be hard pressed to distinguish between the taxes levied in some provinces and the forced labour extracted in others. In the same vein, taxes levied in an authoritarian regime, in which the citizen has no ability to influence either the method of raising taxes or the spending of revenue from the taxes would be difficult to distinguish from medieval tithes levied against regional barons who, in turn, generated the revenue from the labour of serfs.

The point of these examples is that there is a close relationship between taxation and democracy. Decisions about taxation – about the proportion of society's production that should be devoted to collective consumption and to individual consumption, and how the obligation to pay taxes should be divided among the members of the society – reflect that society's most fundamental values. Taxation also symbolizes the delicate compromise between the voluntary and the compulsory that is the essence of democratic society. In a democracy, we agree voluntarily to be compelled by the will of the majority. In establishing systems of taxation for the purpose of paying for collectively provided services, we consent to be compelled to contribute towards the provision of those services on a basis determined by the will of the majority.

Taxes can generate economic distortions and can entail collection and compliance costs. However, the adverse economic impact from taxation is generally lower than that associated with other methods of public finance. Unlike the alternatives, taxes permit the burden of government expenditures to be allocated in a manner that is neither hidden nor arbitrary, but instead reflects generally accepted notions of fairness. Thus, governments rely on taxation as a primary means of public finance not because there are no available alternatives, but because taxation is generally regarded as a superior way to raise revenue for public services and the only way consistent with liberal democratic values.

Purposes of the Tax System

Understanding the purposes of the tax system is important to understanding the issues of tax fairness. Those purposes fall into six general categories:

- raising revenue to pay for public services;
- redistributing economic resources among individuals in society;
- influencing economic decisions, thereby performing a function equivalent to regulation;
- delivering benefits to individuals which are similar to those provided in direct expenditure programs;
- providing a mechanism for compensating society for actions of individuals which impose costs on society as a whole; and
- stabilizing economic activity over the business cycle.

Raising Revenue

All other purposes of a tax system are incidental to the need to raise revenues to pay for public services. It is extremely unlikely that we would have a tax system at all if taxes were not needed to pay for public services.

Although our mandate is to review the fairness of the tax system, and not the effectiveness or value of public expenditures, the connection between taxation and government expenditures is crucial to an inquiry into the tax system for two reasons. First, to the extent that taxation is the main source of revenue used to pay for public goods and services, the total of all taxes levied in any jurisdiction is determined largely by the quantity and quality of goods and services that are provided through its public sector, and by the efficiency with which these goods and services are delivered.

Second, the kind of government expenditures that are financed by tax revenues may influence the desirability of one type of tax versus another. For expenditures on public highways and municipal services, for example, strong arguments can be made that a fair and efficient tax system should allocate these costs according to the value of the good or service received by each taxpayer.[2] Gasoline taxes

---

[2] See Thirsk and Bird (n.d.).

and/or toll charges may achieve this result in the case of highway expenditures, while property taxes and/or user charges may serve this purpose in the case of municipal services.[3]

For expenditures on services such as education and social assistance, however, the notion that taxes should correspond to the value of the benefit to each recipient is much less compelling. In the case of education, the ultimate distribution of public benefits is difficult to determine: students, parents, future employers, and society as a whole may all share in the benefits of public spending on education. Moreover, since primary and secondary education are considered to be a universal right in a liberal democracy, it would be inappropriate to ration access on the basis of a benefit-related tax. With social assistance, taxing recipients according to the value of the benefits conferred upon them would undermine the very purpose of this type of public expenditure: since social assistance is intended to transfer resources to specific groups of qualified individuals, it would be contradictory to require recipients to pay for the benefits they receive. As a result, it is generally agreed that these kinds of public expenditures should be financed through comprehensive taxes based on a suitable measure of each taxpayer's economic capacity.[4] However, where social insurance schemes are intended to provide insurance only, without deliberately redistributing resources, it is arguable that they should be financed through taxes applied on the basis of the benefits received (with risk-rated premiums designed to cover expected costs among specific categories of those who are insured).

Other Functions

The tax system is one of the main points of contact between individuals or organizations and government. As a result, although it is unlikely that taxes would be enacted to fulfil other objectives if the tax system did not already exist to raise revenues, it is not surprising that the tax system is used to achieve a variety of purposes besides its most obvious function of raising revenues to finance public goods and services.

---

[3] Taxation for municipal services is examined in part eleven.

[4] See Carter Report (1966, vol. 3, 3–5), and Smith Committee (1967, vol. 3, 11).

Distribution

The tax system also has a role to play in government policies designed to influence the distribution of economic resources – income and wealth – among members of society. As is the case for taxation as a regulatory instrument, taxation policies may act either as substitutes for or complements to non-taxation policies with the same objectives. Expenditure programs can have an impact on the distribution of income and wealth either directly, by transferring income to individuals, or indirectly, by increasing access to public services which, in turn, influence the distribution of income.

For example, a major federal direct spending program intended to alter the distribution of income in Canada is transfers to the elderly, including Old Age Security and the Guaranteed Income Supplement. In Ontario the largest provincial expenditure category for transfer payments is for social assistance. The most significant spending programs with an indirect impact on distribution involve education and training and health care, both of which fall primarily under the jurisdiction of provincial governments.

The tax system contributes to redistribution in two ways. First, it contributes to the ultimate aim of direct spending programs designed to redistribute income by raising the revenue required to fund these programs. Second, the tax system itself can play a redistributive role irrespective of the public goods and services these taxes pay for. Progressive income taxes, for example, create a more equal distribution of disposable income by imposing a larger burden on high-income taxpayers than on low-income taxpayers. Taxes on wealth and wealth transfers can influence both the distribution of wealth and the distribution of income generated from wealth. Similarly, various exemptions and credits (such as the exemption for food under the retail sales tax, and income tax credits for sales tax and property tax paid by low-income households) are intended to alter the distribution of purchasing power by reducing the total tax burden on less affluent taxpayers.

Although redistribution is widely regarded as an important function of the tax system, opinions differ over the relative effectiveness of taxation and spending policies in achieving redistributive objectives. Similarly, there are debates over the extent to which a single province, as opposed to the federal government or all provinces in concert, can and should use the tax system to redistribute resources, given that economic activities can be moved to other provinces more easily than they can to other countries.

Regulatory Taxation

Because taxes can be applied in different ways to different kinds of transactions or activities, they are often used as substitutes for or complements to the government's more general regulatory processes. Taxes can be structured to provide economic decision makers with incentives to make decisions that are more consistent with the public interest than those that would be made in the absence of the tax. They can also be structured to extract compensation from those whose decisions impose costs on society generally. Taxation and regulation are not perfect substitutes. Taxation is a fairly blunt instrument. It is difficult to fine-tune taxation regimes to achieve the complex results that are often required of regulation. Taxation is also not the appropriate instrument to use if the objective is to exercise control over an activity, or to prevent it from taking place. Taxation comes into its own as a regulatory instrument in situations where there are far too many transactions taking place to be regulated effectively, or where the objective is to use incentives to reduce an activity that it is either impractical or impolitic to prevent.

Ontario's tax system is used extensively to regulate economic behaviour.[5] One of the purposes of taxes such as those on alcohol, tobacco, fuel-inefficient vehicles, and gasoline and motor vehicle fuel is to provide economic incentives to reduce consumption. Other regulatory taxes involve adjustments to general tax arrangements, such as those disallowing deductions for advertising in US magazines sold in Canada.

As with direct regulation, regulatory taxes and tax provisions are meant to advance a number of economic and social policy objectives, such as adjusting prices so that market signals more accurately reflect the full social costs associated with the discouraged activity (for example, alcohol taxes, tobacco taxes, and environmental taxes), conveying public censure for certain socially undesirable activities (drinking, smoking, polluting), and encouraging specifically desired

[5] For a summary of regulatory taxation at the federal and provincial levels, see Poddar (1992).

activities by penalizing close substitutes (encouraging Canadian cultural industries by discouraging Canadian advertising in US publications destined for Canada). Views on regulatory taxation vary widely, with supporters highlighting the flexibility and visibility of this form of regulation and critics noting that many regulatory taxes fall disproportionately on low-income families.[6]

Because many taxes serve a number of purposes, even the classification of certain taxes as regulatory in nature is controversial. For example, one of the traditional arguments for substantial taxes on alcohol and tobacco rests on a premise that is the exact opposite of the premise of the regulatory argument: because high levels of taxation result in substantial changes in consumption, taxes on these commodities can raise significant revenue without distorting economic behaviour. The steady decrease in tobacco consumption over the past decade suggests that the premise on which this argument is based is weak. Another argument for such taxes is that, by imposing additional costs on people whose addiction to tobacco imposes costs on the health system, these taxes in effect compensate society for the impact of smokers' behaviour on the public health system.

Expenditure Program Delivery: Tax Expenditures

In addition to raising revenue, the administrative mechanism in the tax system can be used to deliver benefits to individuals or corporations which might otherwise be delivered through direct spending programs. In effect, the same administrative system that causes funds to flow from taxpayers to the government is used to direct funds from the government to taxpayers. It is often difficult to distinguish between taxation itself and spending through the tax system, or tax expenditures. The two transactions, paying taxes and receiving a benefit, generally take place simultaneously and often simply offset each other, resulting in a lower net tax bill for the taxpayer.

Tax expenditures are used to deliver benefits designed to redistribute income, to subsidize particular types of economic activity, and to promote the production or consumption of goods in the private sector which might otherwise be provided publicly.

---

[6] These views are summarized in Poddar (1992, 87–95).

Specific incentives can be found in most of the major taxes currently levied in Ontario.[7] Among others, for example, the personal income tax contains incentives to earn capital gains, to save for retirement, to make charitable donations, to contribute to political parties, and to invest in worker-owned firms and labour-sponsored mutual funds. Similarly, the corporate income tax provides special incentives for investment in scientific research and development and in pollution control equipment, and for lower tax rates for corporate income earned by manufacturing companies and small businesses. Ontario's retail sales tax exempts food, children's clothing, and footwear under $30. These measures are described as *tax expenditures*, since they reduce the amount of taxes otherwise payable and are conceptually equivalent to taxation at the full amount combined with payment by the government of a subsidy equal to the value of the tax reduction.[8]

As with direct subsidies, these tax expenditures are intended to promote a variety of economic and social policy goals. These include economic growth (such as incentives for scientific research and development), environmental protection (such as incentives for investment in pollution control equipment), the reduction of poverty among the elderly (such as subsidies for retirement saving), and enhancing the ability of low-income families to afford basic needs (such as retail sales tax exemptions for food, children's clothing, and footwear under $30).

Although tax expenditures have become increasingly popular in recent years, opinions about their desirability differ widely. Supporters emphasize their flexibility as instruments of economic and social policy. Others criticize the hidden character of these subsidies as well as their potentially adverse impact on total tax revenues and the distribution of the tax burden.

Compensation

Other types of taxes are designed not to finance the public provision of a good or service, but to compensate society for the private use of publicly owned natural resources. These resources are the property

---

7 These incentives are itemized and quantified in Block and Maslove (n.d.).

8 See Surrey and McDaniel (1985).

of all members of society – received from our predecessors, and in some sense held in trust for future generations.[9] By charging individuals and companies for the use of these resources, the government ensures that society as a whole obtains a direct benefit when these resources are used or depleted. The most obvious of these types of taxes are resource taxes. Ontario levies special taxes and fees on the mining and forestry industries as payment for the depletion of non-renewable mineral resources and the use of renewable timber resources.

Less obvious examples are taxes on discharges of pollution into the air or water. These taxes are intended in part to complement the regulatory system and in part to compensate society for the consumption by individuals and corporations of resources – clean air and water – held in common.

Stabilization

Through monetary and fiscal policies, governments are able to influence the overall level of activity in the economy by adjusting interest rates and the money supply (monetary policy) and by altering aggregate levels of government spending, borrowing, or taxation (fiscal policy).

Monetary and debt-financing alternatives to taxation as a way to raise money for public services are important instruments to support government efforts for economic stabilization. By shifting the emphasis in financing public services among taxation, debt financing, and monetary expansion, governments influence economic activity by stimulating or discouraging consumption and investment by individuals and businesses.

Because the federal government alone controls the supply of money, provincial governments are unable to employ monetary policies. Subnational governments may, however, have a useful stabilization role to play through provincial fiscal policies. Independent provincial fiscal policies can be questioned because they are likely to be less effective than federal initiatives (since fiscal impact tends to spill over to other jurisdictions) and because they might counteract federal policies. Yet, research conducted for the commission suggests

---

[9] On related intergenerational aspects of fairness, see Osberg (1993).

that provincial fiscal policies may be both effective, since the fiscal impact of combined provincial expenditures is as great as that of federal expenditures, and justifiable, since Canadian economic cycles display a distinct regional character. The same research also suggests that, of the array of fiscal policies available to provincial governments, direct spending policies are more likely to be effective than taxation policies designed to influence private consumption or investment decisions. Direct spending policies are also likely to be more effective in influencing economic activity within the province because the impact of spending decisions is much more easily targeted than the impact of taxation decisions.[10]

There are two ways in which fiscal policy can be pursued through the tax system. First, through changes in the rates, tax base, or mix of taxes, governments can change the total level of taxation. Lower taxes will tend to increase private disposable income and stimulate demand in the private economy. Higher taxes will have the reverse effect. Second, where tax revenues are themselves sensitive to current levels of economic activity, the tax system may stabilize cycles in economic activity automatically by reducing total taxes during economic downturns and by increasing tax revenues during periods of inflation.

Role of the Fair Tax Commission

It is not our role to assess the economic and social policy goals of government as they are pursued through the tax system, nor is it our role to evaluate those goals as they are pursued through direct spending and regulation. We believe, however, that we have an important role to play in evaluating the effectiveness of the tax system relative to other measures in achieving those goals. We must also assess the impact of these uses of the tax system on its fairness, both in fact and as it is perceived by citizens; on its effectiveness in achieving its fundamental objectives of raising money to pay for public goods and services; and on its ability to support societal goals for the creation and distribution of wealth within society.

We recognize that the tax system and the tax expenditure system have potential roles to play in delivering public policies. We are

[10] See Auld (1993).

concerned, however, that the lower visibility of tax measures has meant that subsidy programs that would never have been implemented as direct spending programs have become entrenched in the tax system. We are also concerned with the potential for conflict between these policy delivery objectives and the tax system's more fundamental objectives.

Although the most obvious answer to the question "What is the purpose of taxation?" is that taxes are necessary to pay for government expenditures, our review of tax purposes reveals a diversity of possible purposes for the tax system and suggests a variety of criteria by which to assess specific taxes and the tax system as a whole. Taxes are intended not simply to finance government, but to do so in a fair and efficient way; moreover, taxation can serve a number of goals besides raising revenue, and each goal has its own criteria of fairness and efficiency.

This diversity creates a special problem for the design of a fair and efficient tax system. Although some objectives may be broadly compatible (as examples, redistributive taxation and taxation according to ability to pay are often perceived to be consistent), others are noticeably at odds. For example, to the extent that the burden of regulatory or benefit taxes is found to be regressive, the effect of these taxes would seem to contradict the principles of fairness associated with redistributive taxation and taxation according ability to pay. Likewise, taxation based on benefits received or resources extracted may undermine the pursuit of fiscal stabilization through the tax system.

There are two ways these sorts of conflicts might be addressed through the tax system. Choices might be made and balances struck to favour some objectives over others and to limit the number of purposes that might be pursued through the tax system. Alternatively, by relying on a mix of taxes, it might be possible to minimize the conflicts among various objectives. For example, one potentially regressive tax might be used to achieve a regulatory purpose, but other taxes could ensure that the tax system as a whole reflects ability to pay. Although this second approach likely involves a more complex tax system than the first, it permits a more diverse set of objectives to be pursued through the tax system. It is this second approach that Ontario appears to have followed in the development of its tax system. We favour this same approach in our evaluation of the provincial tax system.

4 Fairness and Other Criteria in Taxation

In taxation, as in other areas of public policy, fairness is essential. The pre-eminence of fairness as a principle of public action is a fundamental tenet of our democratic system of government. In Canada, as in other democratic countries, there is an implied contract through which individuals cede certain powers and authority to governments that provide for their collective needs. In return, the state agrees it will act in accord with certain norms. Fair taxation is one such norm.

Taxation is an important instrument by which governments gain control over the resources required to meet collective needs. Citizen-taxpayers need to be confident that these tax revenues are collected in a just, non-arbitrary manner. They require assurance that the taxes they pay and that their fellow citizens pay are just or fair. But, important as it is, fairness cannot be the sole criterion by which people judge the tax system. Other goals besides fairness must be considered, among them economic efficiency, simplicity, accountability, and predictability. Ideally, one would like to achieve all these goals – as well as fairness – simultaneously.

Judging by popular discussion, including the contributions the commission has received from Ontarians, there are a number of possible dimensions to the concept of fairness. What constitutes fairness for many people is a reasonable balance between the taxes they pay and the services they receive from government. People who are convinced that government is too big, or too wasteful, or too out of touch often express their concerns in terms of the "unfairness" of the tax system. Others focus more on the appropriate matching of revenue sources and expenditure programs. For example, we learned that much of the dissatisfaction with property taxes in Ontario is related to the high proportion of education expenditures supported by the property tax. People do not regard this as an appropriate match.

The concept of fairness dominated discussion at all of our public hearings. Although participants had different concepts of fairness, the issues of government spending and accountability were raised in almost every discussion as fairness issues. What people perceived as wasteful, ineffective government spending was consistently linked with taxes and fairness. If governments were seen to be wasting tax dollars, the taxes were perceived as unfair. This led many people to comment that the only way we could make taxes fairer would be to reduce them. In particular, people criticized government extravagance, demonstrated by the tax-free allowances given to members of the provincial parliament and the practice of "double-dipping" (collecting a public service pension while still employed elsewhere in the public sector).

The question of how to achieve social equity objectives through the tax system coloured the debate at several roundtables. Most participants related fairness to ability to pay and agreed that low-income individuals should not be "penalized" by the tax system. Some agreed that the tax system should be used to redistribute wealth, while others related tax fairness solely to the benefits consumed. Heated discussions about the tax treatment of income from wages and salaries as compared with the tax treatment of income from dividends and capital gains illustrated the range of perspectives brought before us.

Debates about fairness often centred on the perceived effects of a particular change in tax policy. For example, some representatives from business organizations, such as chambers of commerce and other local associations, were concerned about the impact of potential changes – for instance the taxation of capital gains – on the province's climate for investment, while others argued that fairness issues were far more important than economic incentives or competitiveness.

Fairness among People

In a formal or legal sense, taxes are levied both on people and on institutions in various capacities. Corporations, for example, pay taxes based on their profits, on their payrolls, on some of the goods they purchase, and, in some businesses, on other aspects of their operation as well. However, when considering whether a particular tax, or an array of taxes, is fair, it is necessary to get behind the legal responsibility for payment of taxes and to focus on who actually pays the taxes. In particular, it is necessary to determine who actually bears the burden of taxes that appear, in the first instance, to be paid by institutions.

In the final analysis, all taxes are paid by individuals, not institutions. Corporations, for example, exist as legal creations. As such, they assist in organizing the relationships among individuals who bear the burden of taxes, but they themselves do not bear the burden of taxes. As we discuss in detail in chapter 9, to determine who actually pays the burden of taxes levied on corporations, one must look to the individuals who are affected by the operation of the corporation. For example, the owners (shareholders) may pay the tax because they receive smaller returns on their investments, such as dividends and capital gains, than they would have without the tax. Alternatively, the purchasers of the corporation's products may pay the tax in the sense that they pay higher prices than otherwise would have been the case. Finally, the tax may result in lower compensation for the people who work for the company than they would have received, and in this sense the employees can be said to pay the tax. When we speak of tax fairness among individuals it is in reference to this ultimate distribution of taxes, after allowing for the impacts of taxes on institutions, prices, wages, and return on investments.

There are two broad approaches to fairness in the taxation of individuals: fairness based on some measure of people's ability to pay and fairness based on the benefits people receive from government services. From the perspective of the ability-to-pay approach, a fair tax system will distribute the net burden of taxation in accordance with the ability to pay of individuals or families. The benefit approach views fair taxation as an exchange process "whereby taxes are paid in accordance with benefits received from government-provided goods and services" (Birch 1988, 1005). We believe that while individual taxes based on the benefit principle of fairness may be appropriate, the tax system as a whole must be fair in the sense that those who have a greater capacity to pay taxes contribute a greater share of the cost of general government services.

Ability-to-Pay Principle

The ability-to-pay principle considers tax fairness in relation to the capacity of individuals (or families) to pay taxes. Its basic premise is that the economic circumstances of taxpayers differ, and that these differences should be the basis for allocating responsibility to support general goods and services supplied by governments. Besides having an intuitive appeal, the intellectual roots of this approach emerge from scholarly writings on distributive justice. "Distributive justice has come to be synonymous with economic justice, that is, with the distribution of economic benefits and burdens" (Arthur and Shaw 1978, 5). There are two bases on which to rest the argument for distributive justice, and, by extension, taxation based on ability to pay: one is the concept of equal sacrifice and the other is concerned with reducing inequality in society.

The equal sacrifice approach comes from the school of thought which believes that distributive justice means achieving the greatest sum of happiness for all concerned. The greatest sum of happiness is achieved if everyone makes an equal and minimal sacrifice. However, to understand the concept of equal sacrifice requires clarification of the meaning of equal.

One can distinguish among equal absolute, equal proportional, and equal marginal sacrifice (Musgrave 1959, 95–96). Theorists have argued that as people's incomes increase, the value they place on an additional unit of income decreases (declining marginal utility of income).[1] A fair distribution of the tax burden could be arrived at if taxpayers made an equal marginal sacrifice: the greater an individual's income, the larger the proportion of it he or she would have to give up in order to lose a given proportion of his or her total utility. The implied outcome of this approach would appear to be progressive income taxation.

Today, the assumption of diminishing marginal utility is accepted as a basis for progressive income taxation. The personal sacrifice by an individual involved in paying a dollar of tax decreases as income increases. In this argument, progressive taxation is required to

---

[1] Hare describes the diminishing marginal utility of income as follows: "a millionaire minds less about the gain or loss of a dollar than I do, and I than a pauper" (Hare 1978, 125).

equalize the sacrifice involved in paying an additional dollar of tax. A related argument in favour of progressive taxation is that as income increases, the proportion of income that is discretionary (not required for the necessities of life) increases. In this argument, progressive taxation is required to ensure that discretionary income is taxed at a higher rate than non-discretionary income (Musgrave 1959, 95).

The second type of argument for taxation according to ability to pay is based on the role of the tax system in redistributing income. This school of thought, represented by John Rawls, challenges the maximization-of-happiness approach to distributive justice by asking if an increase in total happiness may be purchased at the price of pain to some (Arthur and Shaw 1978, 7). Rawls argues that if people made their choice regarding the principles of economic distribution without reference to their own circumstances, they would choose to distribute economic goods "equally unless an unequal distribution would work to the benefit of all, especially the worst off" (Arthur and Shaw 1978, 7–8).

Rawls thus presents the case for an equal (or, at least, more equal) distribution of income, unless a departure from equality could be shown to be of absolute benefit to individuals at the bottom. Progressive taxation has an important, though not unique, role to play in the Rawlsian society because of its potential as a significant instrument for the redistribution of income to promote a more egalitarian distribution. This argument implies, at a minimum, that the poorest members of society should not be required to pay tax at the same rate as those with higher incomes.

The ability-to-pay principle is sometimes described as the equal treatment of taxpayers in equal economic circumstances, and the appropriately different treatment of taxpayers in unequal positions. In his study for the commission, Green (1993) suggests that the problem with this type of maxim is that it tempts policy makers to avoid fundamental questions of the distributive principle and to focus instead on problems of defining terms. Nonetheless, in order to suggest guidelines for fairness, we need to define the terms by exploring such questions as: Who are the taxpayers? How does one measure economic circumstances or what constitutes economic well-being? What time periods are relevant? What is "appropriately different treatment"? The answers turn in part on empirical evidence, but inevitably lead us back into matters of principle.

Identifying the taxpayer involves identifying the basic unit of economic decision making. Fair treatment by the tax system would suggest that if one or more persons constitute the basic unit of economic decision making (decisions about housing, how much work the unit should do, how much and what should be consumed, and so on), the tax system should not intrude into that unit (if more than one person is involved), nor should it aggregate beyond the unit (treat people outside the decision-making unit as if they belonged to it). In practical terms, the issue for tax policy is whether to treat adults living together (whether legally married or not) as one unit or as separate individuals. This issue has become particularly acute given contemporary concerns over the economic status of women. If the tax system is structured to treat the household (couple) as the basic decision-making unit, there is concern that this approach will impede women's ability to attain economic independence. On the other hand, treating individuals separately for tax purposes creates complications with respect to responsibilities for children and other dependants.

Ability to pay is clearly related to economic well-being. Ideally, one would approximate this capacity by measuring income to the taxpayer unit from all sources (including inheritances) over a long period, perhaps as long as a lifetime. This concept is sometimes referred to as lifetime comprehensive income. In practice, there are two types of accommodation to the pure concept of ability to pay that must be considered: one having to do with how comprehensive the income measure[2] should be; the other, the time horizons that should apply.

Some types of income, while they are real contributions to income and economic well-being, are treated differently from other types of income, and other types are not included in measured income at all. An example of the first type is the difference between the tax treatment of income from wages and salaries and the tax treatment of income from capital – for example, dividends and capital gains. The equal treatment of all types of income was a fundamental recommendation of the Carter Report (1966) and was best expressed in the popular adage, "A buck is a buck." An example of the second type is

---

[2] The modern comprehensive income concept was the developed by Haig (1921) and Simons (1938).

imputed income flows that individuals and families "earn" from the long-lived assets they own. The most important of these assets, of course, is housing. An individual who lives in a dwelling that he or she owns in fact earns income from it. One could think of this income as being equivalent to the rent the individual would have to pay to live in the dwelling if it was owned by someone else, or, alternatively, the income the owner could earn by renting it out rather than living in it. In this sense, the owner-occupier is in an advantageous position compared with another individual with the same money income but who does not own a dwelling, and that advantage can be measured in terms of a real income difference between them.

In practice, however, no jurisdiction currently includes this imputed rent in income for tax purposes. While difficult to justify on theoretical grounds, we accept this "convention." Including such elements in income for tax purposes would clearly violate deeply held values about the importance of home ownership and its special status compared with other forms of personal investment.

A further example of the second issue – real income components that are not included in measured income – illustrates the practical difficulties even more clearly. Two individuals with the same money income (or wage) work at two different jobs. One is employed in a pleasant, healthy environment and enjoys his or her work; the other works in a hazardous, arduous occupation and hates the work. Clearly, by any abstract measure, the former is better off than the latter. The problem in taxation, however, is that intangibles such as (un)pleasant work environments cannot be incorporated into the tax base – taxation can deal only with magnitudes that are or can be readily measured in dollar terms. One can easily think of further examples that illustrate the difficulties in making the comprehensive income concept operational.

The second practical adjustment to the ability-to-pay concept relates to the time horizon or accounting period over which tax is determined. One approach, the lifetime perspective, has considerable appeal on theoretical grounds.

The theoretical foundation of this argument can be traced to theories of behaviour known as "lifetime consumption" theories. The basic argument of these theories is that individuals' consumption decisions and conceptions of well-being are related not to current income (this month or this year) but to much longer-term income flows (many years or a lifetime). Spending patterns can be explained by these long-term income flows more successfully than by current income. Thus, for example, people plan for retirement and do not consume all their current income in their earning years so their consumption will not have to change dramatically when they retire and their earnings decline. Similarly, individuals who experience modest one-time gains or losses that are unlikely to be repeated do not adjust their consumption habits in the same way they would if they were to experience the same gains or losses on a permanent basis. Individuals who invest in their own human capital (often forgoing current income to do so) are clearly acting in terms of a long-term plan and not simply in terms of current considerations. Individuals and families purchasing major assets such as their principal residences generally make such commitments with their long-run income prospects in mind.

All these behavioural patterns are indicative of individuals acting on the basis of a long-term horizon, and the lifetime tax advocates argue that a tax regime based on short-term accounting periods distorts these decisions and is ultimately unfair. While individuals recognize that their annual incomes may fluctuate around their long-term income paths, and behave accordingly, an annual-based income tax does not recognize these year-to-year changes as fluctuations above or below a longer-term income flow.

The opposing argument starts with a recognition that individuals do look at long-term considerations when making important decisions, though whether this long term is truly a lifetime perspective is less clear. For most people, however, their current situations are directly and strongly related to their sense of well-being and behaviour. Long-term income prospects can only be contemplated with a high level of uncertainty. One may experience unforeseen income declines, bouts of unemployment, or major illness, any of which makes planning based on assumed future income flows uncertain. Moreover, people can insure themselves against these uncertainties only imperfectly, if at all. Most private contracts, to which most individuals' incomes are related (collective agreements, tenancy agreements, etc.), are of relatively short duration, perhaps extending for one or more years but much less than a "lifetime." In addition, the lifetime perspective presupposes that individuals are able to borrow without restriction during periods in which their resources are below their "lifetime averages" and to repay during the above average periods (Davies n.d.). While some such borrowing does occur, it is clearly not readily available to most individuals.[3]

Perhaps even more to the point, lifetime income taxation assumes a policy environment that does not exist in reality. First and foremost, the tax system itself is changed frequently. In addition, the spectrum of services that individuals may receive from government at various times is certainly not fixed. For example, in recent years there have been significant changes in the old age security system and in the child benefits system; it would not be logical to tax individuals as if all these other elements of the public environment were fixed. Virtually all other government programs are based on much shorter accounting periods which implicitly assume a relatively short planning horizon; indeed, in the case of social assistance and unemployment benefits, the relevant periods are in terms of weeks. Considerations such as these would put a lifetime income tax concept out of step with most other relevant parameters in both the public and the private sectors. Finally, a tax system which, at a given time, "overtaxed" individuals with current low incomes and "undertaxed" individuals with current high incomes, based on their presumed lifetime income flows, would be unlikely to resonate with prevailing public perceptions. Therefore, a shorter accounting period is called for, and an annual cycle, because it is so common in other financial arrangements, is reasonable.

In practical terms the question of annual versus lifetime accounting is most relevant to the personal income tax. Expressing the choice in a somewhat different fashion, the issue is whether income should be taxed as it accrues or as it is consumed. The difference between these alternatives lies, of course, in the treatment of saving. The existing income tax can be regarded as somewhat of a hybrid in that some savings are accorded differential treatment, particularly savings in registered retirement savings plans and pension plans, and savings in the form of accumulated equity in owner-occupied homes. We believe that it is fairest to tax income as it accrues. This measure is most relevant to people's perceptions of their own and of others' well-being. A comprehensive notion of current income best measures the

---

[3] Government student loan plans/guarantees are evidence that capital markets do not function efficiently in this sense.

economic resources that an individual controls, and as such is a fair basis for taxation.[4]

Having worked through the major issues in the determination of ability to pay, one is then in a position to specify two basic rules of fair taxation. The first, known as horizontal equity, requires that all taxpaying units with equal ability to pay be treated equally by the tax system. The second, known as vertical equity, requires that units with different abilities to pay be treated appropriately differently by the tax system.

Horizontal equity is the idea of fairness that suggests that taxpayers with the same ability to pay should pay the same tax. While this principle seems so straightforward as to be obvious, it gives rise to a number of difficult practical questions. Some of these relate to the characteristics of different taxpayers and their "non-discretionary" responsibilities. Other difficulties relate to the treatment of income from different sources, such as wages and salaries, self-employment, and capital (interest, dividends, and capital gains), which were discussed earlier in this chapter.

Vertical equity embodies the idea that there is an appropriate degree of inequality in the treatment of individuals with different financial resources. The government revenues to support public services of a general nature (those for which user fees or benefit taxes cannot be levied or are not appropriate) should be raised fairly from taxpayers with different incomes or abilities to pay. In most discussions of vertical equity, two alternative propositions are accorded serious consideration – proportional or progressive taxation. In a proportional tax system, higher-income individuals pay more in tax than lower-income taxpayers, but the share of income tax paid remains constant. Proportional taxation (what some writers refer to as "flat" taxation) has an immediate intuitive appeal. Everyone pays the same percentage of their income to finance the government services that benefit all members of society. It is fair because all taxpayers are

---

[4] This position does influence how one views the tax provisions relevant to savings. To be specific, if one adopts current annual income as the basis for the tax, then, for example, current treatment of retirement savings is correspondingly regarded as a tax expenditure. We return to this and similar provisions later in this report.

treated the same, while still requiring those with high incomes to pay more than those with low incomes.[5]

In a progressive tax system, taxpayers are obliged to pay a larger proportion of their incomes in tax as their incomes increase. Progressive taxation may be justified either by distributive justice arguments or by vertical equity arguments, and the two are conceptually distinct. For some, the idea of using taxes to achieve some redistribution is so integral to our tax system that redistribution is part of tax fairness. Whatever one's reasoning, as a practical matter it is impossible to draw a distinction between progressive elements of tax structure required for tax fairness and progressive elements required for the tax system to function as an instrument for income redistribution. Any progressive tax is redistributive.

In tax reform exercises over the last decade or so, principles of vertical equity as reflected in progressive taxation have taken a back seat to concerns about the economic impact of high tax rates on the economic behaviour of high-income individuals. These arguments suggest that it is not economically efficient to impose disincentives on those in our society with the highest incomes. As a result of these recent reforms, the marginal tax rates on higher-income individuals have come down in many countries. In addition, to varying degrees, there has been movement away from a progressive rate structure, in which rates on additional income increase as income increases, to a flatter structure, in which the rate on additional income is the same, regardless of the level of income.

We recognize that in a progressive system, marginal tax rates on the highest-income taxpayers must be a matter of concern. Nonetheless, after sifting through the arguments we have concluded that a fair tax system is one based primarily on the ability-to-pay principle, and that, in turn, requires the overall tax system to be progressive. Progressivity is a fundamental component of tax fairness. Later in this report we advance recommendations to enhance the progressivity of the tax system while keeping in mind concerns such as the practical limits on marginal tax rates.

---

[5] A flat rate income tax combined with a basic exemption will result in a pattern of effective average rates that is progressive.

Benefit Principle

One way of judging tax fairness is based on the extent to which there is a link between the taxes a person pays and the publicly provided services he or she enjoys. In this view, taxes are akin to the prices people pay for goods and services in private markets.

The ability-to-pay approach to tax fairness is focused solely on the fairest way of distributing the net burden of raising revenue from taxes. The benefit approach, in contrast, views taxation as linked with government expenditures. Underlying this approach is the principle of voluntary exchange in which taxes are viewed as fair when they can be interpreted as a voluntary payment for benefits received (Birch 1988, 1006). Although we tend to think of the benefit rationale for taxation applying appropriately to only a few types of taxes (for example, user fees, licence fees, and permits), many early theorists framed their entire discussion of tax fairness in terms of benefits received.

It is useful to divide interpretations of the benefit principle into those that focus on the cost of the service rendered to a particular person and those that focus on what a person (given his or her income and preferences) would be willing to pay (Musgrave 1985, 17). Early proponents of allocating taxes according to the benefit principle focused on the cost of the service to particular individuals.

Eighteenth-century proponents of the benefit principle, such as Adam Smith, argued that equity was achieved by splitting the tax burden according to the benefits gained from government expenditures funded by taxation. Since government expenditures in this era were largely for protection, roads, and canals, benefits and tax prices could not readily be allocated to individuals. As a result, varying judgments were made regarding who benefits the most and the least from public services. For example, Smith regarded the wealthy as benefiting more than the poor from public services, and advocated taxing individuals "in proportion to their respective abilities; that is, the revenue which they respectively enjoy under the protection of the state."[6]

The debate changed somewhat in the late 19th century with expression of the view that "since ... society is based on the freedom of

---

[6] Adam Smith's *Wealth of Nations* (1776), as described in Musgrave (1959, 67).

the individual, it would be unjust to force anyone to contribute to public services that he does not desire" (Musgrave 1959, 71). Thus, the benefit principle began to be discussed in terms of what a person would be willing to pay for a particular public service, or the principle of voluntary exchange. The voluntary exchange approach suggests that taxes are "more or less voluntary payments rendered by the individual in exchange for services supplied by the government in accordance with personal evaluation of such services" (Musgrave 1959, 69).

The voluntary exchange approach to determining a benefit tax has been criticized in the 20th century because of the "free-rider problem" of indivisible public goods. Allocating collective benefits based on what people are willing to pay invites people to understate their preferences or not reveal them at all, so they benefit from the public service but do not pay what it is worth to them (Musgrave 1959, 80). In practice, individuals can express their preferences for indivisible public goods only through the electoral system. In light of this reality, the benefit principle by itself is insufficient as the basis for determining options for the design of the overall tax system.

Another problem with the benefit approach in general is that it does not account for differences in ability to express preferences or to bear the costs of public services because of disparities of income or wealth. This deficiency was recognized by some 19th-century and early 20th-century theorists, who acknowledged that justice in taxation consisted of "the 'sociopolitical' problem of creating a just distribution of income ... and the 'purely fiscal' problem of providing for the satisfaction of public wants while leaving the just state of distribution undisturbed" (Musgrave 1959, 74).

In the present day, the benefit principle is again thought of as a useful way of allocating the costs of public services, but only those costs which are divisible between individuals so that the tax resembles a user fee. In these cases, the benefit principle has an advantage over the ability-to-pay principle of "providing for a simultaneous determination of public services and tax shares, thus combining both sides of the budget process" (Musgrave 1959, 62).

Benefit-based taxes may be linked to services on a one-to-one basis. The analogy with market prices is, of course, quite direct in these cases. For example, tolls on freeways can be determined on the basis of the distance travelled; user fees can be charged for recreation facilities such as municipal swimming pools and golf courses; and tuition fees can be assessed on students enrolling in public education institutions. Other benefit-based taxes may be less tightly linked to particular public services. Instead, a tax may be determined to approximate the benefits received from a combination of government-provided goods and services. The property tax may be the best example, if it relates to the municipal services provided to properties and benefits residents of a municipality.

Finally, there are at least four categories where one would not want to rely on taxes determined solely on the benefit principle, and where the applicability of this rule is limited. First, benefits of many public services cannot be attributed to particular individuals or groups of individuals. These benefits are more general in nature, and there is no reliable method of allocating benefits among individuals. Examples include the benefits of national defence services, large-scale environmental programs, and some aspects of public health services. Second, for some government services it may be possible to identify direct beneficiaries, but at the same time significant benefits from these services accrue to society more generally. Thus, while in principle benefit taxes could be levied on primary beneficiaries, in light of these "spillovers" into the larger society it would be neither fair nor efficient to make direct beneficiaries bear the full costs of the services. Examples include education and public transit. Third, some government programs are undertaken specifically for purposes of redistribution, and there clearly would be no point in having the beneficiaries pay for their own benefits. This group includes programs such as social assistance, Old Age Security, and other transfer programs. Finally, society has decided that some public services should be provided to individuals as a matter of right and that no direct fees or benefit taxes should be related to them for that reason. Such taxes would inhibit access to these services and would dilute the universal right to their consumption, especially for lower-income individuals and families. It would be inappropriate to finance essential services in this way, even if it were technically possible to assign benefits and benefit taxes. The most important examples of the application of this principle in Canada are the universal health care system and universal public elementary and secondary education.

Fairness between Generations

The principle of fairness in the tax system can apply between generations as well as between individuals. Intergenerational equity is in part the basis for taxes that seek to ensure equality of opportunity for successive generations by preserving the natural environment, encouraging investment in physical infrastructure, and nurturing our society's democratic decision-making processes.

The concept of intergenerational equity is obviously associated with preservation of the natural environment and sustainable development.[7] Wise stewardship of the Earth's resources by the present generation is seen as both a benefit today and a necessary investment in the well-being of subsequent generations. Taxes used to reflect the full cost of environmental degradation (for example, taxes on carbon emissions) are one way of achieving greater intergenerational equity with respect to the natural environment. Taxes can also be used to encourage conservation or to increase the price of non-renewable resources, and thereby to promote development of sustainable substitutes.

In his study for the Fair Tax Commission, Osberg (1993, 80) argues that current generations bequeath "a physical capital stock of plant, equipment, and public works" to future generations. He cites such tax provisions as accelerated depreciation for investment in plant and equipment as effective incentives for business to increase the value of society's capital stock and thus the bequest to subsequent generations. The unknown quantity is whether future generations will in fact value the physical stock left by the current generation. It is reasonable to assume that future generations will place some value on the physical stock left to them, although the rate and types of technological changes that occur will change the degree to which specific assets are valued. The extent to which government policies, including provisions of the tax system, provide an incentive to invest in physical infrastructure implies some judgment about the value of those investments to future generations.

---

[7] The definition given by the World Commission on Environment and Development (1987, 43) of sustainable development is "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

The nurture and transfer to subsequent generations of a system of governance based on democratic institutions is another component of intergenerational equity. Advocates of the taxation of wealth argue that one of the threats to democratic governance is large inequalities of wealth in a society, inequalities that can be alleviated to some degree by wealth transfer taxes. The basis for this assertion follows.

- The most recent available evidence indicates, not surprisingly, that the distribution of wealth in Canada is unequal, and more unequal than the distribution of income. Using data from a 1986 Statistics Canada study, the Wealth Tax Working Group estimated that, in 1984, the wealthiest 1 per cent of Canadian households owned 16.8 per cent of net wealth, and the top 5 per cent owned 37.5 per cent of net wealth (Wealth Tax Working Group 1993, A9).
- The unequal distribution of wealth in our society is due in large measure to transfers of wealth through inheritances and intergenerational gifts. Maloney (1991, 246) cites evidence from the United States and Britain in support of this claim, noting that a US study "found that over 50 per cent of wealthy men owed their large fortune to inheritance ... [and] in England ... over two-thirds of accumulated wealth is due to inheritance."
- The economic power that accompanies concentrations of wealth results in undue political power for the wealthy, an outcome that weakens democracy. The relationship between economic and political power is revealed, for example, in the "selective funding of sympathetic politicians and political parties" (Duff 1993, 25). In order to ensure that a vibrant democracy is passed on to future generations, it is necessary to reduce excessive concentrations of economic and thus political power in our society. A wealth transfer tax, as the Ontario Committee on Taxation pointed out, controls the amount of capital that passes from one generation to another, thereby controlling the growth of an economically powerful minority and safeguarding the "fabric of a democratic society" (quoted in Duff 1993, 24–25).

Concern regarding the level of public debt is frequently expressed in the language of intergenerational fairness. As Osberg (1993, 81) states, "the total magnitude of taxation, relative to expenditure, becomes an equity issue, in the sense that deficits accumulate and become a debt burden on future generations." The intergenerational fairness of debt accumulation is an issue not of taxation but of the relationship between taxes and expenditures. It is not our mandate nor is it our intention to comment on the level of public expenditure in Ontario, but we must determine the fairest way to raise revenue given public decisions about expenditures and debt.

Nevertheless, at our hearings, the issues of government spending and accountability were reflected in widespread public concern about the national and provincial deficits and their effect on the tax liabilities of future generations.

Fairness in a Multi-jurisdictional Setting

The discussion of fairness in taxation becomes more complicated in a federal setting. Specifically, issues arise concerning (a) the division or sharing of tax bases by different orders of government, and (b) the coordination of taxation of the same base between governments.[8] The first issue is central to the operation of federal fiscal relations. The importance of the second relates to concern about the undertaxation or the double taxation of income. Decisions about these issues are made in a context that involves broader aspects of a federal system. An important rationale for establishing a federal structure in a nation is to reap the benefits of larger economic markets while accommodating the desire for different combinations of public services at the subnational level. The relative absence of economic barriers within a nation means that mobility between the parts of the federation becomes an important consideration in the design of tax policy.[9] Part of this design involves determining which public services are provided by the regional (provincial) governments and which are provided by the common (national) government. For example, the decision whether income redistribution is primarily a central or a provincial function may affect the allocation of taxing authorities between the two orders of government.

These issues, and others involving taxation in a federal system, are discussed in chapter 6. A vigorous debate about the best constitu-

---

[8] These issues are thoroughly addressed in Musgrave and Musgrave (1993).

[9] Similar concerns arise between separate countries, especially with respect to the mobility of capital, advances in communications technology, the reduction of transportation costs, and the lowering of trade barriers. See the discussion in chapter 7.

tional processes and structures to determine these issues is ongoing.[10] The purpose of referring to some of these issues here is to note the implications for fairness in taxation. Tax fairness can be examined for one order of government by itself or for some or all of the components of the federal system combined. Because of our mandate, we have restricted our attention to the provincial and local levels of government. However, the analysis in this report and the recommendations drawn from it were developed in the context of Ontario as a province in the Canadian federation. In some instances the report identifies fairness problems that can only be solved with the cooperation of the federal government, and in others where only the federal government has a role to play.

Fair Process

What the tax statutes say is only part of attaining a fair tax system. Fairness in taxation is also about how the statutes are developed and how they are administered. At one extreme, some writers argue that fairness in process is all that matters – that if the process is inherently just, one accepts the outcome of that process as being just. The concept, called commutative justice, describes end results as just solely on the basis that they are the result of a just procedure (Birch 1988, 1006). Fairness in process (broadly defined to include administrative processes, judicial processes, and policy formation processes) is seen as the guarantor of substantive fairness in the tax system over time. It is an answer to the dilemma of how to prevent the system from becoming eroded again once the structure of the tax system is reformed to enhance its fairness.

In addition, fairness in process is desired in its own right because of its central importance in a democratic system of government. In this context, it is intimately linked to openness. Accessible information and open debate over policy options help people to understand and to have confidence that policy choices are fair, even for those who oppose the choices made. Openness promotes "civic discovery" or public learning (Reich 1988, 144–46), an important aspect of fairness in itself. These issues are discussed in more detail in chapter 11,

---

[10] See, for example, Breton (1993).

where recommendations to enhance the fairness and openness of the tax policy process are made.

Implications

As one thinks through the concept of fairness in taxation it becomes clear that there are different levels of fairness and, at each level, different dimensions. Fairness lies partly in relating taxes paid to benefits received, and partly in relating taxes paid to ability to pay. Ability to pay, in turn, has a horizontal and a vertical dimension. Fairness can be defined across generations as well as within a generation.

Given these and other aspects of fairness, it is unlikely that any one tax can achieve an acceptable balance among all these dimensions. A mix of taxes rather than one single tax will provide some of the extra degrees of freedom to address the multiple dimensions of fairness. Tax fairness, then, should ultimately be judged in terms of the overall mix of taxes; while we obviously want each individual tax in the system to be as well structured as possible, we should not expect to find the various dimensions of fairness adequately represented in any one tax. In chapter 33 we discuss the issue of the existing tax mix and how it can be improved. Moreover, tax fairness is part of a larger concern – general fiscal equity. While our concern is with fairness in taxation, we are cognizant of the broader picture. We are aware, for example, that there are limits to what can be accomplished through the tax system, especially for a single province. The fiscal and tax situations in other jurisdictions constrain Ontario's options because of the open economic relationships among them. However, even in a closed economy, limits would exist because of the responses of taxpaying units to the imposition of various taxes at various rates.

Some aspects of fairness are difficult to disentangle from the context in which they are raised, particularly those relating to particular groups, such as people with disabilities or care-givers. It is important to distinguish between the tax system recognizing the special circumstances of these groups as a matter of fairness, and the tax system providing instruments to benefit these groups. The first is a matter of horizontal equity; the second is a matter of social policy. In the following chapters we return to this distinction on several occasions.

Most of our discussion of fairness has dealt with the issues in a "pure" sense, as if we were designing a tax system *de novo*, without an existing system already in place. In reality, we recognize that, under the existing tax system, individuals and businesses have committed themselves to an immense array of formal contracts and agreements, as well as to less formal commitments. As a result, the existing rules are reflected and embodied in a range of real property values, other asset values, wages and salaries, and the like. To change the rules suddenly would be unfair in itself, even if the new rules, which would eventually be reflected in a new set of arrangements, are fairer.

The existence of prior arrangements suggests the need for transitional mechanisms when certain tax rules are changed. As a general principle, the transitional measures should be related to the longevity of the prior arrangement. Contracts that extend for a period of years may be recognized through phase-in provisions or through arrangements which delay implementation for some years after the changes are announced. Arrangements that are long lived or essentially permanent may be appropriately recognized through "grandparenting" schemes, which allow existing contracts the benefits of the old rules for as long as the contracts exist.

One particular transition problem occurs when the effect of a tax rule is reflected in the price of an asset; this is known as capitalization. For example, if a particular parcel of real estate is favoured by existing property tax provisions, that advantage comes to be reflected in a higher price for that property compared with similar properties not so favoured. A sudden change in the tax provision may reduce the price of the property, thereby creating a loss for its owner, even though the current owner may not be the one who benefited from the tax advantage. Where there is strong reason to believe that capitalization has occurred, fairness requires that transition measures be carefully designed to avoid undue penalties to current asset holders. Later in this report we discuss implementation issues and, where appropriate, propose transitional measures to deal with them.

Other Criteria in Tax System Design

While fairness is our dominant principle for tax design, other criteria are also important. In this section we discuss the other criteria that have guided our deliberations, along with some of the relationships between these criteria and tax fairness.

Economic Neutrality

The criterion of economic neutrality requires that tax provisions interfere as little as possible with the decisions of individuals and businesses, so there is as little difference as possible between the decisions they make and those they would make in the absence of the tax provisions. Often these criteria are stated as they relate to specific taxes. For example:

- the income tax should affect as little as possible the amount of paid work people choose to do;
- corporate taxes should only minimally influence whether and where businesses decide to invest; and
- a payroll tax should affect as little as possible how many workers a business chooses to hire or the form in which they are paid.

As a general rule, the argument for neutrality can be read as an argument that private, market-related decisions are, by and large, efficient and that they should be disrupted to the least extent possible. At the same time, it is important to recognize that all taxes elicit some behavioural response.

While neutrality may be desirable as a general principle, there are numerous instances in the tax system where the intent of the tax or tax provision is to affect the economic decisions of people and businesses. Examples include taxes on tobacco and alcohol, in part to discourage their consumption; corporate tax incentives for businesses to undertake additional research and development; tax incentives for workers to assume ownership of their companies; and provisions to encourage individuals to save for their retirement. Whether all these provisions are desirable or effective is another issue. For the moment, the point is that economic neutrality is not an absolute; it should be taken as a statement that it is desirable for taxes to affect private economic choices minimally, unless intrusion is the deliberate intention of the provision and is advanced as such.

Overhead Costs

Overhead costs refer to the administrative costs governments incur to administer, collect, audit, and enforce the provisions of a tax statute. They also refer to the compliance costs experienced by individuals and businesses that pay or remit taxes to governments. These costs may be out-of-pocket money costs (hiring staff or tax advisers) and time (filling in forms), or other forms of non-monetary costs. Clearly, it is desirable that these costs be minimized.

Taxpayer compliance problems can be of two general types. The first are problems that arise from lack of knowledge or confusion. The second are those that arise from deliberate evasion by taxpayers. Perhaps the most interesting instance of the latter involves the "underground economy."

The underground economy, for our purposes, refers to economic activities that are themselves legal, but which are organized differently in order to avoid tax. Common examples are work performed for cash, in order not to leave a "paper trail," and barter exchanges of goods and services. The most obvious effect of underground economic activities (or grey markets as they are sometimes called) is the loss of tax revenue to governments, even when the nature of the activity itself remains unaffected. A less obvious effect is that economic inefficiencies are introduced, because "going underground" often means organizing and performing the underlying activities in more costly ways. For example, barter arrangements are more costly because of the need to locate matching partners with whom to trade. Other costs are sometimes incurred to protect against detection.

Besides revenue and efficiency losses, underground activities lead to real and perceived unfairness in the tax system. Recorded activities and incomes are taxed, while unrecorded activities and incomes escape tax. These perceptions can sow the seeds of further tax avoidance, if they contribute to cynicism about the tax system – a potentially troublesome development for a system that depends largely on self-assessment and voluntary compliance.

Simplicity/Visibility

Simplicity in the tax system is desirable because it is important that taxpayers (individuals and businesses) understand the taxes they pay and the tax implications of activities they may undertake. There is no inherent benefit to simplicity per se; rather, simplicity is desired because of the contribution it makes to meeting other criteria.

In particular, a tax system that is easily understood will contribute more to accountability, the minimization of overhead costs, and predictability of revenues than a tax system that is complex and opaque. Fairness itself, and the perception of fairness, may also be related to simplicity in the tax system. Many public misperceptions about the taxes people pay flow directly from the complexity of the current tax system.

Almost without exception, participants in our public hearings called for more accessibility. Participants from every community told us that improving tax literacy and creating a simpler system are the building blocks of a more equitable tax system. Citing fairness as a major concern, small business lobbied commissioners to reduce escalating compliance costs due to the system's complexity, particularly since the introduction of the Goods and Services Tax.

Having noted the case for a simple and transparent tax system, it is important not to be deluded as to how simple things can be made. The tax system operates in a complex and sophisticated economy, which in turn operates in a sophisticated political and constitutional environment. People are taxed in their roles as income recipients, wealth holders, and consumers, and sometimes more than once in each role. All this means that complexity is inevitable. The challenge is not to introduce any more complexity than is absolutely necessary.

Accountability

Ideally, the tax system should be consistent with and should reinforce the precepts of democratic government. Effective democratic government requires a variety of accountability structures between elected officials and citizens. This report is not the place to enumerate these links; our concern is their relationship to the tax system. There are two sides to the accountability coin. First and most obvious, governments are accountable to their electorates through prescribed processes, elections, conflict of interest rules, openness, administrative rules, and so forth. Second, citizens must maintain an interest in keeping governments accountable. They must be prepared to play the role of watchdog.

Taxation is involved on both sides of the accountability coin. Governments must account for their financial operations, and citizens, because they pay taxes, have an incentive and a reason to monitor what their governments do with the taxes they pay. In recent years, there has been concern that accountability is failing. Governments are seen as distant, fiscally irresponsible, and unresponsive to the needs and demands of their constituents. Participants at our public hearings were concerned about the relationships among the taxes they pay, accountability, and government spending. Often, the notion of the fairness of a particular tax was inextricably linked to whether governments were wasting public money. One "reform" idea which has gained considerable currency in this environment, and which was expressed to us numerous times, is earmarked taxes. Loosely put, the argument is that if a particular tax is tied to a particular expenditure program, the citizens who pay the tax will gain a direct measure of control over the services they receive in return. In short, earmarking would deal with the accountability problem by limiting the discretion of government; it argues that if we cannot hold governments effectively accountable we will limit their powers, at least with respect to how they choose to spend our money. At one level this is an appealing argument; at another level, it may lead to another form of non-accountability. If interpreted tightly enough to be a meaningful concept, earmarking stipulates that public spending on a designated program is determined in some fashion by the amount of revenues generated by the earmarked tax. This amount may or may not have much to do with the correct level of the public service from a societal perspective. In chapter 11 we explore this issue in more detail and arrive at some conclusions and recommendations.

Revenue Predictability

Governments should be able to predict reasonably precisely how much revenue will be generated by a tax at various levels of economic activity. This objective, while not of direct concern to taxpayers individually, is important to governments and therefore to taxpayers collectively. If governments are to be able to plan effectively, they must be able to predict revenue flows. Surprises in revenues, particularly in the downward direction, disrupt budget and deficit plans, creating pressures for changes in spending and taxes (rates and/or structures). Revenue predictability for governments is somewhat akin to visibility/transparency for taxpayers. It is desirable for both to know the impact of the tax system on their financial situation.

Relationships among Criteria

Fairness and the other tax criteria discussed in this chapter are not independent of one another. Improving the system in one area will, in general, have positive or negative effects on the others. Three short examples illustrate the point. First, governments can improve revenue predictability if they adopt procedures to increase compliance – such as more auditing and more enforcement. However, this surveillance will increase overhead costs of operating the tax system in terms of direct administrative costs, and also in terms of taxpayer compliance costs. Second, improved clarity for taxpayers can enhance their ability to play watchdog over government – an example of simplicity enhancing accountability. Finally, tax neutrality may conflict with fairness. Designing taxes to minimize their impact on private decisions may be unfair if it means that capital income will be treated differently from labour income, or if high-income taxpayers are taxed at the same rate as low-income taxpayers.

In our deliberations we were cognizant of the linkages that exist among criteria. Our primary concern, however, is with fairness in the tax system. In our view, then, the net benefits of any tax measures designed to meet other goals (such as neutrality) must clearly outweigh any negative impact these measures might have on fairness.

Part Two
The Context for Tax Reform

5 The Economic and Social Environment

In the past 25 years, the international economy has undergone sweeping change. Capital, goods and services, and to some extent even labour move far more freely from nation to nation. International trade and financial agreements both reinforce and extend that mobility. The industries that have traditionally formed the foundation of Canada's and Ontario's economic development – resources for export, automobile assembly for the North American market, and light manufacturing for the Canadian market – have been forced by competitive pressures to undergo substantial restructuring. This continuing restructuring heightens concerns about the impact of taxes on investment and business location. And by increasing opportunities for tax avoidance, the enhanced mobility of capital, goods, and services that gave rise to the restructuring in the first place undermines the effectiveness of the tax system itself. Finally, in combination with demographic changes within Canada, these changes are altering patterns of employment, income, and consumption, and thus affecting both public expenditures and the revenue potential of various elements of the tax system.

Economic Internationalization

International economic integration has profound implications for taxation in a relatively small, open economy like Ontario's. Some of the factors driving economic integration include international sourcing of inputs in the production of goods, the liberalization of trade, and the ease with which financial capital can move from jurisdiction to jurisdiction. These three developments have both diminished the ability of jurisdictions to tax corporate profits and the capital income of high-income individuals, and reduced the scope of governments to use the tax system to achieve economic objectives.

International Sourcing in Goods Production

The emergence of low-cost mass production in the past 20 years in newly industrializing countries (NICs) has challenged the traditional mass production manufacturing base of the North American economy. As some of the early NICs, such as Korea, develop into higher-wage economies, new centres of low-wage, low-skilled production, such as Thailand, emerge. Mass-produced goods from these countries can be shipped for sale to markets all over the world thanks to a decline in shipping costs, reductions of trade barriers, and the success of multinational enterprises in marketing their products in every corner of the globe.

At the other end of the spectrum, high value-added products and services are now frequently created through what Reich refers to as the "web enterprise" (1991, 87–97). Such an enterprise does not produce products or services from start to finish, but rather contracts with working units all over the world to produce the products and services that meet a particular customer's need. Reich provides the example of precision ice hockey equipment which is "designed in Sweden, financed in Canada, and assembled in Cleveland and Denmark for distribution in North America and Europe, respectively, out of alloys whose molecular structure was researched and patented in Delaware and fabricated in Japan" (Reich 1991, 112). Ontario is increasingly a part of these enterprise webs as it develops its production of high value-added goods and services.

The challenge for the tax system posed by international sourcing and production is largely one of allocating profits. As Peggy Musgrave (1991, 282) notes, it seems reasonable to permit the country in which income has been earned to tax that income to some degree even though it is owned or consumed by a foreign resident. However, without special arrangements between jurisdictions, double taxation will occur if capital income is taxed in the jurisdiction in which it is earned (source principle taxation) as well as in the jurisdiction where the person who earned the income is resident (residence principle taxation).

Multinational enterprises (MNEs) are one component of the internationalization of production. MNEs are firms that have facilities located in a number of jurisdictions. As Eden (n.d.) explains in her study for the Fair Tax Commission, MNEs choose locations based on factors such as the availability of resources (natural and human) and the cost of operating in that location. Each MNE carries out primary activities, such as administration and technological development, and support activities, such as resource extraction and processing, fabrication and sub-assembly, final assembly, sales and service. In some cases, different branches of the MNE add value and the final product emerges after a series of intra-firm transfers (vertical integration). In other cases, different plants produce the same or similar product lines, with intra-firm trade occurring to meet excess demand or supply niche markets (horizontal integration). There is increasing competition among jurisdictions for the primary activities of multinational enterprises because these tend to be high value-added activities which have significant spin-offs for domestic economic growth (Ontario 1992, 5).

The ability of multinational enterprises to shift earnings from jurisdiction to jurisdiction to minimize tax liability creates a challenge for tax authorities in the nations in which they operate or pay dividends. One way MNEs can minimize their tax liability is to locate patents for new technology in the country with the most favourable tax system (Gordon 1992a, 84). MNEs can also minimize their total tax liability by financing debt in a jurisdiction with high tax rates thereby reducing profits in that jurisdiction and hence taxes payable (Conklin and Whalley n.d.). A third method by which multinationals reduce their global tax liability is a practice commonly called transfer pricing. A transfer price is the price of any non–arm's-length transaction involving goods, technology, or services between affiliates of a multinational enterprise. A need for transfer pricing arises where firms and their subsidiaries operate in two or more jurisdictions, and there is a need to assign prices for internally traded products to support decentralized decision-making systems, or to determine income by jurisdiction or decision-making unit (Eden n.d.). Transfer prices are set by the multinationals and logically would reflect the price per unit of the commodity, good, or service as well as the allocated charges for services such as interest, management fees, and research and development charges (Eden n.d.). In some jurisdictions, including Canada, multinationals are required to price transactions in the same way as transactions between unaffiliated firms (referred to as a reasonable arm's-length price). The arm's-length transfer-pricing requirement is difficult to achieve in practice because it is hard to find comparable transactions among independent firms and because there is no agreement on a single correct way to allocate common overhead costs among subsidiaries of a multinational. The concern with respect to transfer pricing is that multinationals may misrepresent the prices of intra-company transfers "in order to shift profits from high-tax to low-tax jurisdictions" (Munnell 1992, 38).

Although profits may be shifted extensively by multinationals, production may not be shifted as much. A study for the Fair Tax Commission notes that multinationals are more likely to shift profits to take advantage of low effective tax rates than to shift the location of production (Conklin and Whalley n.d.). With respect to the European experience, another study comments that "differences in taxation appear to have a greater impact on companies' tax-planning behaviour, particularly with regard to the choice of financial and legal structures, than they do on their direct investment decisions" (Daly 1992, 1063). Thus, transfer pricing and other tax minimization techniques affect the level of tax revenues a jurisdiction may collect but not necessarily the level of economic activity in that jurisdiction.

Trade Liberalization

As production processes have become more international, access to markets for goods and services has become a key concern for nations all over the world. At the federal level, Canada has signed two major trade liberalization agreements: the Canada–US Free Trade Agreement (FTA), and the North American Free Trade Agreement (NAFTA). Canada is also involved in multilateral trade negotiations as part of the General Agreement on Tariffs and Trade (GATT). At the same time, Ontario, the federal government, and some provincial governments continue to discuss the reduction of interprovincial barriers to trade.

Canada–US Free Trade Agreement

The Canada–US Free Trade Agreement was implemented on 1 January 1989 and covers bilateral trade in goods and certain services, as well as a wide range of issues related to investment. It covers about three-quarters of Canada's merchandise exports and two-thirds of its imports and provides for the phasing out of all tariffs on bilateral trade by 1998 (GATT 1992, 29). In 1990 the tariff elimination process was accelerated for 400 items and in 1991, for a further 250 items. At the time of writing, the accelerated elimination of tariffs was being negotiated for a number of additional categories of goods including some steel products, household appliances, textiles and clothing, plywood, and most agricultural products (GATT 1992, 29).

There are both direct and indirect tax policy implications of the FTA. One of the provisions that may have an impact on Ontario's tax system is the "national treatment" provision which ensures that US imports are not discriminated against in the Canadian market through, for example, differential tax treatment or regulations. This article of the agreement effectively reduces the types of subsidization that Canada can provide for domestic goods in competition with imports. However, the definition of what is or is not a subsidy is a subject of some disagreement between Canada and the United States and is likely to be established on a case-by-case basis. As tariff protection is reduced, and if direct subsidies are disallowed, firms may seek alternative kinds of government support for activities to increase their competitiveness. Such support may take the form of tax expenditures, although certain kinds of tax expenditures, specifically ones that benefit a sector or firm, may also be restricted. Tax expenditures and subsidies may be more acceptable at the "pre-competition" phase; for example, for training or research and development. One analyst argues that the national treatment provisions force Canada and the United States either to eliminate any tax provisions which favour their own firms or to agree to a common set of tax distortions to eliminate the differences in the effective tax rate on different industries (Gordon 1992a, 91).

The FTA has also reduced tax policy options for the Canadian government and the provincial governments. The FTA allows goods, services, and investment capital to flow relatively freely across the Canada–US border. It is likely that investment capital, in particular, will flow to locations where the return on investment is highest, often a lower-taxing jurisdiction. This will put pressure on Ontario to align its tax system more closely with the tax systems of competing US states. Further, although the FTA held out the promise of larger markets for Ontario's products, "many companies have found that they can only compete on the basis of significant structural adjustment" (Conklin and Whalley n.d.). Such adjustment has typically included reducing the size of the workforce and in some cases moving to another jurisdiction. If firms reduce their labour force or move to other jurisdictions, the loss of jobs will have a negative impact in the short term on the revenue governments can raise from personal income tax, sales tax, payroll tax, and corporate income tax.

North American Free Trade Agreement

Since 1991 Canada has been negotiating a trilateral free trade agreement with Mexico and the United States. The intent of NAFTA is to eliminate tariff barriers in most sectors and most investment restrictions among Canada, the United States, and Mexico over a 10- to 15-year period. With NAFTA's approval, there is likely to be a further increase in the international division of labour and the degree to which different countries specialize in particular products or product niches within industries which are then traded across national boundaries (Dobson 1992, 108, 109). This may increase tax rate competition among Canada, the United States, and Mexico as each jurisdiction vies for investment capital.

General Agreement on Tariffs and Trade

The current round of GATT negotiations (the Uruguay Round) began in 1986 with 108 countries involved. The agenda for the round includes liberalizing trade in services, textiles, and agriculture and limiting non-tariff barriers like subsidies and government procurement policies. However, there is considerable doubt as to when or if agreement will be reached in this round.

If agreement is reached in the Uruguay Round, markets will be increasingly open to goods and services produced in other jurisdictions. This openness will increase the flexibility firms have with respect to their location and may increase tax competition between jurisdictions. As the United Nations' 1991 World Investment Report warns, jurisdictions that provide extensive social benefits and levy high taxes to support those programs may find their fiscal base eroded "if business shifts to neighbouring countries with lower taxes following regional integration" (Campbell n.d.).

Reducing Interprovincial Trade Barriers

During the constitutional negotiations of 1991–92, the federal government proposed a constitutional amendment that would have reduced interprovincial barriers to trade. A watered-down version of the federal proposal was included in the Charlottetown accord, which was defeated in a national referendum in October 1992. The question remains whether the federal government will pursue the reduction of interprovincial barriers in the future. Although discussion of this issue among the provinces and the federal government is ongoing, few observers feel that any reductions will occur in the near future (see Dungan n.d.). However, as trade is liberalized through the FTA and NAFTA and changes to GATT, there may be increasing pressure on the provinces to negotiate reductions in interprovincial barriers. The tax implications of such a change are difficult to anticipate, although it is certain that, in some industries, rationalization would occur and jobs would be lost.

Movement of Financial Capital

A third development that has contributed to international economic integration is the increasing cross-border movement of financial capital. Flows of financial capital grew at a rapid rate during the 1980s, greatly exceeding the rate of growth in trade. For instance, from 1983 to 1988 financial capital flows grew by 20 per cent per year compared with a 5 per cent per year growth rate in trade (Campbell n.d.). Financial integration has been driven in part by modern methods of communication, which allow investors, borrowers, and financial institutions to obtain information easily on opportunities and risks all over the world. In addition, financial deregulation has opened many domestic markets, including Ontario's, to foreign financial institutions (Economic Council of Canada 1990, 59).

Financial capital is perhaps the most mobile of resources (Musgrave 1991, 283) and thus most likely to flow to locations where effective tax rates are low. The mobility of financial capital creates an incentive for jurisdictions to maintain low effective tax rates.

Unfortunately, this hurts the residents of the country from which the capital has been attracted and the resultant tax rates "will be too low compared to a cooperative solution" (Slemrod 1990, 20). From the perspective of the taxpayer, "movement, in particular of capital, to low-tax locations permits the owner who resides in a high-tax location to act as a free rider enjoying a high level of public services without contributing to their cost" (Musgrave 1991, 286).

The cooperative solution alluded to by Slemrod is tax coordination of some kind.[1] Musgrave argues that cooperation can take the form of either minimal or full fiscal coordination. Minimal coordination is characterized as the prevention of one jurisdiction from "engaging in discriminatory fiscal practices to the detriment of other jurisdictions" (Musgrave 1991, 293). Provisions this implies include those to avoid the full double taxation of foreign capital. Full coordination implies establishing "an inter-jurisdictional fiscal environment which is neutral with respect to flows of trade, factors, and residents, and at the same time secures fair tax shares by each jurisdiction in gains accruing to non-residents, while preserving standards of taxpayer equity prevailing in the residence jurisdiction" (Musgrave 1991, 293).

Tax coordination has been considered on a practical level in Europe. In 1986 the Single European Act was signed with the aim of creating by the end of 1992 the European Economic Area (EEA), a single internal market in which the movement of goods, persons, services, and capital was to be ensured. One of the anticipated implications of reduced economic barriers is that capital flows would be increasingly sensitive to international tax differences (Daly 1992, 1053). Another possible tax-related outcome of a single market in Europe is thought to be the use of special tax incentives by governments trying to attract certain types of activities (Daly 1992, 1053). Both of these possibilities raised concerns that investment decisions would be altered by tax provisions.

In anticipation of the problem of allocating income from capital between the nation in which it is earned and the nation in which the

[1] Another school of thought argues that the process of competition between nations for mobile factors like financial and investment capital promotes efficiency and responsiveness of governments. Thus, the cooperative solution would be counterproductive and fiscal competition is desirable (Musgrave 1991, 277). Musgrave suggests that this school of thought is best represented in Brennan and Buchanán (1980).

recipient resides, the Commission of the European Communities established the Committee of Independent Experts on Company Taxation to advise them on ways to improve the harmonization of capital income taxation within the EEA. The committee concluded that, in the long term, a fully harmonized corporate tax system was desirable for the establishment of a single capital market within the European Communities (Daly 1992, 1076). In its report, the committee recommended measures to eliminate the double taxation of cross-border income flows, harmonizing the treatment of foreign source and domestic source income, and minimizing the differences in effective corporate tax rates among European nations (Munnell 1992, 43). However, taxation is one of the areas of EC policy which requires unanimous approval of new legislation, and informed observers feel that increased harmonization of national tax laws will be difficult to achieve politically (Daly 1992, 1081).

This conclusion is echoed by another observer, who dismisses the possibility of multilateral cooperation on taxes because "countries differ enormously in their revenue requirements, capacity to raise taxes, and their predisposition toward alternative tax systems, including the perceived need to use tax policy to affect economic activity" (Slemrod 1990, 21). A more modest goal that might be achieved, he suggests, is the harmonization of both statutory corporate tax rates and withholding taxes on interest, dividends, and royalties to equalize the ability of countries to impose residence-based taxes.

As international economic integration continues, the mobility of financial capital and production will put pressure on jurisdictions to reduce effective tax rates on these factors. As a result, open economies like Ontario's will feel pressure to increase their reliance on taxes on less mobile factors like labour and taxes on consumption. (But significant levels of cross-border shopping in the late 1980s showed that consumption can also be relatively mobile for some.) In addition, Canada may want to enter into tax coordination agreements with competing jurisdictions to avoid the bidding down of effective tax rates.

The Changing Economy in Ontario and Canada

Changing Economic Activities

The Ontario and Canadian economies are not isolated from the international influences on economic activity and investment outlined in the previous section. The emphasis in much of the recent literature on structural adjustment in Ontario and Canada focuses on the central role played by traded goods and services in ensuring our continued economic well-being. Ontario's Premier's Council on Technology argued in its 1988 report that Ontario's high-wage economy and future prosperity would depend on "our ability to sustain a sufficiently large base of companies competing in world markets, not on the basis of lower labour or raw material costs, but rather through technical innovation, skilled labour, adept marketing, and high productivity" (Premier's Council on Technology 1988, 35). The council report argues that businesses which produce traded goods and services are central to the wealth creation process.

Traded Goods

Ontario's economy is characterized by a high level of trade. In 1990, merchandise exports and imports made up 54 per cent of gross provincial product (Conklin and Whalley n.d.). Traditionally, Ontario's exports have been raw materials and manufactured products, such as automobiles, produced as part of a North American production system (Premier's Council on Technology 1988, 35). In 1990, 40 per cent of international exports were related to the motor vehicle industry and in 1992, 93 per cent of Ontario's international exports were in the form of fabricated materials or end products (Conklin and Whalley n.d.). Although Ontario's resource-based businesses are internationally competitive and contribute significantly to provincial living standards, substantial growth in this area is unlikely in the future in light of increasing competition from developing countries and declining world prices for natural resources (Premier's Council on Technology 1988, 55). Porter echoes this prognosis in his 1991 report on Canada. He argues that the sustainability of Canada's resource industries is threatened by a number of factors including resource depletion, the elimination of markets for some of our resources as synthetic substitutes are found, the emergence of low-cost competitors in both developed and developing countries, and declining real prices (Porter 1991, 156–60).

Traded Services

In 1989 the service sector made up 64 per cent of Canada's GDP, up from 55 per cent in 1967 (Betcherman 1991, 58). (The most comprehensive information on the service sector is available for Canada as a whole and is not Ontario-specific.) A 1991 Economic Council report on the growth and character of the service economy, defines three types of services: **dynamic services**, which include transportation, communications and utilities, finance, insurance, real estate, wholesale trade, and business services; **traditional services,** which include retail trade, amusements and recreation, accommodation, food and beverages, and personal services; and **non-market services,** which include education, health care, social services, and public administration (Betcherman 1991, 9). Most of the growth in the service sector occurred in dynamic services, while traditional services made up only slightly more of the GDP in 1989 than they did in 1967 (Betcherman 1991, 58).

Traded services are a small component of Canada's trade. In 1988, services, primarily dynamic services, made up 13 per cent of Canada's exports and just less than 17 per cent of imports (Betcherman 1991, 16). Historically, services have been located close to the customer. This is still true for most traditional services. However, as Campbell (n.d.) notes, the 1991 World Investment Report of the UN Centre on Transnational Corporations predicted that technological developments, specifically the convergence of computer and communications technology, would make it possible for information intensive services to be produced in one place and consumed in another, thereby increasing the tradability of these types of services. In addition, the internationalization of banking and other financial services and of telecommunications is increasing their tradability. The enhanced tradability of dynamic services has made the providers of these services more responsive to economic factors, including the level of taxation in a jurisdiction. If Ontario hopes to nurture the traded services sector, tax policies will have to take into account the ease with which the production of these services can be relocated.

The ability of Ontario's economy to maintain its traded goods sector and enhance the traded services sector will have an impact on the ability of governments to raise tax revenue. If Ontario is unable to maintain its traditional high-wage economy by shifting to high value-added production of goods and services, the ability of the government to raise revenue will be compromised, especially from its major revenue sources, the personal income tax and the retail sales tax.

Labour Market Characteristics

The average unemployment rate in Ontario from September 1992 to August 1993 was 10.8 per cent (Ontario Ministry of Finance, Office of Economic Policy 1993, table 7). A study for the Fair Tax Commission projects that the unemployment rate in Ontario will continue above 10 per cent through 1994 and then fall gradually to about 7 per cent by the year 2000 (Dungan n.d.). The slow fall predicted for the unemployment rate reflects structural adjustments that accompany the current economic recovery. While the Ontario economy is predicted to grow over the next few years (Dungan n.d.), the growth is generally expected to be a result of productivity improvements, rather than employment growth. As a result, the economic recovery of the early 1990s has been referred to as a "jobless recovery."

The labour market changes that have accompanied the structural changes in the Ontario and Canadian economies include shrinking employment in the relatively highly paid manufacturing and resource extraction sector and growth in low-paid consumer service jobs and part-time and other forms of non-standard employment. From 1976 to 1992 employment in Ontario's goods-producing sector declined by 3 per cent, while employment in the service sector increased by 49 per cent. Within Ontario's goods-producing sector, the number of people employed in manufacturing declined by 8 per cent from 1976 to 1992. A slightly larger decline took place in Ontario's primary industries sector (mining, trapping, fishing, forestry, and agriculture). From 1976 to 1992 the number of those employed in primary industries declined by about 9 per cent.[2]

[2] Fair Tax Commission calculation based on Statistics Canada (1993f, table A-22).

TABLE 5.1
Distribution of Employment by Occupation in Ontario, 1976 and 1992

Occupations	1976	1992	Percentage change	Earnings index (1990) [a]
	%			
Managerial and other professionals	23	33	+43	1.16
Clerical	19	17	-11	0.74
Sales	11	10	-9	0.97
Service	12	13	+8	0.73
Primary occupations	4	3	-25	0.87
Processing, machining, and fabricating	17	13	-24	0.89
Construction	6	5	-17	1.01
Transportation/transport equipment operating	4	3	-25	0.95
Material handling and other crafts	4	3	-25	0.79

Sources: Statistics Canada, *Labour Force Annual Averages, 1984.* Cat. 71-529, table 22; *Labour Force Annual Averages, 1993*, Cat. 71-220, table 17; *Employment Income by Occupation, 1993*, Cat. 93-332, 142–173.

a. Earnings index is average earnings in each occupation as a percentage of average earnings for all occupations in 1990 on a full-time, full-year basis.

The large disparities in skills and compensation levels among types of employment in the service sector mean that employment growth in this sector cannot compensate for shrinking employment in the relatively well-paid goods-producing sector. About a third of service sector employment is in traditional services and a third is in dynamic services. The final third is employed in the area of non-market services, services provided by the public sector. Jobs in the dynamic services sector tend to require high skill levels, while traditional service jobs require much lower skill levels (Betcherman 1991, 94). Average hourly earnings in the dynamic services sector were more than 50 per cent above those in the traditional services in 1987.[3]

[3] FTC calculation based on Betcherman (1991, table 8.17).

Table 5.1 shows employment in the major occupational categories for Ontario in 1976 and 1992 and how much employment in those occupations has increased or decreased in that 16-year period. The table shows that employment has increased only in services, management, and the professions, and has decreased most substantially in primary occupations (logging, mining, farming, and fishing) and in "blue collar" occupations such as processing, machining and fabricating, transport equipment operating, and material handling. The table also shows that average earnings in service sector occupations, where employment growth is occurring, are only 73 per cent of the average earnings for all occupations on a full-year, full-time basis.

Growth is also occurring in non-standard employment (Betcherman 1991, 81). Non-standard employment is generally understood to encompass part-time work (less than 30 hours per week), short-term (less than six months) and contract jobs, certain types of self-employment, and work within the temporary help industry (Betcherman 1991, 71, 72). Analysts caution that although data are available on part-time work, labour force data in Canada do not permit accurate estimates of all types of non-standard work. A significant characteristic of non-standard employment is the generally inferior compensation, security, and advancement opportunities attached to the jobs. According to estimates in a study for the Economic Council of Canada, 28 per cent of all employment in 1989 was non-standard and 44 per cent of all employment growth in the 1980s was accounted for by non-standard employment (Betcherman 1991, 81).

Part-time employment is the largest and most accurately measured component of non-standard employment. In 1992, 17 per cent of employed Ontarians worked part-time.[4] If the Canadian pattern of part-time work is assumed to apply to Ontario, about half of all part-time jobs are in the service sector (Betcherman 1991, 73). Part-time jobs in the service sector tend to be short-term, compensation is lower than for comparable full-time workers, and access to fringe benefits is more limited – in 1987, only about 11 per cent of part-time employees had work-related pension plans, compared with 46 per cent of full-time employees (Betcherman 1991, 75).

---

[4] FTC calculation based on Statistics Canada (1993h, table 18).

Changes in the labour market – the falling number of well-paid "blue collar" jobs that is characterizing the economic recovery in 1993 and the growth in low-paid service jobs and non-standard employment – are resulting in a polarization of earnings in Canada. An Economic Council of Canada study of earnings from 1967 to 1986 cited by Betcherman (1992, 126) found that the middle band of earners in Canada (the proportion of those making between 75 and 125 per cent of the median earnings) declined from 27 per cent of the workforce in 1967 to 21.5 per cent in 1986. The phenomenon of polarized earnings has been referred to as the "declining middle" by both Canadian and US analysts. Betcherman concludes that while the ageing of the workforce might moderate this declining middle phenomenon – as fewer workers are available to fill jobs, wages will be bid up somewhat – "the closely related forces of globalization and technological change may well continue to be polarizing forces" (Betcherman 1992, 133).

The implications of the declining middle phenomenon for tax revenues may well be substantial. If incomes become polarized to a great degree, the larger proportion of relatively low income earners will reduce revenues from the personal income tax and presumably revenue from consumption taxes.

A Profile of Ontario's Population and Labour Force

Population Growth

In 1992 the Ontario population was just over 10 million. The population has increased by more than 100,000 each year since 1983 (Statistics Canada 1992g, 85). Part of the increase is due to natural increase (a greater number of births than deaths) and part is due to net migration. In 1990, the fertility rate in Ontario was 1.8 children per woman aged 15 to 49 (Statistics Canada 1992g, 10). Net migration into Ontario per 1000 of the population was 9.3 in 1991 (Statistics Canada 1992g, 10). The migration figures include both immigrants to Canada who settled in Ontario and net migration from other parts of Canada. Although Ontario has experienced a net loss in population from interprovincial migration since 1989 (Statistics Canada 1992g, 78), this trend was moderated by the large number of immigrants from outside Canada who have settled in Ontario. In 1990 the federal government set national immigration levels at 220,000 for that year and at 250,000 per year from 1991 to 1995 (Statistics Canada 1992g, 70). This was a significant increase from the numbers in the 1980s, which ranged from 84,302 in 1985 to 192,001 in 1989 (Statistics Canada 1992g, 71). Employment and Immigration Canada data show that from 1956 to 1991, between 43 and 56 per cent of the immigrants to Canada in each year settled in Ontario (Statistics Canada 1992g, 75). Given this steady flow of immigration into the province and a steady birth rate, the provincial population is expected to continue growing and to exceed 11 million in the year 2000 (Dungan n.d.).

A growing population will increase tax revenues in the long term based on the assumption that a growing labour force increases revenue from taxes on income and payrolls and a growing consumer market increases revenues from consumption taxes. In the short term, however, a growing population puts more pressure on public services like education, health care, and social services, particularly in municipalities that experience large influxes of recent immigrants.

Ageing Population

In 1991 almost 12 per cent of the Ontario population was age 65 or older (Statistics Canada 1992g, 12). The proportion of the population age 65 and older is expected to increase significantly when people born during the postwar baby boom begin to reach that age. It is predicted that by 2031, almost one-quarter of the Canadian population will be 65 and over (Statistics Canada 1990c, 11). This high proportion of elderly may be somewhat moderated in Ontario if high levels of immigration to the province continue.

One of the results of an ageing population is an increased dependency ratio – the ratio of those in the paid labour force to those who are not. In Ontario in 1993, there were 107 people not in the labour force for every 100 labour force participants. The Canadian dependency ratio was higher than Ontario's at 123 to 100 (Murphy and Wolfson n.d.). Over the next two decades, the dependency ratio in Ontario will be influenced by population growth and the labour force participation rate of women. If population growth increases, the dependency ratio will rise, while any increase in the participation rate of women will tend to drive the ratio down (Murphy and Wolfson n.d.).

Ultimately, a higher dependency ratio means a reduction in the total income available to support those not in the labour force and a reduction in the revenue per capita that can be raised from the personal income tax. While retired individuals with generous pensions continue to consume goods and services, they tend to spend less than in their pre-retirement years (Statistics Canada 1990c, 30). Thus, as the proportion of Ontario's population over retirement age increases, relative revenue from consumption taxes will also tend to decline, but probably by a smaller amount. In addition to these likely reductions in tax revenue, the cost of public services to the ageing population may increase (Murphy and Wolfson n.d.).

Selected Labour Force Characteristics

Labour Force Participation of Women

The most significant change in the labour force over the last two decades has been the increased participation of women. In 1992 women made up 46 per cent of the labour force in Ontario, up from 43 per cent in 1982 and 36 per cent in 1972.[5] The labour force participation rate – the proportion of the total population working or looking for work – of Ontario women has also been increasing steadily over the last 20 years. In 1992 the labour force participation rate for women was almost 60 per cent, up from 56 per cent in 1982 and 44 per cent in 1972 (Statistics Canada 1993f, 323). In contrast, the labour force participation rate of men has declined over the same period from 80 per cent in 1972 to 75 per cent in 1992 (Statistics Canada 1993f, 322). Families in which both a female and a male partner were in the labour force made up 54 per cent of all Ontario families in 1991 (Statistics Canada 1993e, table 7).

Although women's incomes are lower on average than men's, their participation in the labour force increases the revenue raised from personal income tax. In addition, it is possible that retail sales tax revenue has increased as families substitute commercially produced goods for goods previously produced by women working in the home.

---

[5] FTC calculations based on Statistics Canada (1993f, 36–37).

Labour Force Participation of Older Men

Another change in the labour force is the reduced participation rate of men aged 55 to 64. In 1990 only 61 per cent of men in Canada aged 55 to 64 had jobs, compared with 76 per cent in 1975 (Statistics Canada 1991a, 25). This decline is due in part to job loss and in part to early retirement. Of those men aged 55 to 64 who did not have jobs, 36 per cent had retired, 15 per cent were not working due to illness, and 9 per cent had lost their job or been laid off (Statistics Canada 1991a, 26). This trend has the effect of reducing income levels, which in turn reduces both personal income tax and retail sales tax revenues.

Labour Force Participation of Immigrants

In recent years, about half of all immigrants to Canada have settled in Ontario, and high national immigration levels are planned by the federal government to 1995. This means that Ontario can probably expect an additional 100,000 immigrants or so to the province each year until 1996. The question is to what extent this will have an impact on the Ontario labour force. Evidence regarding the labour force impact of immigrants is found in a 1991 study for the Economic Council of Canada. The study notes that in 1981, the labour force participation rate for male immigrants, adjusted for age, was 79 per cent, compared with 78 per cent for Canadian-born males. The participation rates for female immigrants in 1981, adjusted for age, was 55 per cent, compared with 51 per cent for native-born Canadians (Swan 1991, 82). The study notes, however, that labour force participation rates for immigrants are lower for recent arrivals. For those immigrants who had arrived in 1980 – 81, the labour force participation rate was 69 per cent for men and 41 per cent for women, lower than native-born participation rates (Swan 1991, 82). The study also notes that the national unemployment rate of immigrants in 1986 was 8.2 per cent, compared with 10.8 per cent for Canadian-born individuals, although the unemployment rate is higher for more recent arrivals (Swan 1991, 81). A popular, though unproven explanation for the lower participation rates and higher unemployment rates of more recent immigrants is that immigrants experience a period of social, cultural, and linguistic adjustment. This period of adjustment may be more prolonged for refugees than for immigrants since the former are selected on humanitarian criteria and the latter on socio-economic criteria. However, the proportion of refugees in the total immigration stream remains small – 9 per cent of the immigrants admitted in 1991 – and their impact on the labour force characteristics of immigrants will be relatively slight. The conclusion that can be drawn from this evidence is that in the medium and long term, high levels of immigration will not significantly affect the characteristics of Ontario's labour force.

Educational Attainment of the Labour Force

The level of educational attainment of Ontario's labour force has been increasing steadily over the last decade. Since 1980 the percentage of Ontarians in the labour force with some post-secondary education has increased from about 37 per cent in 1980 to over 50 per cent in 1991 (Premier's Council 1992, 11). In 1992, 41 per cent of the labour force had completed a post-secondary certificate or diploma or a university degree and an additional 33 per cent had graduated from high school (Statistics Canada 1993h, table 5). This is an important development since an educated labour force is widely regarded as a key to Ontario's future prosperity.[6] According to a study by Ontario's Premier's Council on Economic Renewal, this aspect of Ontario's workforce compares favourably with other jurisdictions, both in Canada and the United States.[7] According to the study, among the 14 jurisdictions surveyed, only Massachusetts, California, and British Columbia had a greater proportion of workers with some post-secondary education than Ontario (Premier's Council 1992, 12).

---

[6] Studies by Porter, Reich, the Economic Council of Canada, and the Premier's Council have all reached this conclusion.

[7] The Premier's Council study compared the educational attainment levels of the Ontario labour force with the labour force in three Canadian provinces (Alberta, British Columbia, and Quebec) and 11 US states (Massachusetts, California, New York, Illinois, Minnesota, Michigan, Georgia, Ohio, Pennsylvania, Kentucky, and Tennessee).

6 Federalism and the Tax System

Along with the economic and social conditions facing the province, the fact that Ontario is part of a federal system, in which taxes are collected and government programs delivered both provincially and federally, is a key consideration for tax reform. In part, our federal system is defined by the constitutional distribution of legislative powers in Canada to tax and to provide public goods and services. In part, it is determined by institutional arrangements through which taxes are collected both federally and provincially and revenues are transferred from the federal government to the provinces. Technically, the institutional arrangements for the collection of taxes in Ontario can be changed by unilateral provincial decision. As a practical matter, constitutional and institutional factors both influence the structure of Ontario's tax system and limit options for tax reform.

The Structure of Fiscal Federalism

Constitutional Framework

The essential starting point for any description of fiscal federalism in Canada is the constitutional framework. This framework comprises legislative powers to tax, federal and provincial spending responsibilities, and constitutional provisions for the Canadian economic union. Municipalities, which have no distinct constitutional foundation but fall within the constitutional authority of the provinces, are included in the description of provincial powers and responsibilities.

Taxation

Constitutional provisions governing the distribution of taxing powers among the federal and provincial governments are found in the Constitution Act, 1867 (formerly the British North America Act), as amended by the Constitution Act, 1982. According to the key sections, the federal government is permitted to raise revenues by "any Mode or System of Taxation," and is granted exclusive control over customs and excise duties. In contrast, provincial governments are limited to "Direct Taxation within the Province," though they are also allowed to raise revenues through licences and are effectively assigned primary jurisdiction over natural resource taxes through the combined effect of sections that confirm provincial ownership of natural resources, authorize provinces to manage and sell these resources, prohibit taxes on lands or property belonging to either level of government, and explicitly allow provinces to tax natural resources "by any mode or system of taxation."[1] Except in the area of resource taxation, therefore, provinces would seem to be constitutionally much more limited in their ability to tax than the federal government – barred from any kind of indirect taxation and precluded from levying customs duties or excise taxes.

Despite these apparent limitations, however, constitutional restrictions on provincial and municipal taxing powers have actually been quite minor. With respect to whether a tax is direct or indirect, courts have disregarded issues of who in the end pays the tax,[2] adopting instead John Stuart Mill's view that a direct tax is "demanded from the very person who it is intended or desired should pay it" while an indirect tax is "demanded from one person in the expectation and intention that he shall indemnify himself at

---

[1] Section 92A was added by the Constitution Act, 1982, reversing the Supreme Court decision in *Canadian Industrial Gas and Oil Limited v. Government of Saskatchewan* (1977), 80 DLR (3d) 449, which had struck down a Saskatchewan tax on oil producers on the grounds that most of the oil was destined for export. According to section 92A(4), provinces are authorized to tax natural resources "whether or not such production is exported in whole or in part from the province," but are prohibited from differentiating between taxes on exports to other parts of Canada and taxes on natural resources consumed within the province.

[2] *Cairns Construction Ltd. v. Government of Saskatchewan* (1959), 16 DLR (2d) 465.

the expense of another."[3] On this basis, courts have upheld provincial corporate taxes on the grounds that they are intended to be paid by corporations themselves, regardless of their ultimate burden.[4] Similarly, they have upheld provincial succession duties, provided they are imposed on beneficiaries directly rather than those responsible for administering estates;[5] and provincial retail sales taxes, on the condition they are levied on consumers, not retailers, though they may be collected by retailers as agents of the province.[6] Although courts have ruled that provinces are constitutionally prohibited from taxing provincial imports and exports on the grounds that these taxes are indirect and conflict with exclusive federal jurisdiction over customs duties,[7] provinces are not precluded from levying excise-type taxes on particular goods (for example, alcohol, tobacco, and gasoline), provided these levies are imposed on consumers in the form of a retail sales tax.[8]

As a result, despite potentially significant constitutional constraints on their taxing powers, provincial (and municipal) governments have been able to levy most kinds of taxes, with the single exception of customs duties. Similarly, except for natural resource taxes, the federal government is constitutionally entitled to levy any kind of tax, provided it does not otherwise interfere with provincial legislative powers.[9] Consequently, apart from customs duties (levied federally), resource taxes (levied provincially), property taxes

---

[3] J.S. Mill, *Principles of Political Economy*, book V, chap. 2, cited in LaForest (1981, 78).

[4] *Bank of Toronto v. Lambe* (1887), 12 AC 575.

[5] *Provincial Treasurer of Alberta v. Kerr*, [1933] AC 710. Because the constitution restricts provinces to "direct taxation within the province," it is also argued that provinces cannot levy an estate-type wealth transfer tax that would apply to transfers of property situated outside Ontario from a deceased resident to a non-resident beneficiary. This question is considered in chapter 19, on wealth taxes.

[6] *Simpsons-Sears Ltd. v. Provincial Secretary of New Brunswick* (1978), 82 DLR (3d) 321.

[7] See, for example, *Attorney-General of British Columbia v. McDonald Murphy Lumber Co.*, [1930] AC 357. These taxes also violate section 121 of the Constitution Act, 1867, which provides that goods from any one province are to be admitted into any other province free of any duty. This subject is discussed in LaForest (1981, 94–96).

[8] *Atlantic Smoke Shops Ltd. v. Conlon*, [1942] AC 550. For this reason, it is often argued that provinces are constitutionally precluded from levying a multi-stage sales tax like the federal Goods and Services Tax.

[9] *In re Insurance Act of Canada*, [1932] AC 41, 53. This additional constraint, which is mainly concerned with the proper characterization of federal measures as regulatory or revenue-motivated, is discussed in LaForest (1981, 41–45).

(levied only by provincial and municipal governments), and wealth taxes (no longer levied by either level of government), virtually every major tax that is collected in Canada (personal income taxes, corporate taxes, payroll taxes, sales taxes, and excise taxes) is levied by both the federal government and the provincial governments. In fact, the federal government derived over three-quarters of its tax revenue in 1987–88 from these so-called "shared tax fields," while the corresponding figure for provincial and municipal governments was just under two-thirds (Boadway and Flatters 1991, 93).

Spending

Although the constitutional distribution of taxing powers has had little effect on the structure of fiscal federalism in Canada, the impact of the constitutional distribution of spending responsibilities has been considerable. Based on the Constitution Act, 1867, provincial (and by extension municipal) governments have been given exclusive constitutional responsibility for spending on education, health, and social services, among other areas. The federal government is generally responsible for all subjects not exclusively assigned to the provinces, but areas of exclusive federal responsibility are limited to matters such as trade and commerce, the postal service, national defence, money and banking, aboriginal peoples, the criminal law, and federal penitentiaries. As a result, although the federal government acquired additional responsibilities over unemployment insurance in 1940 and over old age pensions in 1954,[10] the main areas of growth in government expenditures during the postwar period (education, health, and social services) have fallen within the exclusive constitutional responsibilities of the provincial governments.

Despite this constitutional allocation of spending responsibilities, however, the federal government has played an important financial role in the areas of post-secondary education, health care, and social services, both through its constitutional authority to tax and through the use of what is referred to as federal spending power. Through

[10] While section 91(2A) gives the federal government exclusive jurisdiction over unemployment insurance, section 94A establishes joint responsibility for old age pensions and supplementary benefits on the part of the federal and provincial governments.

the tax system, the federal government provides indirect support to these areas of provincial expenditure responsibility in the form of tax credits such as those for tuition fees, medical expenses, and disabilities. More importantly, the federal government has provided direct support to provincial spending in the areas of post-secondary education, health care, and social services through various kinds of revenue transfers to provincial governments. These transfers are constitutionally justified under several sections of the Constitution Act, 1867, which have been held to allow the federal government to spend funds for any public purpose, including purposes within areas of exclusive provincial jurisdiction, provided that this spending is consistent with ultimate provincial authority to make laws and deliver programs in these areas.[11] Since provincial governments are free to refuse these funds, it is also legitimate for the federal government to attach conditions to these transfers, requiring funds to be spent in specific ways or programs to satisfy certain criteria.

Economic Union

The constitution also contains specific provisions defining Canada's character as an economic union.[12] Of most importance to the tax system in Canada, section 121 of the Constitution Act, 1867, provides for free trade among all provinces in goods produced in any province, while section 6 of the Canadian Charter of Rights and Freedoms guarantees that citizens and permanent residents of Canada have the right "to move to and take up residence in any province" and "to pursue the gaining of a livelihood in any province." Together, these provisions prohibit any level of government from erecting tax barriers to the free movement of goods and people from one province to another.

---

[11] The key sections on which this spending power has been based are section 91(1A) authorizing the federal government to make laws respecting the public debt and property, section 102 granting the federal government the right to appropriate funds from the consolidated revenue fund for the "Public Service," and the preamble to section 91 directing the federal government to make laws for the "Peace, Order and Good Government of Canada." On the constitutional basis of the spending power, see LaForest (1981, 45–51).

[12] See Sheppard (1986, 154–59).

Further, section 36(1) of the Constitution Act, 1982, establishes a constitutional obligation for the federal and provincial governments to promote equal opportunities, to further economic development, and to provide "essential public services of reasonable quality to all Canadians," while section 36(2) commits the federal government to the principle of making equalization payments "to ensure that provincial governments have sufficient revenues to provide reasonably comparable levels of public services at reasonably comparable levels of taxation." In addition to the spending obligations that these provisions impose on the federal and provincial governments, this section has practical implications for the allocation of taxing powers between levels of government by requiring the federal government to raise sufficient revenues to finance equalization payments to economically disadvantaged regions.

Institutional Framework

The constitution establishes the foundation on which fiscal federalism is based, but the structure of this system is actually defined by the institutional arrangements agreed to by the federal and provincial governments. This institutional framework involves arrangements both for the collection of taxes and for the transfer of revenues from the federal government to the provinces.

Tax Collection

The current federal-provincial framework for tax collection in Canada originated during and immediately after the Second World War, both as a response to the wartime revenue needs of the federal government and as a reaction to the complicated tax system that had developed immediately before the war. During the 1930s, several provinces had decided to levy their own income taxes – creating what the Rowell-Sirois Commission later described as a "tax jungle" in which the federal government and the provinces each levied separate income taxes with different bases, rate structures, and residence rules.

During the war, the provinces agreed to abandon their personal and corporate income taxes to the federal government on a temporary basis in exchange for "rental" payments. While this arrangement created a centralized or unified tax system in the areas of personal and corporate income taxation, diversity persisted in the areas of sales taxation and wealth transfer taxation – both of which were levied by both levels of government,[13] with little or no coordination.

In 1947 the wartime tax rental agreements were renewed and broadened to include federal and provincial succession duties. Participating provinces received 50 per cent of tax revenues collected in the province plus a cash transfer of a flat dollar amount per capita. Only Quebec and Ontario opted out of this arrangement, choosing instead to collect their own corporate income taxes and succession duties. In turn, the federal government granted a 50 per cent credit against federal corporate income taxes and succession duties payable in each of these two non-participating provinces – thereby providing a measure of "tax room" equal to the amount of revenue that the federal government would otherwise have collected from these taxes on behalf of the province.

From 1947 to 1957 this arrangement for collecting taxes in Canada changed little. In 1957, however, the federal government changed the method of determining rental payments by eliminating the equal per capita cash transfer and calculating payments solely on the basis of tax revenues actually collected in the province. At the same time, however, the federal government also introduced an explicit equalization scheme to transfer revenues to poorer provinces regardless of whether they participated in the agreements. Quebec continued to opt out of the agreements entirely, while Ontario proceeded to "rent" its personal income tax to the federal government but to levy its own corporate income tax and succession duty. As before, for provinces that chose to opt out of the scheme, the federal government granted credits or "abatements" equal to the share of federal tax collections otherwise payable under the formula.

The last major step in the evolution of federal-provincial arrangements came with the negotiation of the Tax Collection Agreements (TCA) in 1962. This arrangement has required provinces to levy their own personal and corporate income taxes, under an agreement

[13] Provincial governments entered the sales tax field in the 1930s, joining the federal government which had introduced a sales tax on manufactured goods in the 1920s. With respect to wealth transfer taxes, the federal government followed the provinces, introducing a succession duty only in 1941, whereas most provincial taxes originated in the 1890s.

whereby the federal government will collect these taxes provided they meet certain conditions – specifically, acceptance of a common federally defined base and agreement to a common method for allocating personal and corporate income among provinces.

With personal income taxes, the Tax Collection Agreements provide that provinces will levy their tax on Basic Federal Tax (tax on tax). With corporate income taxes, provincial governments levy their tax on federally defined taxable income (tax on base). According to the TCA, personal income is taxed in the jurisdiction in which the taxpayer was resident on 31 December of the taxation year, while corporate income is allocated among provinces in which the corporation has permanent establishments according to a formula based on the percentage of total gross revenue earned in the province and the share of total wages and salaries paid in the province (with special ratios in the areas of insurance, banking, and transportation). In turn, the federal government has provided tax room for provinces to levy their own taxes in the form of "standard" abatements like those previously available to provinces opting out of the prior tax rental and tax-sharing agreements.

Although the personal income tax abatement increased substantially over the next 15 years as the federal government transferred an increasing amount of tax room to the provinces, the Tax Collection Agreements have remained largely unchanged since 1962. In 1962 the standard abatements were 16 per cent for provincial personal income taxes, and 9 per cent for provincial corporate income taxes. By 1977 they had been increased to 44 per cent for personal income taxes and 10 per cent for corporate income taxes. The only major departures from the original framework have been the emergence of provincial credits and surcharges beginning in the 1970s and the introduction of experimental flat taxes in Alberta, Manitoba, and Saskatchewan in the 1980s. Ontario and Alberta administer their own corporate income taxes, and Quebec operates its own personal and corporate income taxes. Otherwise, all provinces participate in the agreements pertaining to both taxes. Further, non-participating provinces maintain the same allocation rules and adhere to much the same base for personal and corporate income taxes, although recent developments have produced some minor differences in tax bases. In Quebec, for example, the personal income tax allows an employment expense deduction (recently abolished at the federal level) and permits tuition fees to be claimed as a deductible expense (versus a credit at the federal level). In addition, Quebec has taken steps to integrate its personal income tax with transfer payments to individuals (Hartle 1993, 22–36). In Ontario, the most recent provincial budget lowers the share of business meals and entertainment that can be deducted for corporate income tax purposes to 50 per cent from the 80 per cent figure allowed at the federal level. Despite these small differences, a considerable degree of harmony in the taxation of income has been achieved in Canada, particularly when compared with the situation in other federal countries.[14] Nonetheless, more recent experience with provincial flat taxes and tax credits designed to encourage provincial economic development suggests at least some weaknesses in the current arrangement. Indeed, the *Report* of the Royal Commission on the Economic Union and Development Prospects for Canada (Macdonald Commission) suggested as early as 1985 (234) that the high degree of harmony and coordination achieved by the Tax Collection Agreements was showing "signs of breaking down."[15]

With respect to other shared tax fields, Canadian experience is much less harmonious. The federal government continued to share its wealth transfer tax revenues with the provinces after 1962 (and provide an equivalent abatement to provinces levying their own succession duties), and increased the provincial share (or abatement) to 75 per cent after 1964, but decided to abolish the federal Gift and Estate Tax effective 1 January 1972. This decision left provincial governments in the difficult position of trying to administer their own succession duties independently at a subnational level. The last provincial succession duty was abolished in 1985.

The federal government has not been able to persuade provincial governments to agree to a national sales tax collected at the federal level. Quebec has partially harmonized its retail sales tax with the federal Goods and Services Tax (GST) and collects the GST on behalf of the federal government; other provinces (except Alberta, which levies no sales tax) continue to levy their own retail sales taxes. Even without harmonization, however, the federal decision to introduce

---

[14] See Bird (1986) and Rounds (1992).

[15] The Tax Collection Agreements are discussed more fully in chapter 13. On the history of the agreements and recent variations on the original scheme, see Courchene and Stewart (1991).

the GST appears to have reduced the tax room available to the provinces in this tax field.

Finally, federal-provincial coordination is largely absent in other shared tax fields such as corporate capital taxes, payroll taxes, and excise taxes. As a result, the rapid growth in these taxes over the last two decades has contributed to federal-provincial discord and could lead to the emergence of a new "tax jungle" in Canada, much like that perceived by the Rowell-Sirois Commission over 50 years ago.

Revenue Transfers

In addition to specific agreements by which provincial taxes are collected at the federal level (or vice versa in the case of Quebec and the GST), the institutional framework of fiscal federalism in Canada includes various arrangements through which federal tax revenues are transferred to provincial governments both for general purposes and to support provincial and municipal spending in specific areas (especially education, health, and social services). Besides payments to participating provinces under the Tax Collection Agreements, the federal government distributes revenues to the provinces via three main programs.

First, through equalization payments, the federal government compensates for the diminished tax capacities of poorer provinces by supplementing their per capita tax revenues up to a calculated national standard.[16] Implicit in the cash transfer component of the 1947–57 tax rental agreements, and explicitly established with the shift to a tax-sharing arrangement in 1957, these payments acquired constitutional status in the Constitution Act, 1982, as an essential characteristic of the Canadian economic union. Nonetheless, since Ontario has never qualified as a recipient province under this scheme, these transfers are considered only indirectly in this chapter.

Second, through Established Programs Financing (EPF), the federal government provides equal per capita grants to each province in the form of personal income tax abatements and cash transfers.

[16] Although this standard has varied over time, it is currently determined by the per capita revenue yield in the five "representative" provinces (British Columbia, Manitoba, Ontario, Quebec, and Saskatchewan). See Boadway and Hobson (1993, 40-42, 54-60,) and Leslie (1993, 31–35).

Enacted in 1977 as a successor to federal grant programs for health and post-secondary education, EPF was intended to increase provincial autonomy by allowing provincial governments to allocate these revenues as they chose; it was also to encourage provincial fiscal responsibility by limiting future growth in the per capita value of these transfers to increases in GNP per capita, rather than increases in average provincial expenditures on health and post-secondary education.[17] At the same time, however, the federal government has continued to impose specific conditions on the health component of the transfer; a series of penalties reduces cash transfers to the provinces to the extent that provincial health care plans disregard established "national standards" of uniform availability, comprehensive coverage, portability, and administration on a non-profit basis.[18]

Finally, under the Canada Assistance Plan (CAP), the federal government shares the cost of provincial and municipal spending on social assistance (welfare) as well as the operating costs of eligible social services. Created in 1966 by combining several transfer programs, CAP was designed to encourage provincial spending on social assistance and to influence social assistance eligibility criteria. Under the plan, the federal government pays 50 per cent of the cost of eligible social services in each province provided that assistance is made available on the basis of need and that residence is not required as a condition of receiving assistance. Although a 1978 proposal suggested that CAP should be restructured along the lines of the EPF arrangement, CAP has remained largely unchanged since its inception.

In recent years, however, the federal commitment to each of these transfer programs has diminished as successive federal governments have attempted to reduce the federal deficit. Since 1982–83, for example, the federal government has limited increases in total

---

[17] Although EPF transfers are based on national average per capita grants for health care and post-secondary education in 1975–76, the connection between EPF grants and actual expenditures on health and post-secondary education has diminished over time due to the GNP-related ceiling on increases in the per capita value of the grants.

[18] These standards first appeared in 1966 as criteria for transfers under the Medical Care Act – one of the predecessors to Established Programs Financing. The cash penalty was introduced in 1984 by the Canada Health Act.

equalization payments to the rate of growth in GNP. As a result, in 1991–92 total equalization payments were almost $680 million less than they would otherwise have been (Boadway and Hobson 1993, 58 n43).

More importantly for Ontario, the rate of growth in Established Programs Financing, which was already limited to increases in GNP per capita, was further limited to 6 per cent in 1983–84 and 5 per cent in 1984–85, limited yet again in 1986–87 to the per capita GNP growth rate less 2 per cent, then to per capita GNP growth less 3 per cent, and finally frozen for two years in 1989 and for a further three years in 1991. The combined effect of these changes to the original arrangement are estimated to have cost Ontario $2.7 billion in 1992–93 (Ontario Ministry of Treasury and Economics 1992b, 107). Further, since the cash component of the EPF transfer is a residual while the value of the tax abatements has continued to grow over time, these cash transfers have actually begun to decrease and are expected to disappear as early as 1997–98 for some provinces and over the next 10 to 15 years for all provinces (Leslie 1993, 47–48).

Finally, the federal government amended the Canada Assistance Plan in 1990 by introducing a 5 per cent limit on annual increases in CAP transfers to each of the three "have" provinces (Alberta, British Columbia, and Ontario). Since this ceiling came into effect just as the Ontario economy went into a severe recession, the fiscal consequences for the province have been especially severe: from 50 per cent as recently as 1989–90, the federal share of eligible social assistance expenditures in Ontario fell to 28 per cent in 1992–93, representing a revenue loss of $1.8 billion from CAP payments to which the provincial government would otherwise have been entitled (Ontario, Ministry of Treasury and Economics 1992b, 103, 108).

Implications for Ontario's Tax System

The federal structure described in the previous section raises two kinds of issues for Ontario's tax system. The first concerns the relationship between taxation in Ontario and taxes in other provinces. The second concerns the relationship between Ontario's tax system and taxation at the federal level.

Relationship with Other Provinces

In one respect, the issues raised by the relationship between Ontario's tax system and taxes levied in other provinces are similar to the challenges associated with the interaction of different national tax systems at the international level. The opportunity for individuals and enterprises to choose the jurisdiction in which economic activities are located or reported for tax purposes creates competitive pressures that may limit the ability of any jurisdiction to pursue an independent tax policy. In addition, the potential complexities of paying dissimilar taxes in different jurisdictions can lead to substantial compliance costs for individuals and enterprises engaged in economic activities in more than one jurisdiction. Finally, where economic activities are shared among various jurisdictions, governments must devise rules to allocate the authority to tax among these jurisdictions – both to minimize the unfairness and economic inefficiency that results when the same activity is subject to tax in two or more jurisdictions, and to recognize the legitimate claims of each jurisdiction to a share of the tax revenues produced by activities within its boundaries.[19]

Despite these similarities, there are important distinctions between the interaction of different tax systems internationally and the relationships among different subnational tax systems. On the one hand, because economic mobility is much easier within a federation than between nations, the effects of tax competition are potentially much greater. Similarly, because economic activities are more likely to involve different subnational jurisdictions than different countries,[20] the complexities and compliance costs associated with dissimilar taxes in different jurisdictions are potentially much greater at a subnational level – as is the need for rules to allocate taxes among jurisdictions. On the other hand, since subnational governments operate within a federal system in which intergovernmental efforts are commonplace and governmental action is possible at the national level, measures to limit tax competition, to lessen inter-jurisdictional tax complexity, and to allocate taxes among jurisdictions are

---

[19] To examine these rules in detail, see Musgrave and Musgrave (1993).

[20] Given its lengthy border with the United States and the distribution of most of its population close to this border, Canada may be a rare exception to this general rule.

undoubtedly easier to achieve. Indeed, Canada has achieved many of these results through federal collection of provincial personal and corporate income taxes under the terms of the Tax Collection Agreements.

Support for or opposition to these agreements and to other measures designed to harmonize provincial taxes depends largely on one's views about government in general and federalism in particular. To some, provincial tax harmonization may be undesirable, since it limits provincial opportunities to innovate and experiment in tax policy and restricts variations in provincial tax systems that may be necessary to reflect different public preferences.[21] In addition, tax harmonization is sometimes opposed on the grounds that tax competition is necessary to control the size of government.[22]

In contrast, there are at least four reasons why interprovincial tax harmonization may be preferable to uncoordinated tax competition. First, tax harmonization may be necessary to minimize the complexities and compliance costs experienced by individuals and enterprises with economic activities in more than one province. Second, since tax differentials can influence the allocation of economic activities among provinces, tax harmonization may be necessary to reduce economic inefficiencies associated with the impact of the tax system on economic decisions. Third, since the effects of tax and expenditure decisions in one province often "spill over" to other provinces, interprovincial cooperation may be required to ensure that provincial governments account for these "fiscal externalities" – for example, by avoiding export-oriented taxes that shift one province's tax burden to the residents of another province or by refraining from low-tax "beggar-thy-neighbour" strategies that induce business or capital to abandon provinces in which they are located. Finally, since interprovincial tax competition makes it difficult for governments to levy taxes on any basis other than benefits received, and since it is difficult to fund public goods and services on this basis, tax harmonization may be necessary both to permit taxation according to ability to pay and to maintain the fiscal capacity of provincial governments.

---

21 For an eloquent statement of this position, see Breton (1985).

22 See, for example, Brennan and Buchanan (1983).

The choice between these opposing viewpoints with regard to any specific tax requires that a balance be struck among diversity, accountability, simplicity, efficiency, and equity.

Relationship with the Federal Government

The structure of Canadian federalism also raises a series of issues concerning the relationship between Ontario and the federal government. The first involves the allocation of tax room between the federal and provincial levels of government, and the connection between this allocation and revenue transfers from the federal government to the provinces. A second issue concerns the assignment of different tax fields to each level of government, whether by constitutional stipulation or institutional agreement. A third issue emerges regarding coordination of federal and provincial taxes where tax fields are shared.

Tax Room and Revenue Transfers

As the structure of fiscal federalism in Canada illustrates, it is impossible to assess the allocation of tax room between each level of government without also considering the constitutional distribution of spending responsibilities and the role of revenue transfers from the federal government to the provinces. Since provinces and local governments are directly responsible for the program areas that have experienced the greatest growth in the last 50 years (education, health, and social services), it is understandable that provincial and local governments have occupied an increasing share of total tax room during much of this period.[23] On the other hand, to the extent that the federal government provides cash transfers to the provinces in the form of equalization payments, EPF transfers, and CAP transfers, it must raise more revenue than it requires to finance expenditure programs for which it is directly responsible. The resulting

[23] According to the Canadian Tax Foundation (1992a, table 3.12), provincial revenues (excluding grants) grew from 5.0 per cent of gross domestic product in 1950 to 5.9 per cent in 1960, 11.8 in 1970, 15.0 in 1980, and 17.1 in 1990. During the same period, federal revenues remained relatively constant at 15.8 per cent of GDP in 1950, 16.5 per cent in 1960, 17.4 in 1970, 16.3 in 1980, and 18.8 in 1990.

allocation of tax room between the two levels of government is described as one of "vertical imbalance" whereby the federal government occupies more tax room than it needs to finance its own areas of spending responsibility, while provincial governments occupy less tax room than necessary to support spending programs for which they are constitutionally responsible.

Like the choice between tax competition and tax harmonization, judgments regarding the allocation of tax room between the federal and provincial governments depend on one's views about the nature of federalism and the appropriate size of government. According to classical theories of federalism, national governments should provide goods and services with nationwide benefits (for example, national defence), provinces should provide goods and services with provincial benefits (highways), municipalities should provide goods and services with local benefits (waste disposal), and each level of government should occupy sufficient tax room to finance these responsibilities independently.[24] Although the ideal distribution of spending responsibilities between national and subnational governments is not always obvious, the essential point for allocating tax room between the federal and provincial levels of government is that each level should finance its own expenditures and occupy sufficient tax room to do so. In principle, this arrangement makes each level of government fully accountable for its own tax and spending decisions, and encourages fiscal responsibility and cost effectiveness in the delivery of government programs.

Despite these attractions, there are numerous reasons to depart from this classical model in federal systems generally and in the Canadian context in particular. First, intergovernmental transfers are a useful way to address structural anomalies in the constitutional distribution of taxing powers and spending responsibilities. For example, where constitutionally defined taxing powers are insufficient to support subnational spending responsibilities, revenue transfers may be necessary to enable subnational governments to fulfil their constitutionally assigned functions. Similarly, where constitutionally assigned spending responsibilities transcend subnational boundaries, intergovernmental transfers can encourage subnational governments to take these fiscal externalities into account in determining

---

[24] This model is described in Musgrave, Musgrave, and Bird (1987, 465–70).

the quantity of public goods and services that they provide.[25] Although constitutional limits on provincial taxing powers in Canada are relatively minor, several areas of provincial spending responsibility (for example, post-secondary education and social services) involve interprovincial "spillovers," some of which are addressed in part through federal grant programs like the Canada Assistance Plan. These transfers imply at least some vertical imbalance in the allocation of tax room between the federal and provincial governments.

A second reason to depart from the classical model of federalism involves the principle of regional equalization. It is justified on grounds of inter-regional equity, since it enables citizens in different regions to obtain similar public goods and services at similar levels of taxation, as well as economic efficiency, since it lessens the influence of fiscal variables on economic decisions (Boadway and Hobson 1993, 29–33). In Canada, the federal government has made equalization payments to poorer provinces since 1957 and has been constitutionally committed to the principle of these payments since 1982. Like the special purpose grants that support provincial spending in specific program areas, these payments also imply at least some vertical imbalance in the allocation of tax room between the federal and provincial governments.

A third limitation with the classical framework relates to the stabilization function of government (outlined in chapter 3). Although empirical evidence suggests at least some role for provincial stabilization policy in Ontario (Auld 1993), it is generally agreed that this function is best fulfilled at the federal level since the national economy is larger and more self-contained than the economy of any province (Macdonald Commission 1985, 232). For the federal government to perform this function effectively, however, it must control a significant share of total government taxes and expenditures, since provincial measures might otherwise counteract federal policies. As a result, effective stabilization policy may also require some

---

[25] In theory, provincial governments will be encouraged to take these externalities into account properly if the federal government supports these program areas through matching grants set at a percentage of provincial expenditures equal to the ratio of out-of-province benefits to in-province benefits (Musgrave, Musgrave, and Bird 1987, 472).

vertical imbalance in the allocation of tax room between the federal and provincial governments.

Finally, other reasons to allocate more tax room to the federal government and less to the provinces stem from advantages associated with spending at the subnational level and taxation at a national level. While subnational governments are often better placed than national governments to provide many kinds of public goods and services, national governments are generally better placed to levy many kinds of taxes because tax bases are less mobile between nations than within a federation, and because taxes can be collected more economically at the national level (Breton 1993, 15, 18). In addition, tax harmonization is more likely to be achieved if the national government maintains a dominant position in various tax fields than if tax room is distributed more evenly among national and subnational levels of government (Boadway and Hobson 1993, 33).

As outlined earlier, throughout the last 50 years the federal government has occupied more tax room than it needs for its own spending responsibilities in order to finance various transfer payments to the provinces. As provincial spending responsibilities expanded during much of this period, the federal government responded by increasing these transfer payments and by transferring additional tax room to the provinces, mostly in the form of credits or abatements against federal personal income tax. It is generally agreed that this arrangement has served the country well (Macdonald Commission 1985, 233).

In recent years, however, the essential features of this approach have begun to disintegrate as the federal government has attempted to reduce its deficit. While federal revenue transfers have been limited through the various caps and freezes summarized earlier, the federal government has taken no steps to provide any additional tax room to the provinces. Indeed, with the introduction of the GST it is arguable that the federal government has actually reduced provincial tax room by entering the highly visible retail sales tax area. At the same time, ceilings on equalization and CAP transfers and the gradual erosion of the cash component of EPF transfers necessarily increase the degree of vertical imbalance in Canada and encourage provincial governments to seek new revenue sources.

The implications of these developments for the character of Canada's political community are widely discussed in current literature on Canadian federalism,[26] while the impacts on Ontario's fiscal capacity are examined in chapter 7. These recent trends are also likely to result in less federal-provincial cooperation in tax matters and a reduced federal presence in many tax fields such that it will be difficult for the federal government to ensure that taxes remain relatively similar across the country (Boadway and Flatters 1991, 107, 118). Given the advantages of tax harmonization, we view these recent trends as disturbing.

Tax Assignment

A further question in the fiscal relationship between Ontario and the federal government concerns the assignment of different kinds of taxes to each level of government. As indicated earlier, most major tax fields in Canada are shared by both levels of government. While the constitutional distribution of taxing powers accounts for federal jurisdiction over customs duties and provincial control over resource taxes, the assignment of other tax fields is unconstrained by constitutional provisions and, therefore, may be altered more easily through agreement between the federal and provincial governments.

Several criteria can be used to assign or share different taxes between levels of government. The choice among alternative options depends on the manner in which these criteria are weighed in the context of the tax system as a whole and individual taxes in particular.[27] Simplicity and economic efficiency favour a broad federal presence in virtually all tax fields, since this is likely to ensure a relatively uniform tax system across the country. Indeed, it is instructive to note that the most complicated and distortionary tax field in Canada is generally regarded as resource taxation, which exists only at the provincial level.[28]

Government accountability, however, suggests that each level of government should be assigned entirely distinct tax fields, since this

---

[26] See, for example, Leslie (1993) and Boadway and Hobson (1993, 133–63).

[27] This analysis is based on the useful discussions in Ip and Mintz (1992, 5–13) and Boadway and Hobson (1993, 153–55).

[28] See Ip and Mintz (1992, 81–86). Natural resource taxes are discussed in chapter 23.

approach ensures maximum visibility of each government's taxes and helps to make federal and provincial governments fully answerable for their own tax and spending decisions. Further, to the extent that certain taxes (for example, corporate income and personal wealth taxes, and to some extent personal income taxes) are more vulnerable to interprovincial mobility than others (resource taxes, property taxes, user fees, and to a lesser extent sales taxes), common sense suggests that federal taxes should apply to more mobile tax bases while provincial taxes should concentrate on less mobile bases. In fact, recommendations much along these lines were made by the Rowell-Sirois Commission in 1940 and the Carter Report in 1966, and continue to appear in much of the policy literature on tax assignment.[29]

A further criterion by which specific tax fields might be assigned to each level of government involves flexibility in the choice of policy instruments available to the federal government and the provincial governments. To the extent that the tax system is used for purposes other than raising revenue (for example, regulation or income redistribution), this flexibility criterion recommends that both levels of government should be assigned specific tax fields that complement their respective legislative responsibilities. For example, while customs duties are an essential addition to federal jurisdiction over trade and commerce, excise taxes can be effective ways to implement provincial regulatory policies in the areas of health and the environment. Likewise, since welfare payments can be delivered directly or through the tax system, provincial participation in the area of personal income taxation is regarded as a useful complement to provincial responsibility for social assistance. Unlike the criterion of accountability, however, this flexibility principle does not require each level of government to be assigned entirely distinct tax fields and is fully consistent with joint occupancy of various tax fields.

Finally, taxes can be assigned to each level of government on the basis of fairness or tax equity principles. To the extent that equity is conceived to be fair payment for benefits received, this criterion suggests that both the federal government and the provincial governments should levy user fees, but that these fees should correspond to

---

[29] See, for example, Musgrave, Musgrave, and Bird (1987, 482), Ip and Mintz (1992, 119–24), and Boadway and Hobson (1993, 26).

the specific goods and services that each government provides. In contrast, where fairness is viewed in terms of ability to pay, it is often argued that progressive personal income taxes should be levied mainly at the federal level, on the grounds that fairness transcends provincial boundaries and interpersonal equity should be determined on the basis of national citizenship (Ip and Mintz 1992, 11). Similarly, since some provinces have more natural resources than others, the existing framework is widely criticized as contrary to inter-regional equity (Musgrave, Musgrave, and Bird 1987, 482; Boadway and Hobson 1993, 26). But if political communities in Canada are regarded as largely provincial in scope, provincial variations in personal income taxes may be accepted as horizontally equitable and provincial resource taxes may be judged to be fair among different regions.

Federal-Provincial Coordination

However specific tax fields are ultimately assigned, they need not be assigned exclusively to one level of government or another. Indeed, today in Canada most tax fields are shared by both levels of government. The Tax Collection Agreements permit a harmonizing of personal and corporate income taxes levied at the federal and provincial levels. Other shared tax fields – sales taxes, corporate capital taxes, payroll taxes, and excise taxes – are characterized by a general lack of federal-provincial coordination. We wish to emphasize our general conclusion in favour of tax harmonization both among provinces and between the federal and provincial governments. We also see recent developments at both the provincial level (the introduction of flat taxes and provincial economic development credits) and the federal level (reductions in cash transfers from the federal government to the provinces) as a threat to the degree of tax harmonization that currently exists in Canada. Specific recommendations on these challenges appear later in the report.

7 Preserving the Fiscal Capacity of Government

The central purpose of the tax system is to raise the funds required to pay for activities that society wishes to undertake collectively. As a consequence, the overriding constraint facing us as we consider options for fair tax reform is the need to ensure that a reformed tax system has the capacity to meet the fiscal requirements of government in Ontario now and in the immediate future. The economic, social, and federal-provincial political trends discussed in chapter 5 and chapter 6 pose important challenges for Ontario's ability to raise the revenue it requires to finance public services. Each of these factors influences how much "room" there is for Ontario to raise revenue from various types of taxes. Each of these factors has an impact on Ontario's program spending and therefore on its total revenue requirements. In addition, the federal-provincial fiscal relationship has an important influence on how much revenue in total Ontario must raise from its own revenue sources.

Challenges Facing Ontario's Fiscal Capacity

Mobility of Real Economic Activity

As discussed in detail in chapter 5, barriers to the mobility of goods and services, capital, and, to a lesser extent, people are breaking down. The evolution of international trading agreements such as the General Agreement on Tariffs and Trade (GATT) as well as regional trading blocs established through the European Community (EC) and the Canada–US Free Trade Agreement have substantially reduced the limitations imposed by national boundaries on the movement of goods and services.

These agreements have also reinforced the trend towards greater international mobility of capital. This phenomenon has been driven by the growing sophistication, integration, and globalization of capital markets; the operation of formal agreements that reduce restrictions on the movement of capital; and the continued growth in the importance of transnational corporate organization.

Although labour in general is not particularly mobile internationally, individuals with specialized skills have become more mobile as transnational corporate organization has expanded.

To the extent that the tax system either influences, or is perceived by governments to influence, location decisions, governments will have a tendency to respond to the increased mobility of key elements of the economy. At a minimum, they may attempt to eliminate their tax systems as a negative factor in location decisions, or they may go further to use concessionary tax regimes to make their tax systems a positive factor in location decisions. Increased mobility creates downward pressure, especially on tax rates, towards the lowest common denominator. That downward pressure will be felt most acutely where the activities that create the tax base are most mobile.

The threat of mobility of economic activity has two types of impact on the ability of governments to raise money. If tax rates are reduced because economic activity will otherwise migrate to a jurisdiction with lower rates, the effect on government revenues is direct and obvious. If the location of economic activity is actually responsive to differences in tax rates and if differentials in tax rates persist, government revenues will be reduced as economic activity and the tax base associated with it migrate. The revenue loss from migration is potentially greater than the amount of tax that would be paid directly by the mobile person or corporation, since taxes paid by suppliers and employees will also be affected.

Mobility of Tax Bases

Even if economic activity does not move in response to tax differentials, the increased sophistication and integration of international financial markets and industrial organization makes it much easier for taxpayers to organize their activities to minimize their overall tax liabilities. The activity may not move, but the tax base associated with it may. Although mobility of the tax base alone is not as serious a problem either for the economy or for the fiscal system as mobility of the economic activity that underlies the tax base, it is much more difficult to monitor, let alone influence or control (Eden n.d.).

Greatly enhanced mobility of economic activity and capital has profound implications for our system of public finance. The traditional premise of public finance is that each society decides for itself what goods and services should be provided collectively, how income should be redistributed, and how the revenue required for these purposes should be raised from each of the three broad categories of bases – income, consumption, and wealth. Greater mobility of economic activity makes it possible to separate the tax bases that might support public services from the consumption of the public services themselves. Tax base mobility means it is possible to separate recorded income and wealth from the economic activities that give rise to real income and wealth. For some individuals and corporations, the combination of tax bases, taxes, and public services is being replaced with a kind of cafeteria in which individuals are able to make choices among jurisdictions as to where to locate economic activity, where to consume public services, and where to pay taxes.

The impact of these developments on tax revenue will vary from tax base to tax base. Consumption tends to be mobile only in border communities in which it is possible to live in one jurisdiction and purchase consumer goods in another. Employment income – the base for payroll taxes – is also a relatively immobile tax base. At the opposite extreme, the ease with which transnational corporations can manipulate prices charged in transactions internal to the corporation (transfer pricing), and arrange international financing to minimize tax liability, makes the corporate tax base extremely mobile (Eden n.d.). Personal income from capital and personal wealth are potentially as mobile as corporate income and capital through the use of similar tax-avoiding financial arrangements. These arrangements are attractive only for individuals with large wealth holdings or large pools of income from capital.

The more mobile the tax base, the more difficult it is for a jurisdiction to sustain levels of taxation that exceed common denominator levels of taxation in other jurisdictions. Corporate taxation is the most obvious example of this problem.

Taxation of Income from Capital: The Gap between Fair and Feasible

Competitive pressures and the ease with which capital and income flows can be adjusted internationally to achieve the lowest level of taxation combine to create downward pressure on rates of tax on capital to a lowest common denominator. These pressures undermine the ability of any single jurisdiction to increase the revenue it derives from income from capital. This is particularly true for smaller jurisdictions with open economies such as Ontario and Canada.

Aggressive administrative action by government can limit the use of such techniques as transfer pricing and the manipulation of international capital financing by large corporations. This is not, however, a solution to the general problem, nor is it realistically available to smaller jurisdictions which are not able to mobilize the substantial resources required to tackle these issues. As a result, jurisdictions that are able to mobilize these resources are likely to benefit at the expense of others, such as Canada and Ontario, which are not. For example, the United States may succeed in forcing large corporations to change their transfer-pricing practices to report more of their corporate income in the United States. The result may be that less corporate income will be reported in Canada.

These are not problems for Ontario and Canada alone, nor can they be solved by Ontario and Canada alone. These issues have been addressed in a number of individual countries by research institutes and governments, including the London-based Institute for Fiscal Studies and the US Treasury (Daly 1992, 1080). Although these reports approach the issue of corporate taxation from different perspectives, their common underlying premise is "a growing awareness that existing corporate income taxes may not be the most appropriate basis for taxing corporations in an increasingly integrated global economy with a high degree of capital mobility" (Daly 1992, 1080). Although there has been little concrete action taken to date, consideration of these issues at the official level is most advanced in the EC, which is attempting to deal with the taxation policy implications of the single market. Michael Daly, secretary to the Ruding committee which investigated company taxation in the EC from 1990 to 1992, summarizes the concerns as follows:

> The increased mobility of capital in a single market and the greater scope that it provides for aggressive tax planning and tax evasion will

> increase the extent to which taxes are borne instead by other, less mobile, factors, such as labour (except, possibly, highly skilled and therefore more geographically mobile individuals), land, or consumers. That may undermine taxpayers' confidence in the fairness of member states' income tax laws and thus their acceptability. (Daly 1992, 1054)

At least as it affects the issue of the taxation of capital, the impact of the single market in Europe is not fundamentally different from that of the FTA/NAFTA or, more generally, from the combined effect of market- and GATT-driven changes in the world economy.

The Relationship between Canada and the United States

The public sector plays a much more important role in Canada than it does in the United States. In 1989 the public sector accounted for approximately 44.0 per cent of gross domestic product in Canada (FTC calculation based on Canadian Tax Foundation 1991, 3:2, and Statistics Canada 1993i, 2), compared with 36.4 per cent in the United States (Leong et al. 1992, 34). Canadians collectively have decided to provide a much higher proportion of the goods and services they require through government than have Americans. These differences are not straightforward. Regional development assistance has been an important area of public spending in Canada. In the United States, explicit regional development spending is relatively low, although US spending on defence, which is higher than Canada's, contains a significant regional development component. In other areas, higher spending in Canada would be expected simply because of such unavoidable factors as climate and population density.

The most striking differences reflect divergences in political culture in areas of social spending and transfers to people. In particular, both the health care system and the education system in Canada are to a significant degree more public than they are in the United States. In addition, transfers to people through public programs are much more significant relative to GDP in Canada than they are in the United States. These three factors – education, health care, and transfers to people – explain most of the difference in the relative size of the public sectors of the two countries.

In the United States, spending on health care (not including workers' compensation or public health activities) in 1989 amounted to approximately 10 per cent of GDP (FTC calculations based on Leong et al. 1992, 33). The public sector accounted for only 35 per cent of that spending (FTC calculations based on Leong et al. 1992, 33). In Canada, by contrast, 8.8 per cent of GDP in 1989 was accounted for by health care costs (not including workers' compensation); the public sector accounted for 73 per cent of all health care spending (FTC calculations based on Canada Health and Welfare 1993, table 1). If the private sector share of health spending were the same in Canada as it is in the United States, Canada's public sector would be smaller by 3.4 percentage points as a share of GDP. Alternately, if the United States provided for health services through the public sector to the same degree as Canada, the US public sector would be larger by 3.9 percentage points as a share of GDP.

The second major area of obvious difference is in elementary, secondary, and post-secondary education. In the United States, education accounted for approximately 7 per cent of GDP in 1989 (FTC calculations based on Leong et al. 1992, 34, and US Bureau of the Census 1992, 141). The public sector accounted for about 73 per cent of that spending (US Bureau of the Census 1992, 141). In Canada, education accounted for about 6.8 per cent of GDP in 1989 (FTC calculation based on Statistics Canada 1993i, 2, and Statistics Canada 1990a, 32). The public sector made up 91 per cent of that spending (FTC calculation based on Statistics Canada 1990a, 32). If the private sector share of education spending in Canada were the same as in the United States, the public sector would be smaller by 1.2 percentage points. Alternatively, if education were publicly funded in the United States to the same degree as in Canada, its public sector would be bigger by 1.3 percentage points.

The third area of significant difference between the public sectors of Canada and the United States is in the area of transfers to people. Canada's public pension, unemployment insurance, and social assistance systems are all more generous than those in the United States. Such income transfers are equivalent to 5.3 per cent of GDP in the United States (FTC calculation based on Leong et al. 1992, 31, 34) and 7.6 per cent of GDP in Canada (FTC calculation based on Statistics Canada 1991c, 96, and Statistics Canada 1993i, 2).

These three differences combined mean that if the role of the public sector in health, education, and transfers to people in Canada were the same as in the United States, the Canadian public sector would be 6.9 percentage points smaller than it is at present. If, in contrast, the public sector played the same role in these areas in the

United States as it does in Canada, the US public sector would be 7.4 percentage points higher than it is at present. Taken together, the differences in 1989 between Canada and the United States in transfers to people and in the funding of health and education accounted for more than 90 per cent of the difference in the relative size of the public sector between the two countries.

Canada's greater reliance on the public sector in health and education, together with our more generous programs of transfers to people, makes our public sector relatively bigger than that of the United States. That difference has to be paid for. We cannot simultaneously have more public services than those available in the United States and lower taxes.

If taxes were raised to fund fully government expenditures, taxes in Canada would total 44.0 per cent of GDP to support the Canadian public sector and taxes in the United States would total 36.4 per cent of GDP to support the US public sector. In other words, the price of Canada's greater reliance on the public sector is taxes which on average will be one-fifth to one-quarter higher as a proportion of GDP than those in the United States.

The key question, then, is what tax bases are available that can sustain differences in taxation levels of this magnitude? It is apparent from the analysis above that such differences can only be sustained from taxes levied on bases that are not highly mobile in response to differences in rates. In particular, it is not reasonable to expect that substantial differences in corporate income and capital taxation can be sustained between Canada and the United States. Canada's larger public sector must be supported from taxes whose bases are not as highly mobile – sales taxes, payroll taxes, personal income taxes – from taxes on people.

Statistics from the Organisation for Economic Co-operation and Development (OECD) tend to confirm this general proposition. Countries with relatively larger public sectors reflecting more comprehensive public social services, education, and health systems tend to have high sales, personal income, and payroll taxes. Countries with less well-developed public services in these areas tend to have lower sales, personal income, and payroll taxes (OECD 1992c, 15).

Federal-Provincial Issues

Over the past 50 years there has been a steady increase in the proportion of total public sector spending in Canada that falls under areas of provincial jurisdiction (Ip 1991, 42–43). That trend is not likely to change in the near future. The spending areas that have grown most rapidly in this period include many of the areas of public service expected to have priority in the next decade. Realigned priorities in industrial policy will continue to place new demands on our education and training systems. Continuing economic adjustment will further strain our social insurance and social assistance programs. The ageing of the population will increase demands for health care spending (Murphy and Wolfson n.d.). The continued importance of the role of women in the labour force will contribute to demands for public investment in early childhood education and child care. The constraints on direct industrial assistance in the FTA and NAFTA will increase demand for social services to facilitate economic adjustment – a further likely shift from federal to provincial responsibilities.

Although there is no constitutional limit on the ability of provinces to raise the revenue required to fund the programs that flow from their constitutional responsibilities, the dominance of the federal government in every major tax field except one (property tax) gives the federal government the upper hand in any conflict with provincial governments over tax room.

> Since both the federal government and the provinces co-occupy the major tax bases, and since the federal government can probably be seen as pre-empting its desired share of the tax room from these sources, the amount of vertical imbalance is the outcome of the resolution of the conflict over tax room. The federal government plays a primary role in deciding what share of the tax room to retain for itself and at the same time decides how much to transfer to the provinces in forms other than tax room. (Boadway 1986, 8)

The fiscal capacity questions raised by this situation have been addressed in a number of ways, some constitutional or quasi-constitutional, some fiscal. A national system of unemployment insurance was created through a constitutional amendment that permitted the federal government to act in an area of provincial jurisdiction. The Canada Pension Plan was created on the basis of a federal-provincial agreement, notwithstanding the fact that pensions fall under provincial jurisdiction.

The federal government in the 1960s and 1970s also responded to the fiscal needs of provincial governments by creating significantly enriched transfer programs that effectively shifted a substantial share of federal tax revenues to provincial governments to enable them to meet these demands. Programs such as the Canada Assistance Plan and Established Programs Financing, as well as general fiscal equalization, effectively bridged the gap by funding provincial programs from federal tax dollars. In addition, expansion of such federal programs as Old Age Security, the Guaranteed Income Supplement, and unemployment insurance responded to individual income-security needs to which provincial social assistance programs would otherwise have had to respond.

In the late 1970s and especially in the 1980s, however, the framework changed. The federal government responded to its own fiscal pressures by cutting back dramatically on both transfer and income security programs. The federal government has concluded it no longer has the fiscal capacity to continue the level of support for provincial spending on health, education, and welfare that began with extensive use of federal spending powers in the 1960s and grew to maturity in the 1970s.

Federal financing for these programs has been declining in real terms, and there is no reason to believe this trend will not continue. The problem is that, while the financing programs are gradually disappearing, the economic and political conditions that gave rise to these programs in the first place have not gone away.

This leaves a funding gap for provincial governments that must be met by increasing provincial taxes. Unfortunately, this federally initiated shift from transfers to provincial taxes has not been accompanied by corresponding changes to open up more tax room for provincial governments. Provincial access to personal income, retail sales, payroll, and capital taxes has been limited by federal action or inaction. The personal income tax collection agreement system has remained essentially unchanged since the 1970s despite the rapid growth in the provincial share of total income tax revenues. The lack of policy flexibility offered to provincial governments is clearly out of step with the greater share of income tax revenue going to provincial governments and with the increasing importance of income taxes in provincial revenues. The introduction of the Goods and Services

Tax as a retail-level tax has had a significant impact on the ability of provincial governments to raise additional revenue from sales taxes. And the federal government has announced its intention to restrict provincial access to additional revenue from payroll and corporate capital taxes by limiting their deductibility for corporate income tax purposes.

Provincial governments have not been aggrieved innocents in this process. Part of the attraction of payroll and capital taxes to provincial governments in the mid to late 1980s was their deductibility from taxable income in the corporate income tax, which effectively exported part of the burden of the tax back to the federal government.

Provincial-Municipal Issues

The provincial government has also responded to the fiscal squeeze imposed on it by the federal government's reduced commitment to fiscal sharing in part by allowing its own deficit to rise and in part by cutting back on its own transfers to municipal governments and school boards. As a result, the portion of local education costs funded from provincial grants has declined from roughly 60 per cent in the early 1970s to roughly 40 per cent in 1992 (Ontario Ministry of Education, 1971–92; Municipal Affairs Databases).

Neither of these responses is sustainable as a long-term strategy for dealing with fiscal imbalance. Deficit spending is not a viable response to a long-term structural problem. It is clear from the public reaction to Ontario's increased reliance on property taxes for education funding, not to mention the associated fairness issues, that "downloading" is not consistent with fairness objectives and, in any case, cannot continue indefinitely without generating energetic resistance from local taxpayers.

Implications for the Future of Ontario's Tax System

Public Services and Taxes

The 44 per cent of our GDP produced in the public sector places Canada in the middle range of countries in the OECD – below countries which provide both a very broad range of public services and comprehensive income security programs, but substantially above a number of countries, including the United States, which provide a narrower range of public services and more limited income security systems (OECD 1992c, 14).

It is misleading to suggest we can have taxes in Canada that compare with those in the United States and, at the same time, provide a significantly higher level of public services. The commission believes most Canadians are prepared to pay for the public services we value. Participants in our public hearings confirmed this view. But the consequence is our taxes must be higher than those in jurisdictions that do not provide those services.

Tax Base Mobility and the Funding of Public Services in Ontario

Taxpayer or tax base mobility would be an important consideration in designing a fair tax policy even if the public sector in every jurisdiction were the same size relative to the size of that jurisdiction's GDP. Depending on tax mix choices, some taxes would be high and others low, relative to those in other jurisdictions. Where relative revenue requirements differ between jurisdictions, the issue of tax base mobility comes into much sharper focus. In jurisdictions with relatively greater revenue requirements, however, taxes *on average* will be higher than those in other jurisdictions.

The key general tax policy question for Ontario is: How can the province sustain levels of taxation that are in excess of those in jurisdictions to which Ontario tax bases might migrate, most notably the United States?

For very mobile tax bases, the practical reality is that Ontario's tax rates cannot be significantly different from those of jurisdictions into which the tax base can migrate easily. This constrains the ability of Ontario to raise substantially more revenue from such tax bases as corporate income, the capital income of the very wealthy, corporate assets, and the personal wealth of the very wealthy than is raised from these bases in Europe, Japan, and, principally, the United States.

For other reasons, resource-based taxes are not a promising source of revenue from which to fund this difference. Resource revenues have been declining steadily in real terms as the mining and forest industries mature and continue to suffer from depressed commodity prices worldwide. From 1971–72 to 1991–92 resource taxes have not made up more than 2 per cent of provincial revenue in Ontario (*Public Accounts*).

Ontario's larger public economy is sustainable only on the basis of differences in the levels of taxation on relatively immobile tax bases – taxes on personal income, property, sales, payroll, and, to a lesser extent, wealth, as well as benefit taxes or user charges. Although, in general, concerns about tax base mobility are not as pressing for these tax bases as they are for corporate income and capital, special attention must be paid in the design of income and wealth taxes to the potential for inter-jurisdictional movement of capital and income from capital as a tax-avoidance technique. For high-income and very wealthy individuals, the incentives may become sufficient to justify the higher cost of organizing personal finances to minimize tax liability. These incentives for tax minimization would obviously be greatest where Ontario seeks to tax at substantially higher rates than other jurisdictions in Canada.

People's ability to consume public services in one jurisdiction and pay (lower) taxes in another suggests that taxes should, where possible, be linked to services through benefit taxes or user fees. Although such an approach might be effective in ensuring that people cannot consume public services without paying for them, it creates potential problems for tax fairness. Because these taxes tend to be regressive, the prospect of greater reliance on them to support a broader range of public services creates a tension between maintaining fiscal capacity and fairness.

That is not to say the problem of taxation of income from capital should simply be accepted as unsolvable. For the reasons cited in this chapter, it is an important problem, not only because of its substantive fiscal impact, but also because of its impact on the perceived fairness of a tax system that cannot extract a fair share of tax from capital income. However, the solution to the problem is neither provincial nor national. Recent reviews of corporate taxation contain two basic messages, both of which are relevant for countries like Canada. First, the systems of corporate income taxation currently used in one form or another in most industrialized countries are not well designed to deal with the particular problems posed by a world of highly mobile goods, investment capital, and, increasingly but to a lesser extent, human capital. Second, a significant degree of harmonization of tax rules and agreement on tax rates among jurisdictions is essential if the pressures generated by mobility are not to result in a significant erosion of the ability of governments to raise revenue from capital and income from capital.

These messages in turn point to the need for an agreement on taxation equivalent to the GATT (for trade), as a counterweight to the tendency for tax base migration and lowest common denominator competition.

Resolving Fiscal Capacity Problems among Governments

Taxpayers are not impressed by infighting among governments. They fail to see how any public interest is advanced when one level of government purports to solve a fiscal problem by exporting that problem to another level, with the result that instead of paying taxes to one level of government, they pay to another. In the interests of taxpayer confidence in the fiscal system as well as rationality and efficiency, the fiscal relationships among governments must be reformed.

There is a critical need for a comprehensive fiscal agreement between the provinces and the federal government. Needed as well is an ongoing mechanism for identifying and resolving issues between the federal and provincial governments, and for involving provincial governments in federal policy decisions about shared tax bases. Such a comprehensive agreement must address a number of key issues:

- the large and growing fiscal imbalance between federal revenue access and provincial spending responsibility;
- the impact of decisions by each level of government on the fiscal capacity of the other;
- the differences in mobility among various tax bases;
- the impact of federal decisions with respect to transfer payments on provincial revenues and expenditure responsibilities;
- the need to minimize administrative duplication and competitive tax policies; and
- the need to coordinate policy and administration so as to minimize taxpayer compliance cost.

As with the federal-provincial relationship, the provincial-local relationship needs reform in the areas of taxation and responsibility for expenditures. A mechanism is required for monitoring that relationship on an ongoing basis and resolving emerging difficulties. In addition, there is a need for a broader look at the implications of fiscal reform for the quasi-constitutional role of local government in Ontario.

Managing Fiscal Capacity

Maintaining Ontario's fiscal capacity requires difficult trade-offs among fairness objectives, economic impacts, non–revenue-raising objectives of the tax system, and aggregate fiscal requirements. The elements of these trade-offs are not stable. Political and economic changes at the national, provincial, and local levels have a significant impact both on what is possible and on what is desirable. International factors which Ontario is unable to control or even influence can have a profound impact on Ontario's choices.

Although Ontario has a system in place for public monitoring and review of the expenditure side of its budget, there is no corresponding system for addressing fairness, economic impact, and fiscal capacity issues on the revenue side. In our view, such an ongoing review is essential if Ontario is to maintain both the capacity to raise the revenue required to finance public services in this province and the confidence of taxpayers in the fairness of the system.

Part Three
Where We Are

8 Revenues and Expenditures in Ontario

Tax reform is not the same as designing a tax system from scratch. For tax reform, it is necessary to have some sense of the current system, how it compares with other relevant jurisdictions, and the purposes to which the tax revenues are put.

In this chapter we address the following questions in order to begin building this picture:

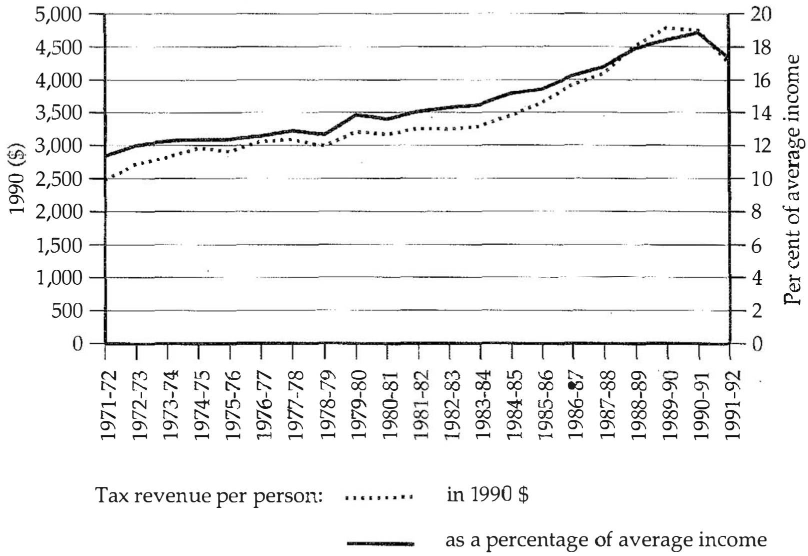
- What taxes do the people of Ontario currently pay, in what amounts, and how has this mix of taxes changed over the past 20 or so years?
- What services are funded by these taxes, and how have these expenditures changed over the years?
- How does our tax structure compare with that of other provinces and US states with which the Ontario economy is often compared?

In chapter 9 we examine how these taxes are distributed among the residents of Ontario in relation to their income and by family type. In short, chapter 9 is a fairness audit of the current tax system.

The Taxes Ontarians Pay

Over the past two decades, residents of Ontario have experienced increased total taxation both in real terms and relative to the size of the provincial economy. The composition of the overall tax bill has also changed in this period. In part, these tax increases reflect the higher costs of delivery for provincial and local government services.

FIGURE 8.1
Provincial and Local Tax Revenue per Person in 1990 Dollars and as a Percentage of Average Income, 1971–72 to 1991–92



Sources: Ontario, Ministry of Treasury and Economics, *Public Accounts, 1971–72 to 1991–92*; Statistics Canada, *Income Distributions by Size in Canada*, Cat. 13-207, 1971 to 1992; Ontario, Ministry of Finance; Ministry of Municipal Affairs, Municipal Affairs databases.

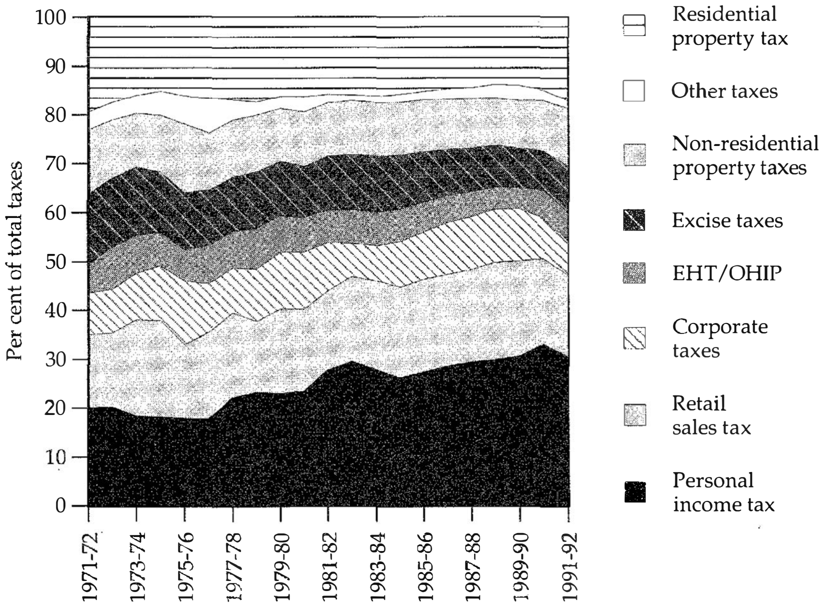
Towards the end of the period the increases also reflect, in part, a less generous system of transfer payments from the federal government. These changes have increased pressure on particular taxes and on the tax system as a whole.

Since 1971–72 provincial and local tax revenue has increased from 12 per cent of gross provincial product (GPP) to 16.5 per cent of GPP in 1991–92.[1] Figure 8.1 shows that tax revenue per person in Ontario

---

[1] The revenue statistics in the chapter come from Fair Tax Commission calculations based on Ontario *Public Accounts* 1971–72 to 1991–92; Municipal Affairs databases (described at the end of this report); Ontario Ministry of Finance (1961–92); Ontario Ministry of Treasury and Economics (1986); Ontario Ministry of Education "School Boards Financial Statement" (1991); and Statistics Canada (1970–92, 1992e, 1993b). Provincial figures in this chapter are reported on a fiscal year basis (from 1 April in

FIGURE 8.2
Shares of Total Tax Revenue from Major Provincial and Local Taxes, Ontario, 1971–72 to 1991–92



Source: Fair Tax Commission calculations based on Ontario, *Public Accounts, 1971–72 to 1991–92*, and Municipal Affairs databases.

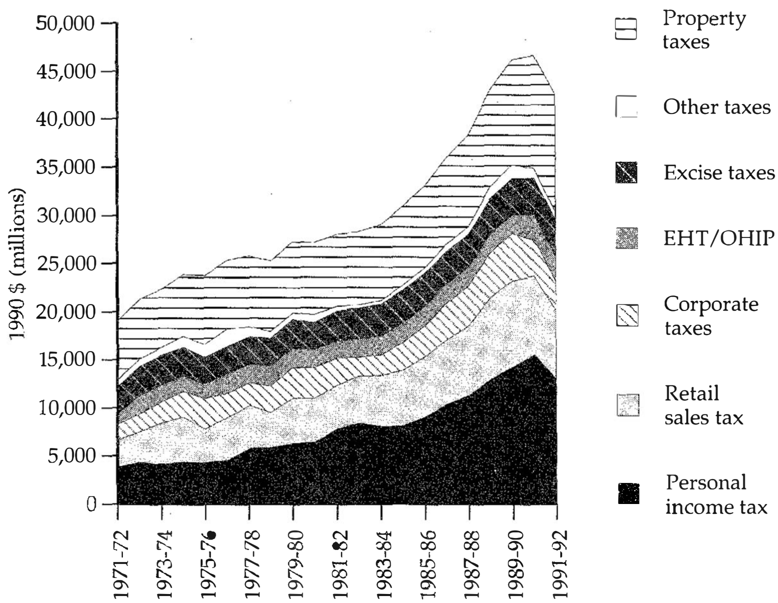
Note: Property tax revenue converted to fiscal year basis.

almost doubled in real terms between 1971–72 and 1989–90 and then fell in 1991–92 (left scale). The figure also shows that per capita taxes in Ontario rose from 11 per cent of average individual income in 1971–72 to 17 per cent of average individual income in 1991–92, indicating the extent to which tax revenue in Ontario has increased above average personal income over the last 20 years (right scale).

---

one year to 31 March in the next). Municipal governments in Ontario report their revenues and expenditures on a calendar year basis (from 1 January until 31 December). In some cases, property tax revenue, which is collected at the local level, is converted to a fiscal year figure in order to add it to provincial figures. Revenue and expenditure data from the United States are reported on a calendar year basis.

FIGURE 8.3
Provincial and Local Tax Revenue in Ontario in Constant (1990) Dollars, 1971–72 to 1991–92

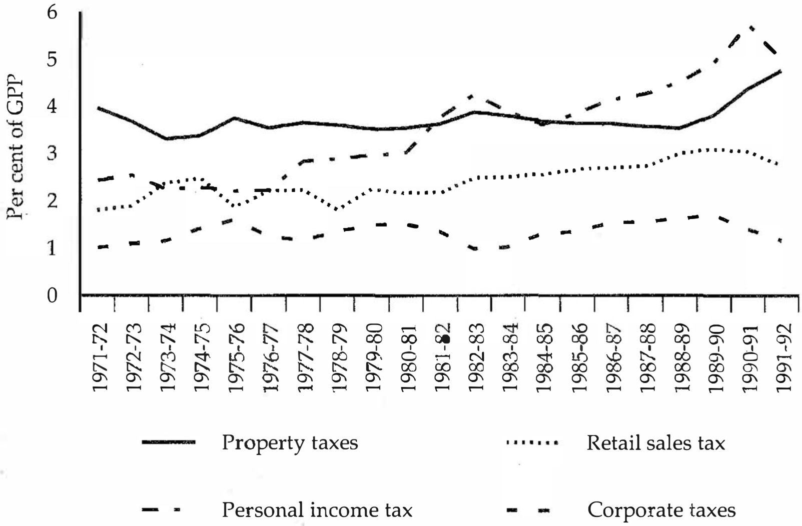


Sources: Fair Tax Commission calculations based on Ontario, *Public Accounts, 1971–72 to 1991–92;* Municipal Affairs databases; Statistics Canada, *Consumer Prices and Price Indexes,* Cat. 62-010 (Ottawa, 1993).

Compared with 20 years ago, Ontario taxpayers now pay a greater proportion of taxes in personal income tax and retail sales tax and a smaller proportion of taxes in the form of excise taxes (levies applied to alcohol, tobacco, fuel and gas), health premiums (revenue from Ontario Health Insurance premiums from 1971 through 1989 and revenue from the Employer Health Tax from 1990 on), corporate taxes, and property taxes (figure 8.2).

Figure 8.3 shows the growth in revenue from taxes raised at the provincial and local levels from 1971–72 to 1991–92 after removing the effect of inflation. Revenue from the personal income tax, the retail sales tax, and property taxes grew significantly more than prices over the 20-year period. The property tax increases partly

FIGURE 8.4
Revenue from Major Provincial and Local Taxes as a Percentage of Gross Provincial Product, 1971–72 to 1991–92



Sources: Fair Tax Commission calculations based on Ontario, *Public Accounts, 1971–72 to 1991–92;* Ontario, Ministry of Finance; Municipal Affairs databases.

reflected the increased reliance on property tax revenue to fund education. Since 1970 an increasing proportion of school board revenue has come from property taxes. In the early 1970s school boards as a whole relied on property taxes for about 40 per cent of their operating revenue. In 1977 their dependence on property taxes began to increase. By 1991 the proportion of school board revenue from property taxes had climbed to 55 per cent.

Over this period, revenue from health premiums and excise taxes increased only modestly in real terms. Revenue from corporate taxes fluctuated with general economic trends. For instance, corporate tax revenue declined in real terms in the early 1980s, increased at a rate above the rate of inflation during the economic boom in the late 1980s, and declined again in 1990 and 1991.

Tax revenue compared with the size of the economy, as measured by GPP, provides another measure of tax change over time.

TABLE 8.1
Personal Income Tax Rate Increases in Ontario, 1977–92

Year	Tax rate as a per cent of Basic Federal Tax
1977	Basic rate increase to 44% from 30.5%
1981	Basic rate increase to 46%
1982	Basic rate increase to 48%
1983	2.5% surtax on tax over $110.80 (one year only)
1984	5% surtax on tax over $110.80 (one year only)
1986	Basic rate increase to 50%; 3% surtax on tax over $5000
1988	Basic rate increase to 51%; additional surtax of 10% on tax over $10,000
1989	Basic rate increase to 52%
1990	Basic rate increase to 53%
1991	Increase in surtax to 12% on tax over $10,000
1992	Basic rate of 54.5%; increase in surtax to 7% on tax between $5500 and $10,000; increase in surtax to 14% on tax over $10,000

Source: Ontario, *Budgets*, 1977–92.

Note: The 1977 increase was in accordance with new agreements on cost-sharing found in the Federal-Provincial Fiscal Arrangements Act and the Established Programs Financing Act of 1977.

Revenue from the personal income tax increased significantly as a percentage of GPP from 1971–72 to 1991–92, partly as a result of periodic provincial-level rate changes (table 8.1). The revenue increases in the late 1980s were also partly a result of a growing provincial economy combined with the progressive rate schedule. The sharp 1991–92 decline in personal income tax revenue as a percentage of GPP was a result not of a policy change, but of a rapidly declining economic situation that reduced tax revenues faster than the GPP.

Revenue from property taxes remained relatively stable as a proportion of GPP from 1971–72 to 1988–89, ranging between 3 and 4 per cent of GPP. However, in the late 1980s and early 1990s property tax revenue grew relative to the economy, rising to almost 5 per cent of GPP in 1991–92. The increase was largely a result of the declining economy and the fact that property taxes are not very sensitive to economic conditions. From 1971–72 to 1980–81 retail sales tax revenues fluctuated as a proportion of the size of the economy, followed by a steady rise in revenue through the 1980s. The fluctuation in the 1970s was in part a result of the government's decision to increase the retail sales tax rate from 5 to 7 per cent in 1973 and then to provide a one-year tax reduction back to 5 per cent in 1975 (*Ontario Budget* 1973 and 1975). The sharp reduction in retail sales tax revenue as a proportion of GPP in 1978 was partially a result of the introduction of a number of exemptions, many of which were removed in 1982 (*Ontario Budget* 1978). The increase in retail sales tax revenues in 1988 resulted from a rate increase from 7 to 8 per cent and increased consumption of taxable goods as a result of a strong economy (*Ontario Budget* 1988). In the early 1990s, retail sales tax revenues declined faster than the economy because of the drop in consumption as the economy weakened and because of the increase in cross-border shopping and activity in the "underground economy."[2] (A discussion of the underground economy is contained in chapter 12.)

Provincial Government, Municipal Government, and School Board Revenues

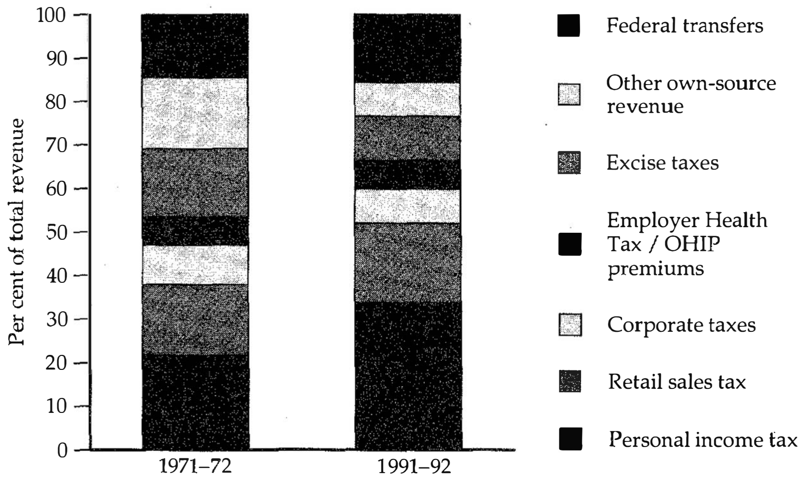
Provincial Government Revenue

The provincial government receives revenue from a number of sources, including taxes, fees, and transfers from the federal government. In 1991–92 the provincial government raised about a third of its revenue from the personal income tax. By way of contrast, in 1971–72 revenue from this tax represented about one-fifth of the provincial government's revenue. The government's reliance on revenue from excise taxes has also declined during that 20-year period. In 1971–72 these taxes together represented about 16 per cent of the total provincial government revenue. In 1991–92 they represent just 10 per cent of the provincial government revenue.

Before 1979 the province levied a succession duty and a gift tax. Together they represented 1.6 per cent of total provincial revenue in 1971–72. Revenue from these taxes steadily declined during the 1970s so that in 1979–80, the year the taxes were abolished, they represented 0.3 per cent of total provincial revenue (*Public Accounts*

[2] Throughout 1991, there were unusually high levels of cross-border shopping by Ontarians in Michigan, New York, and Minnesota (Royal Bank 1992, 2). Spiro (1993, 253) argues that there are a number of indicators supporting the view that there was an increase in the underground economy in 1991.

FIGURE 8.5
Changing Sources of Provincial Government Revenue, 1971–72 and 1991–92



Source: Fair Tax Commission calculations based on Ontario, *Public Accounts*, 1971–72 and 1991–92.

1971–72 and 1979–80). Lottery profits, a source of revenue starting in 1975–76, raised 1.1 per cent of provincial revenue in 1991–92 (*Public Accounts* 1975–76 and 1991–92). Taxes on resources (the mining profits tax and stumpage fees) have always been a very small portion of provincial revenue, making up 0.6 per cent of provincial revenue in 1971–72 and 0.3 per cent in 1991–92 (*Public Accounts* 1971–72 and 1991–92). Federal government transfers were an important source of provincial government revenue in 1971–72 and 1991–92, accounting for about 15 per cent of government revenue in each of those years (*Public Accounts* 1971–72 and 1991–92). However, these figures mask a pattern of decline in the major federal transfers to Ontario since the mid 1980s.

The major transfers to Ontario are made through Established Programs Financing (EPF) and the Canada Assistance Plan (CAP). There are also a number of smaller federal transfers for programs such as training, native welfare services, legal aid, and farm income assistance. A full discussion of the EPF and CAP transfers is found in chapter 6.

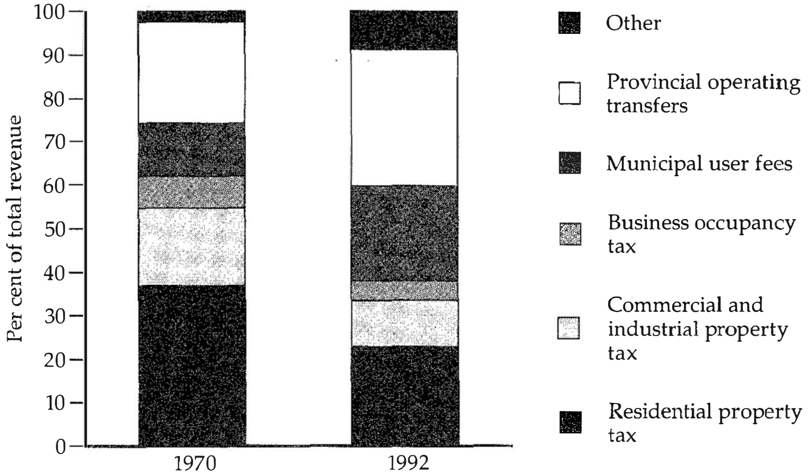
Municipal Government Revenue

Municipal government revenue is derived from property taxes (the residential property tax, the commercial and industrial property tax, and the business occupancy tax), user fees (water billings, sewer surcharges, transit fares, waste disposal fees, and recreation charges), and transfers from the provincial government. The transfers include conditional grants for specific programs and unconditional grants that can be allocated by the municipality as it chooses. The conditional grants are provided for a number of services including public health units, libraries, roads, transit, social assistance payments to individuals, and waste and water infrastructure. The province also provides capital grants to municipalities, but these figures are not included in this analysis because the data are incomplete.

In 1992 the municipal portion of the three property-based taxes together raised about $6.2 billion, or 38 per cent of municipal operating revenue; user fees levied for local services raised about $3.5 billion, or 22 per cent of municipal operating revenue; and the province transferred about $5.1 billion to municipal governments, or 32 per cent of municipal operating revenue. The remaining 9 per cent of municipal operating revenue includes payments in lieu of taxes which other levels of government pay to municipal governments.

In 1970 the residential property tax was the single largest source of revenue for municipal governments, making up 37 per cent of total operating revenue. By 1992 the residential property tax made up only 23 per cent of all municipal-level operating revenue. During the period from 1970 to 1992, municipal governments relied increasingly on revenue from user fees and provincial transfers. The share of municipal operating revenue made up by user fees increased from about 12 per cent of total operating revenue in 1970 to about 22 per cent in 1992. Operating grants from the provincial government made up 23 per cent of total municipal operating revenue in 1970, but, by 1992, these transfers made up 32 per cent of municipal operating revenue (figure 8.6).

FIGURE 8.6
Changing Sources of Municipal Operating Revenue in Ontario, 1970 and 1992



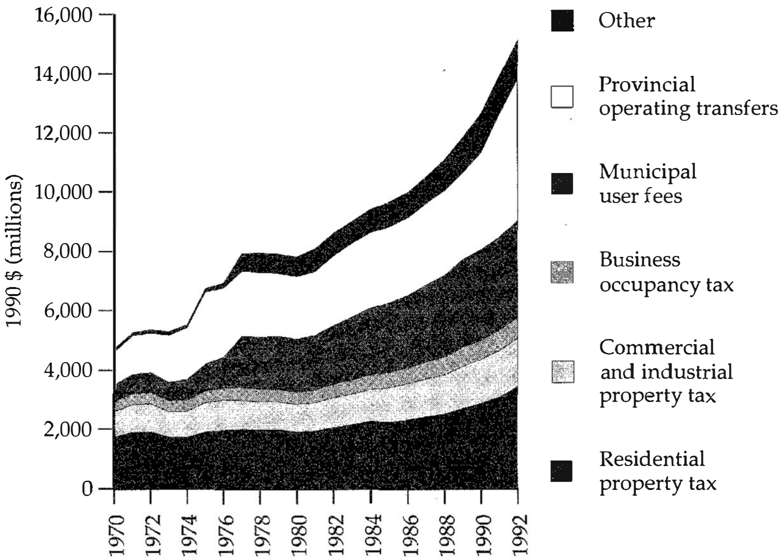
Source: Fair Tax Commission calculations based on Municipal Affairs databases.

Municipal government revenue, like provincial government revenue, has been increasing faster than the rate of inflation since 1970. Municipal revenue from the three property-based taxes almost doubled in real dollar terms from 1970 to 1992 (figure 8.7). Municipal revenue from user fees increased by approximately 500 per cent after allowing for inflation in that period, reflecting cost increases in the provision of many municipal services. Provincial operating grants to the municipalities increased slightly above the rate of inflation from 1970 to 1992. However, municipal operating revenue in the form of provincial transfers increased by 27 per cent in 1991 and by another 15 per cent in 1992, largely because of the increases in transfers from the province for social assistance.

School Board Revenue

School boards in Ontario do not exercise independent taxing authority, although separate schools have the constitutional authority to do so. School board revenue is derived primarily from provincial grants

FIGURE 8.7
Sources of Municipal Operating Revenue in Constant (1990) Dollars, 1970–92



Source: Fair Tax Commission calculations based on Municipal Affairs databases; Statistics Canada, *Consumer Prices and Price Indexes*, Cat. 62-010 (Ottawa, 1993).

and property taxes levied at their request by local municipalities. Other revenue sources, including tuition fees, federal grants, and rental income from school facilities provide a very small amount of additional revenue.

Individual property taxpayers designate a school board for property tax support. Each school board raises property tax revenue based on the assessed value of property owned by supporters of that board. Under a new requirement currently being phased in, the assessment of properties owned by public corporations is divided among boards based on total school support, measured by the assessed value of property owned by each board's supporters.

In 1991, school boards had total revenues of $12.9 billion: 33 per cent from residential property taxes, 15 per cent from commercial and industrial taxes, 7 per cent from business occupancy taxes, 40 per cent from provincial transfers, and 5 per cent from a combination of user charges, tuition fees and grants paid by the federal government and transfers from board reserve funds.

Since the early 1970s, provincial grants have grown more slowly than school board spending. Property taxes increased as a percentage of school board revenue from a low of 40 per cent in the period 1972–74 to 55 per cent in 1991. The combined effect of increases in education costs and reductions in the share of those costs covered by provincial grants caused education property taxes to increase more rapidly than municipal property taxes from 1972 to 1992. By 1992, education property taxes were almost $8 billion and more than 2.5 times their level in 1972 in constant dollars.

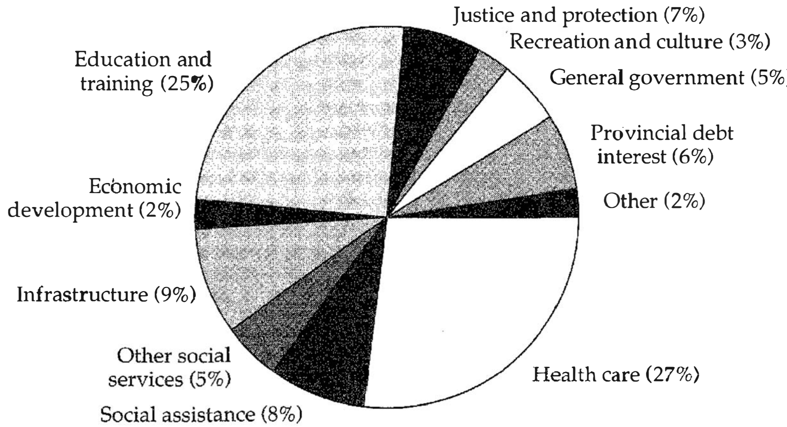
Provincial and Local Expenditures

The taxes Ontarians pay support a wide variety of public services that contribute in important ways to the quality of their lives. In 1991–92 operating expenditures by the provincial government, municipal governments, and school boards totalled $65.4 billion. Just less than three-quarters of all operating expenditures were made by the provincial government, while the remaining quarter was spent by school boards and municipal governments. The largest areas of expenditure were health care and education (including training). Infrastructure expenditures for services like sewers, roads, highways, and transit accounted for 9 per cent of operating expenditures. Social assistance, or welfare and family benefits, accounted for 8 per cent of operating expenditures, while the rest of the social services provided in the province accounted for 5 per cent of the total. Interest on the provincial government's debt accounted for 6 per cent of all expenditures (figure 8.8).[3]

---

[3] Expenditure statistics for provinces, municipalities, and school boards come from Fair Tax Commission calculations based on *Ontario Budget* (1993); Statistics Canada (1992e, 1993b); Municipal Affairs databases; Ontario Ministry of Education "School Boards Financial Statement" (1991); and *Public Accounts* (1975–76 to 1991–92). Municipal and school board figures are reported on a calendar year basis and have not been converted to a fiscal year basis.

FIGURE 8.8
Operating Expenditures by the Provincial Government, Municipal Governments, and School Boards, Ontario, 1991–92



Source: Fair Tax Commission calculation based on Ontario, Ministry of Finance, *1993 Ontario Budget*; Municipal Affairs databases; Ministry of Education, "School Boards Financial Statement," 1991.

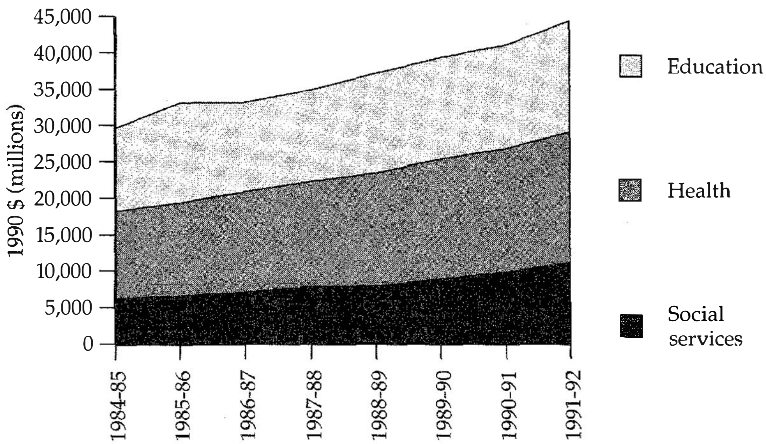
Note: Figures may not add to 100 per cent due to rounding.

The three largest categories of spending in the province are in the areas of health care, primary and secondary school education, and social services. Between 1984–85[4] and 1991–92 spending on primary and secondary school education increased by 35 per cent in real terms. The large increase in education spending over this period provides part of the explanation for the increase in property taxes.

Health care expenditures are made primarily by the provincial government largely in the form of transfers to hospitals and payments to physicians. From 1984–85 to 1991–92 health care expenditures increased by almost 50 per cent after adjusting for inflation.

[4] The year 1984 is the first for which there are accessible municipal-level expenditure and transfer payment data.

FIGURE 8.9
Primary and Secondary School, Health Care, and Social Services Operating Expenditures, Ontario, 1984–85 to 1991–92



Sources: Fair Tax Commission calculations based on Ontario, *Public Accounts*; Municipal Affairs databases; Ministry of Education, "School Boards Financial Statements"; Statistics Canada, *Public Finance Historical Data, 1965/66 – 1991/92*, Cat. 68-512 (Ottawa, 1992).

From 1984–85 to 1991–92 social service spending increased by almost 80 per cent in real terms. The increases resulted largely from increased social assistance payments as a result of the recession.

Over the last 20 years there has been a gap – a deficit – between the provincial government's expenditures and revenues in all but one year, 1989–90 (*Public Accounts* 1979–80, 1986–87, and 1991–92). (Only the provincial government's deficits and debt are considered in this section since, by law, municipal governments are not permitted to incur debt except for capital projects.)

Governments frequently express their debt – the total accumulated deficits – as a proportion of their gross domestic product (GDP) to reflect the size of the debt relative to the size of the economy. From 1975–76 to 1991–92 the provincial government's debt varied between 14.3 per cent of the gross provincial product (GPP) and 19.5 per cent of GPP.[5] From the mid 1970s to the mid 1980s, the debt to GPP ratio hovered around 16 or 17 per cent. The lowest debt to GPP ratios occurred in the late 1980s reflecting a strong economy and gradually reduced annual deficits. In 1991–92, the last year for which data are available, the debt was 19.5 per cent of GPP, reflecting a weakening economy, reduced tax revenues, and an increased deficit.[6]

Ontario's Fiscal System Compared

Ontario and the Provinces

One of the ways people judge the taxes they pay and the services they receive is by comparison with other similar jurisdictions. Statutory tax rates are one of the first things people compare when they discuss the differences between the tax system in Ontario and the system in other provinces. While statutory tax rates are an important component of any comparison, they are definitely not the whole story. They do not, for example, capture the effects of exemptions or credits on the taxes people actually pay. Table 8.2 compares Ontario's personal income tax rates with those in Quebec, Alberta, and British Columbia.

Corporate income tax rate comparisons are even more imprecise than personal income tax rate comparisons because of the variety of preferential treatment accorded specific types of activities and investments. For example, most provinces offer capital cost allowance provisions, tax credits, and tax deductions for investment in specific activities and assets. These concessions result in an effective rate of tax which varies depending on the activities of the business. Table 8.3 shows that Ontario's statutory corporate income tax rates are somewhat more favourable than the rates in British Columbia although the rates in Ontario, British Columbia, and Alberta are all higher than those in Quebec. However, Quebec levies a higher capital tax on corporations than either British Columbia or Ontario.

---

5 Debt figures before 1975–76 include Ontario Hydro's debt and are not comparable to the later figures used here.

6 FTC calculation based on Ontario *Public Accounts 1971–72 to 1991–92;* Ontario, Ministry of Finance, Ontario Gross Domestic Product (Expenditure Based) 1961:1 to 1992:2.

TABLE 8.2
Top Personal Income Tax Rates in Selected Provinces, Effective 1994 (%)[a]

	Top federal rate	Top federal surtax	Provincial rate	Top provincial surtax	Flat tax	Top marginal rate
Ontario	**29.0**	**2.3**	**16.8**	**5.0**[b]	—	**53.2**
Quebec	26.5	—	24.0	2.4	—	52.9
Alberta	29.0	2.3	13.2	1.1	0.5	46.1
British Columbia	29.0	2.3	15.2	7.6	—	54.2

Sources: Canadian Tax Foundation, *The National Finances, 1992* (Toronto, 1992); 1993 budgets of Ontario, Quebec, Alberta, and British Columbia.

a. Includes rates announced in 1993 budgets.

b. Combined top federal rate and top federal surtax.

TABLE 8.3
Corporate Tax Rates in Selected Provinces, 1993

	Corporate income tax (%)			
Province	General	Small business	Manufacturing and processing	Capital tax (%)
Ontario	**15.5**	**9.5**	**13.5**	**0.3**
Quebec	8.9	5.75	8.9	0.56
Alberta	15.5	6.0	14.5	—
British Columbia	16.5	10.0	16.5	0.3

Sources: 1993 budgets for Ontario, Alberta, Quebec, and British Columbia; CCH *Tax Reporter*.

Note: Quebec rates include a 2 per cent surtax on taxable income.

Retail sales tax rates are easier to compare than income tax rates, although here, too, provinces provide a variety of exemptions from taxation for specific goods. In Quebec, selected services are subject to the retail sales tax as part of the semi-harmonization of the federal Goods and Services Tax and the Quebec Sales Tax. Table 8.4 shows that Ontario's retail sales tax is one of the highest among the jurisdictions shown.

TABLE 8.4
Retail Sales Tax Rates in Selected Provinces, 1993

Province	General rate (%)
Ontario	**8.0**
Quebec	8.0/4.0[a]
Alberta	—
British Columbia	6.0

Source: CCH *Tax Reporter.*

a. 8 per cent on goods; 4 per cent on services.

In order to make a meaningful comparison among the tax systems in different provinces, it is necessary to compare how much they each rely on different tax bases. There is significant variation among provinces in the proportion of total provincial revenue which comes from the major taxes. A comparison of the role major taxes play in the revenue mix of Ontario, Alberta, British Columbia, and Quebec in 1991–92 reveals that there was similar reliance on excise taxes at about 5 per cent of total revenue, but on little else. Figure 8.10 shows that Ontario and Quebec relied on personal income tax revenue for over 30 per cent of total revenue, much more than Alberta at 19 per cent and slightly more than British Columbia at 24 per cent of total revenue. Alberta is the only province in Canada that does not levy a retail sales tax, a tax Ontario relied on for 17 per cent of its revenue in 1991–92, Quebec for 16 per cent, and British Columbia for 12 per cent. Alberta's revenue from the taxation of natural resources in 1991–92 made up 24 per cent of total revenue. Natural resource revenues made up 7 per cent of total revenue in British Columbia in 1991–92, but less than 1 per cent in Ontario and Quebec. Revenue from health and social service levies, such as Ontario's Employer Health Tax, made up between 5 and 8 per cent of revenue in Ontario, Alberta, and British Columbia, but represented 11 per cent of total revenue in Quebec in 1991–92.

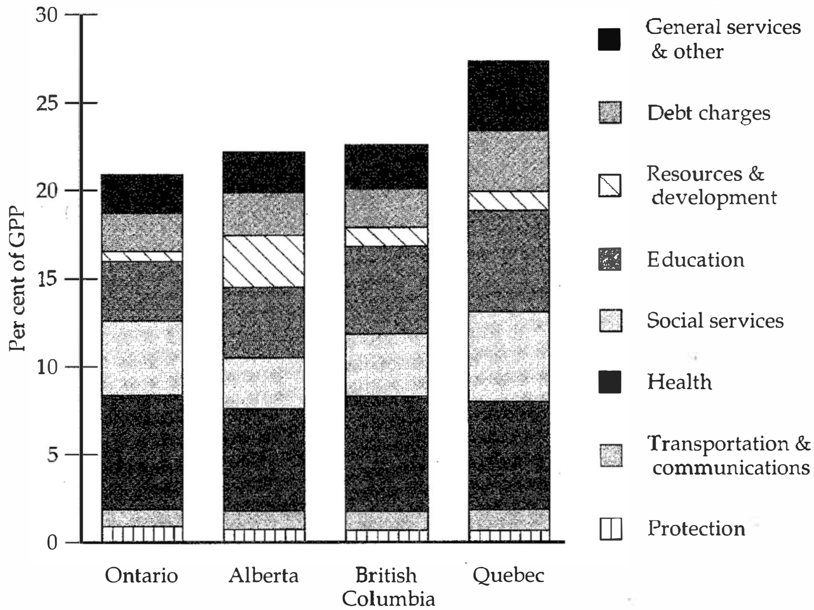
FIGURE 8.10
Revenue from Major Taxes as a Proportion of Provincial Revenue, 1991–92

Source: Canada, Statistics Canada, *Public Finance Historical Data, 1965/66–1991/92*, Cat. 68-512 (Ottawa, 1992).

Priorities with respect to how tax dollars are spent in Ontario, Quebec, Alberta, and British Columbia are shown in figure 8.11. In 1990–91 Ontario had the lowest total public expenditures as a percentage of GPP of the four provinces. The figure also shows that:

- Ontario and British Columbia spent the same on health care in relation to the size of their respective economies, slightly more than Alberta and Quebec;
- Ontario spent the least on education and transportation and communications, as a proportion of GPP, of all the provinces shown; and
- Quebec spent the most on social services as a percentage of GPP, with Ontario and British Columbia spending somewhat less, and Alberta spending the least in relation to the size of the economy.

FIGURE 8.11
Provincial Expenditures as a Proportion of Gross Provincial Product, 1991–92



Source: Based on Canada, Statistics Canada, *Public Finance Historical Data, 1965/66–1991/92,* Cat. 68-512 Ottawa, 1992); Statistics Canada, *Provincial Economic Accounts, Annual Estimates,* Cat. 13-213 (Ottawa, 1991).

Ontario and Selected US States

Comparisons between Ontario and US states are frequently made, but a true comparison is difficult. First, there are significant differences in the public expenditures made at the national level and in subnational jurisdictions in Canada and the United States. For instance, the programs in the United States which provide health care for seniors (Medicare) and the poor (Medicaid) are federal expenditures (Leong et al. 1992, 33), whereas in Canada, the provinces, with indirect federal assistance, fund medicare, which provides coverage for the entire population. Second, as stated in chapter 7, the public sector in Canada is larger as a proportion of the economy than in the United States.[7] Having provided these caveats, it is still informative to make some selected comparisons simply because individuals, owners of businesses, and investors do.

Tax rate comparisons between the United States and Canada are a relatively superficial measure of the differences in the tax systems. It is more meaningful to compare the tax mix in Ontario with competing US jurisdictions. Figure 8.12 shows that, in 1990, revenue from personal income tax and retail sales tax combined made up more than 60 per cent of total tax revenue in Ontario and all the states shown, and that New York, North Carolina, and Minnesota, like Ontario, relied on revenue from the personal income tax for more than 40 per cent of total tax revenue. The other two states shown, California and Michigan, relied more on corporate income tax revenue than the others did in that year. A second interesting point is the greater reliance on consumption taxes (the retail sales tax and excise taxes) in North Carolina, Minnesota, Michigan, and California than in New York or Ontario. Since consumption taxes are less clearly related to ability to pay, a greater reliance on these taxes in the tax mix will result in a less fair tax system. One major difference in the tax mix in Ontario compared with US states is that Ontario levies a payroll tax, while, in the United States, payroll taxes are levied exclusively by the federal government.[8]

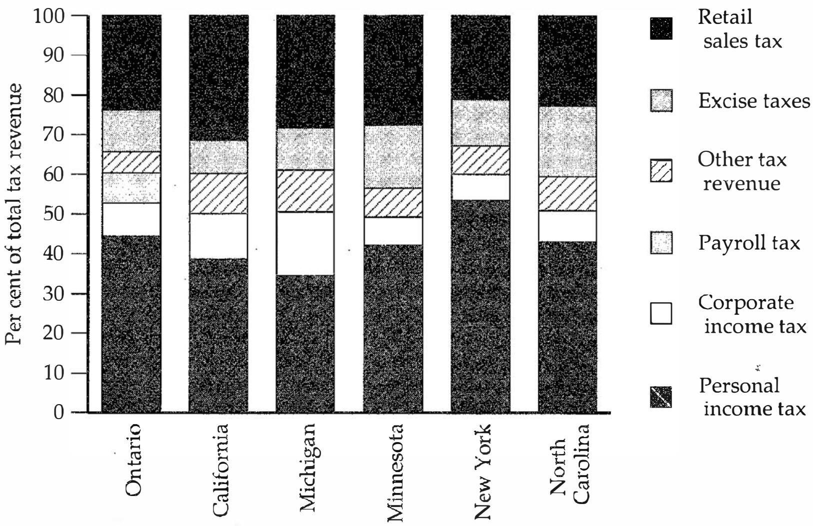
Public services are provided by different levels of government in Canada and the United States. The different alignment of responsibilities in the two countries makes it difficult to compare government expenditures in subnational jurisdictions in the two countries accurately.

---

[7] In 1991 government expenditures at all levels in the United States were 37.5 per cent of GNP (Leong et al. 1992, 34), and 50.4 per cent of GDP in Canada (OECD 1992b, 116).

[8] FTC calculation based on United States Department of Commerce (1991); Ontario *Public Accounts* (1990–91).

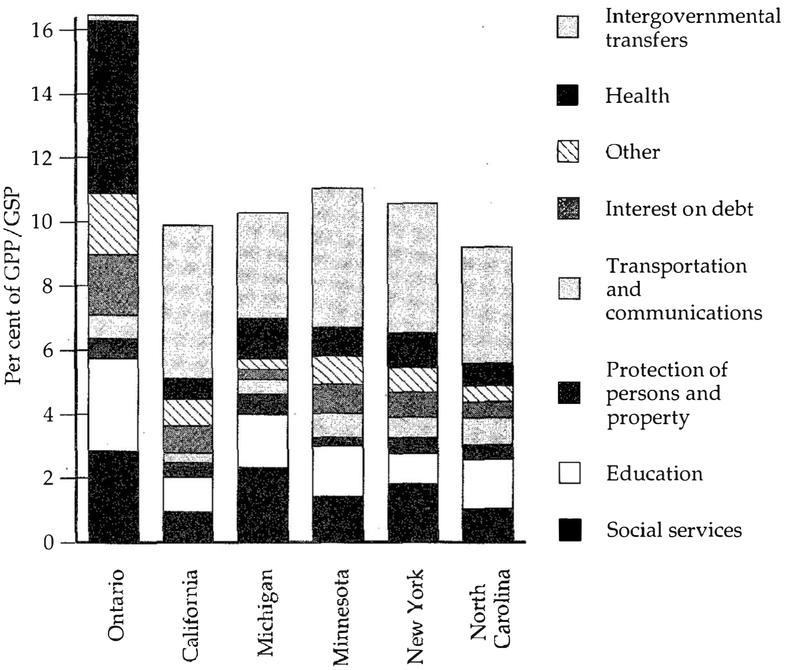
FIGURE 8.12
Tax Mix of the Ontario Government and Selected US State Governments, 1990



Source: Fair Tax Commission calculations based on Ontario, Ministry of Finance, *Public Accounts of Ontario, 1991–1992;* United States, Department of Commerce, *State Government Finances in 1990* (Washington, 1991).

Figure 8.13 shows the breakdown of major program expenditures in Ontario and selected US states in 1989 compared with the size of the economy as measured by gross provincial product (GPP) for Ontario and gross state product (GSP) for the states. Government expenditure as a proportion of GPP/GSP is almost twice as high in Ontario as in the US states shown. This difference is primarily due to the much higher level of spending on health care as a proportion of GPP in Ontario. In the United States, health care expenditures by the government are made primarily at the national level and are much lower to begin with, so it is not surprising that Ontario's spending in this area is higher than in the United States. While it appears that Ontario's contribution to education is about double the contribution of the selected US states, most of the states' intergovernmental transfer is allocated to the local level for education. In the United States, about 70 per cent of primary and secondary school education is paid for at the local level (Leong et al. 1992, 8), about 10 per cent more than is currently the case in Ontario.

FIGURE 8.13
Categories of Government Expenditure as a Proportion of Gross Provincial Product or Gross State Product, 1989



Source: Fair Tax Commission calculations based on Ontario, Ministry of Treasury and Economics, *Public Accounts*, 1989–90; Ontario, Ministry of Finance; United States, Department of Commerce, *State Government Finances in 1989* (Washington, 1990); United States, Department of Commerce, Bureau of Economic Analysis, *Survey of Current Business* (December 1991).

Interestingly, Ontario and the states shown in figure 8.13 spend about the same amount as a proportion of GPP/GSP on transportation and communications and on the protection of persons and property. Ontario does, however, spend more in interest on the debt as a proportion of the size of the economy than any of the states shown here.[9]

[9] FTC calculation based on United States Department of Commerce (1990); Trott et al. (1991); Statistics Canada (1992e); Ontario Ministry of Finance (1961–92).

Appendix
Major Taxes in Ontario

Most of the tax revenue raised in Ontario comes from a handful of taxes. Table 8A.1 lists each of the major taxes in the province, showing how much each tax raised in the fiscal year 1991–92 and how much each tax represented in terms of total taxes paid in Ontario.

Personal Income Tax

Personal income tax is the largest single source of revenue for the Ontario government, as it is for most Western industrialized countries.[10] In 1990, taxes on personal income represented, on average, 12 per cent of GDP and 30 per cent of total tax revenue for all OECD countries (OECD 1992c, 79). For a history of the personal income tax in Ontario, see chapter 6.

Description

Ontario's personal income tax is levied on residents of Ontario. A resident of Ontario is an individual who either lived in Ontario for part or all the tax year or was considered a factual resident. A factual resident is an individual who lived somewhere else but kept residential ties to Ontario. Residential ties include a spouse and dependants, a home, personal property, and eligibility for provincial hospitalization.

Unit of Taxation

In Canada, the individual is the unit of taxation for the purpose of levying personal income tax. Some credits, however, are calculated based on family income and marital status.

---

[10] See Richard Goode (1991, 429).

TABLE 8A.1
Major Sources of Tax Revenue in Ontario, 1991–92

	$ (billions)	% of taxes
Selected provincial taxes		
Personal income tax	13.7	30.5
Retail sales tax	7.5	16.7
Employer health tax	2.6	5.8
Corporate taxes	3.2	7.1
Gas and fuel taxes	2.0	4.4
Other provincial tax revenue	3.0	6.7
Local property taxes		
Residential property tax	7.6	17.0
Commercial and industrial property tax	3.7	8.2
Business occupancy tax	1.6	3.6
Total taxes paid in Ontario	44.9	100.0

Source: Ontario, *Public Accounts*, 1991–92; Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

Note: Revenue from property taxes has been converted to a fiscal-year basis. In 1991 property taxes raised $12.7 billion, and in 1992 property taxes raised $13.7 billion.

Personal Income Tax Base

Personal income taxes in Canada are levied on an individual's taxable income, which is income less specific deductions. Under the Tax Collection Agreements, the federal government defines the types of income subject to tax, deductions from income, exemptions, non-refundable tax credits, tax rates, tax brackets, and indexation factors.

The types of income subject to tax include the following sources of income.

Components of Total Income	Description
Employment income	Salaries, wages, commissions, gratuities, director's or other fees, royalties, net research grants, income from wage loss replacement or guaranteed annual wage plans, Goods and Services Tax (GST) rebates, and other remuneration
Pension income	Old age support, Canada Pension Plan, disability benefits, and other pensions or superannuation
Other income	Unemployment insurance benefits, interest income, alimony or separation allowance, child support payments, capital gains,* dividends,* value of benefits* (board, lodging, and other benefits received or enjoyed by virtue of an office or employment), and other income
Income excluded from taxation	Federal GST and child tax credit, social assistance payments, workers' compensation payments, net federal supplements, lottery winnings, veterans' disability and dependants' pension payments, war veterans' allowances, income and capital gains from a principal residence, inheritances (earnings on an inheritance are taxable)

* Capital gains, dividends, and benefits are only partially taxed under the Income Tax Act.

Social assistance payments and net federal supplements are included in total income for the purpose of calculating tax credits, but are excluded when calculating taxable income.

Taxable income equals total income less specific deductions. The following list gives an indication of the types of deductions from income that are available:

Deductions from income	• alimony or separation allowance paid • registered pension plan and registered retirement savings plan contributions • annual union, professional, and like dues • child care expenses • carrying charges • social benefits repayments • northern residents deductions • employment expense deductions, such as travelling expenses

TABLE 8A.2
Marginal Federal Income Tax Rates, 1993

Rates	Taxable income
17%	$29,590 and under
26%	$29,590–$59,180
29%	$59,180 and over

Sources: Canada, Revenue Canada Taxation, *Federal and Provincial General Tax Guide and Returns: Ontario 1992*; Department of Finance, *The Budget 1993*.

Basic Federal Tax is calculated by applying federal tax rates to taxable income, adding federal tax adjustments for a dependant's income, and subtracting federal non-refundable tax credits and other adjustments.

Ontario personal income tax is levied as a percentage of Basic Federal Tax, and then a number of surtaxes and tax credits are applied to the Ontario tax payable. At the time of writing, Ontario's personal income tax measures included a two-tiered surtax on high-income earners, the Ontario Tax Reduction program for those at the low end of the income scale, the Ontario property and sales tax credits for seniors, the Ontario home ownership savings plan tax credit, a political contribution tax credit, and the Ontario investment and employee ownership tax credit.[11]

Rate Structure

For the 1993 tax year, the federal government applies three marginal income tax rates to taxable income. A marginal tax rate is the rate of taxation that applies to the last (or next) increment of income. This measure is generally regarded as the most relevant when considering the impact of tax changes on taxpayers' behaviour.

Thus, an individual with a taxable income of $70,000 will pay a tax rate of 17 per cent on the first $29,590 of income, a rate of 26 per cent on income between $29,590 and $59,180, and a rate of 29 per cent on the remaining $10,820. In addition to the rates shown in table 8A.2 for 1993, the federal government applies a surtax on Basic Federal Tax at the rate of 3 per cent, and an additional 5 per cent surtax on federal tax in excess of $12,500.

[11] A deduction for occupancy costs is also available. For more information, see Canada *Federal and Provincial General Tax Guide* (1992).

TABLE 8A.3
Marginal Personal Income Tax Rates, Ontario, 1993 (%)

	Taxable income (by rate bracket)					
	Under $29,590	$29,590– $46,716	$46,716– $58,320	$58,320– $59,180	$59,180– $62,866	Over $62,866
Basic federal tax	17.0	26.0	26.0	26.0	29.0	29.0
Federal surtax	0.51	0.78	0.78	2.08	2.32	2.32
Basic Ontario tax	9.86	15.08	15.08	15.08	16.82	16.82
Ontario surtax[a]	—	—	3.02	3.02	3.02	5.05
Regular combined rate	27.37	41.86	44.88	46.18	51.16	53.19

Sources: Calculated by the Fair Tax Commission from *1993 Ontario Budget;* Canada, Revenue Canada Taxation, *Federal and Provincial General Tax Guide and Returns: Ontario 1992.*

a. Annual surtax rate effective 1 July 1993

Ontario's personal income tax rate in 1993 is 58 per cent of Basic Federal Tax. In addition, Ontario levies surtaxes of 20 per cent of Ontario personal income tax in excess of $5500, and an additional 10 per cent of Ontario income tax in excess of $8000 (Ontario Ministry of Finance 1993a, 21).

Table 8A.3 shows the marginal tax rates facing Ontario taxpayers, including all federal and provincial income tax rates.

The current rate structure is further complicated by the fact that the income tax system is used as a mechanism for reducing Old Age Security payments and unemployment insurance benefits paid to high-income earners. In addition, individuals who receive refundable tax credits from the federal government or from Ontario also face "recapture rates" if their income exceeds certain thresholds. A recapture rate is the rate at which a credit is reduced as the relevant measure of income increases. The recapture rate for most federal credits is 5 per cent of family income over a threshold. For the Ontario property and sales tax credits, the recapture rate is 2 per cent of net income over $4000. Both the claw-back and recapture rates represent additional effective marginal tax rates on individuals with incomes above certain levels.

Administrative Arrangements

Administrative arrangements for the collection of Ontario personal income tax are described in detail in the section of chapter 13 dealing with the Tax Collection Agreements.

Corporate Taxes

Under the Ontario Corporations Tax Act, corporations with business activities in the province pay a corporate income tax on their profits. Ontario, Alberta, and Quebec are the only provinces that levy their own corporate income tax. The other provinces have corporate tax collection agreements with the federal government. Corporations in Ontario with total assets or gross revenues in excess of $1 million also pay a capital tax on corporate capital. Ontario levies a premiums tax on insurance companies in lieu of this capital tax. In 1993 a new corporate tax was introduced, the corporate minimum tax which will be levied beginning in 1994.

Although taxes may be paid by corporations, all taxes are ultimately borne by people; thus, corporate taxes ultimately fall on individuals as shareholders, owners, employees, or consumers. Still, there are a number of reasons for applying taxes at the corporate level. Since corporations retain income for investment, corporate taxes ensure that tax is levied as income is earned, rather than being delayed until the income is distributed. Without this withholding mechanism, there would be significant tax deferrals available on income earned and retained in corporations. Corporate taxes also function to withhold tax on income that will ultimately be distributed to foreign shareholders, thus ensuring that Ontario levies tax on income from economic activities occurring in the province. Finally, the corporate income tax in particular is used as an instrument of economic policy. Tax incentives are provided for investment in such things as capital equipment and research and development.

Description

Unit of Taxation

Each corporation with a permanent establishment in Ontario is subject to the Ontario corporate income tax. Each corporation is treated as a separate entity, files its own return, and calculates its own tax payable.

The fact that the tax applies to each corporation separately can have important implications for the level of tax payable by the corporation in Ontario. A corporation operating in Ontario may not be generating taxable income even though a related corporation in another Canadian or foreign jurisdiction is reporting taxable income and paying tax in that jurisdiction. The reverse situation is also possible. This may become a concern when the distribution of profits and losses is not related to the actual economic results in the various jurisdictions, but instead reflects planning by the corporate group to report income only in selected jurisdictions. Similarly, a corporation may be paying tax in the province, while another corporation with the same ownership is experiencing losses.

Corporate Income Tax Base

The major categories of income for corporations are income from a business or property, capital gains, and certain other items specifically listed in the act. In calculating income from a business, the starting point is income as determined under generally accepted accounting principles or "book income."[12] It is book income that is reported to the shareholders in public corporations. The act then specifies certain cases where statutory allowances replace the book deduction for capital expenditures – for example, capital cost allowances. Finally, certain income or expense items are disallowed, such as foreign advertising expenses. The calculation of a corporation's taxable income in Ontario is generally similar to the calculation of taxable income for the federal corporate income tax.

There are various reasons why Ontario and other governments define taxable income differently from book income. For example, inter-corporate dividends are deducted for income tax purposes to prevent double taxation of income as it flows through the corporate sector. Taxable income may also be lower than book income as a result of incentives such as accelerated write-offs for some capital investment, provisions for exploration and development expenses,

---

[12] "Book income" is financial statement profits multiplied by the percentage of each corporation's taxable income that is allocated to Ontario for income tax purposes.

and inducements for research and development which are designed to achieve economic policy objectives.

The Ontario and the federal corporate income tax bases differ in only a few areas, including the tax treatment of pollution control equipment, scientific research expenditures, resource allowances, low or interest-free loans to foreigners, and certain types of government grants.

The income tax system differentiates between public and private corporations. Public corporations are generally listed on prescribed stock exchanges, while private corporations tend to be closely held – for instance, by a family. A special class of private corporations are identified as Canadian-controlled private corporations.

Private corporations are subject to special taxes and refunds for inter-corporate dividends and other investment income designed to integrate the corporate and personal tax systems more closely than is the case for public corporations, and to prevent tax deferrals via use of personal "investment corporations."

Corporate Income Tax Rates

Ontario has three different corporate tax rates: the small business rate, the manufacturing and processing rate, and the general rate. The small business rate applies to the first $200,000 of active business income of a Canadian-controlled private corporation. The manufacturing and processing rate (M&P) applies not only to manufacturing and processing profits, but also to income from mining, logging, fishing, and farming. Ontario has also adopted a measure to claw back the value of the lower corporate tax rate for small business. This involves an additional 4 per cent surtax for income in the range of $200,000 to $500,000 for Canadian-controlled private corporations. This effectively creates two further tax rates for manufacturing and processing and other income in this range.

TABLE 8A.4
Ontario's Corporate Income Tax Rates, 1993 (%)

Small business rate	Manufacturing and processing rate (M&P)	General rate	Small business deduction claw-back	
			M&P	Other
9.5	13.5	15.5	17.5	19.5

Source: Canadian Tax Foundation, *The National Finances, 1992* (Toronto, 1992).

Integration

An important aspect of Canadian income tax rules are provisions that attempt to integrate the corporate and personal income tax systems. Integration provisions are designed to recognize that shareholders receiving dividends from a taxable corporation pay personal tax on the dividends that have already been taxed through the corporate income tax. The integration provisions work as follows: declared dividends are increased (grossed-up) to bring the amount taxable back to the original amount earned at the corporate level, which then can be taxed at the appropriate personal rate. A tax credit in turn provides an offset for the corporate tax assumed to be previously paid. The system distinguishes among small business income (first $200,000 earned by a Canadian-controlled private corporation), investment income earned by a private corporation, and other income, most significantly income earned by public companies. For the first type of income, the dividend gross-up and tax credit system is designed, at least notionally, to levy the same tax whether the income is earned directly or through a corporation. For the other types of income, the structure provides some recognition of corporate level tax, but not a full credit. (An example of how the integration mechanism works appears in chapter 21.)

Capital Tax Base

The base for the capital tax is the taxable capital employed by the corporation. This includes paid-up capital stock, retained earnings, surpluses, and debt less an investment allowance for investment in other corporations. In theory, the tax base presents the liability side of the balance sheet adjusted to prevent double taxation of assets employed in the corporate sector. Separate rules apply in determining the base for the application of the tax to financial institutions (banks and trust companies). In particular, the deductions from paid-up capital for goodwill and investments do not apply. The same allocation formula is used to determine the portion of taxable capital employed in Ontario by multi-jurisdictional firms as is used for the income tax.

Capital Tax Rates

TABLE 8A.5
Ontario's Capital Tax Rates, 1993

Eligibility	Capital tax
Corporations with capital of less than $1 million	Exempt
Corporations with total assets or gross revenue of more than $1 million and taxable paid-up capital of not more than $1 million	$100
Corporations with total assets or gross revenue of $1–$1.5 million and taxable paid-up capital of $1–$2 million	$200
Corporations with total assets or gross revenue of more than $1.5 million and taxable paid-up capital of not more than $2 million	$500
Corporations with taxable paid-up capital of $2–$2.3 million	Amount by which tax exceeds 1.83% of the amount by which the $2.3 million exceeds the taxable paid-up capital
Corporations with capital of $2.3 million or more	0.3%
Trust companies	1.0%
Banks	1.12%
Credit unions, mortgage investment corporations, family farm/fishing corporations, schools, and charitable organizations	$100

Source: Ontario, Corporations Tax Act, RSO 1990, c. 40, ss. 66–69.

Payroll Taxes

In Canada, where payroll taxes are levied by both the federal and provincial governments. The federal government levies payroll taxes to finance the Canada Pension Plan and the unemployment insurance system. Ontario currently levies two payroll taxes – the Employer Health Tax and workers' compensation contributions. Unlike the payroll taxes levied by the federal government and despite its name, Employer Health Tax revenues are not earmarked or specifically designated to fund health care.

The second major payroll tax levied in Ontario is workers' compensation contributions. Revenues from this tax are not included in Ontario's budgetary figures, but are used by the Workers' Compensation Board to provide compensation to injured workers. In this sense, then, workers' compensation contributions are earmarked to a specific program. Although contributions are structured as payroll taxes, any meaningful discussion of these contributions would require a review of the claims system – a review that is beyond our mandate. Accordingly, our focus will be on the Employer Health Tax (see also chapter 22).

History

Between 1959 and 1990 health insurance premiums were used to finance a large part of provincial health care costs. Premium amounts were set on a per capita and per family basis and were not linked to use of the health care system (Dahlby 1993, 81). This system, which later became known as the Ontario Health Insurance Plan or OHIP, came under a series of reviews in the 1970s and 1980s. In general, governments of the day were concerned about two things. First, the premiums were regressive because they were not linked to individual or family income. Second, the proportion of health care costs covered by OHIP premiums had been declining (Dahlby 1993, 82). To make the system less regressive, premium assistance for low-income individuals and families was enriched several times during the 1980s, and in 1985 OHIP premiums were frozen altogether (Ontario Ministry of Treasury and Economics 1989b, 6). In 1989 the government eliminated OHIP premiums and introduced the Employer Health Tax, which came into effect on 1 January 1990. At that time, the new payroll tax applied to total Ontario remuneration paid by an employer and did not apply to the earnings of self-employed individuals. The 1992 Ontario budget stated that, beginning 1 January 1993, the tax would also apply to earnings of the self-employed.

Description

Employer Health Tax Base

The 1993 base of the Employer Health Tax includes total Ontario remuneration paid by an employer and earnings of the self-employed. Under the Employer Health Tax Act, remuneration includes "all salaries and wages, bonuses, taxable allowances and commissions and other similar amounts fixed by reference to the volume of sales made or contracts negotiated, but does not include a pension, annuity or superannuation benefit paid by an employer to a former employee after retirement of the employee" (Employer Health Tax Act, 1989, 2). The act also specifies total Ontario remuneration to mean remuneration paid to employees who "report for work at a permanent establishment of the employer in Ontario" or are "paid from or through a permanent establishment of the employer in Ontario" (Employer Health Tax Act, 1989, 2). It should also be noted that the Employer Health Tax Act specifically includes the Government of Canada as an employer for tax purposes, as well as Ontario municipalities, universities, schools, hospitals, non-profit organizations, and charities. Under the current system, only embassies, consulates, and Indians employed on reserves do not pay the Employer Health Tax.

The Employer Health Tax is levied on individuals who are operating a business or working for themselves in an unincorporated form. Accordingly, professionals, farmers, and fishers, and anyone carrying on a business in the form of a sole proprietorship or partnership must pay the tax on net income over $40,000. Depending on how remuneration is structured, individuals carrying on a business in the form of a joint venture or syndicate may also have to pay the tax on net income over $40,000. Corporations, limited partners, trusts (in most cases), and status Indians who are self-employed and operating an unincorporated business on a reserve do not pay the Employer Health Tax for the self-employed. It should also be noted that self-employed individuals who have employees must pay the health tax on their payroll.

TABLE 8A.6
Rate Structure of Employer Health Tax

Rate (%)	Total remuneration ($)
0.980	200,000 and under
1.101	200,001–230,000
1.223	230,001–260,000
1.344	260,001–290,000
1.465	290,001–320,000
1.586	320,001–350,000
1.708	350,001–380,000
1.829	380,001–400,000
1.950	Over 400,000

Source: Employer Health Tax Act, 1989.

The Employer Health Tax is deductible from Ontario's corporate income tax and the federal corporate income tax, but is not deductible under the Personal Income Tax Act. This means that, unlike an employer, self-employed individuals cannot deduct the health tax to reduce their taxable income. To address this inequity, the 1993 Ontario Budget stated that "a tax credit of 22 per cent of tax otherwise payable will be provided in lieu of a deduction for Ontario personal income tax purposes" (Ontario Ministry of Finance 1993a, 23). This credit will reduce the effective tax burden of the tax for self-employed individuals.

Rate Structure

There are two separate rate schedules for the Employer Health Tax. One rate schedule applies to total Ontario remuneration paid by employers, while the other applies to the earnings of the self-employed. Under the employer rate schedule the general health tax rate is 1.95 per cent of total Ontario remuneration paid. Employers with annual payrolls of less than $400,000 have lower rates applied to them. For example, employers with annual payrolls of less than $200,000 pay the tax at approximately half the general rate, or 0.98 per cent of total Ontario remuneration paid. Employers with annual payrolls between $200,000 and $400,000 pay graduated rates.

TABLE 8A.7
Employer Health Tax Rate Schedule for Self-Employed Individuals

Rate[a]	Net self-employment income ($)
Exempt from tax	40,000 and under
0.98%	40,001–200,000
$1568 plus 2.726% on net income over $200,000	200,001–400,000
1.95% on net income over $400,000	Over 400,000

Source: *1992 Ontario Budget.*

a. Prior to application of the 22 per cent non-deductibility tax credit.

Unlike the Employer Health Tax rate schedule for employers, which is based on the total annual gross wages, salaries, and other remuneration paid to employees, the payroll tax applied to self-employed individuals is based on net income. The Employer Health Tax rate schedule for the self-employed exempts the first $40,000 of net income earned from tax. A three-level graduated rate structure applies to net income over $40,000.

The higher rate on net self-employment income between $200,001 and $400,000 is designed to claw back the preferential rate for individuals with net incomes between $40,001 and $200,000.

Administrative Arrangements

The Employer Health Tax is administered by the Ontario Ministry of Finance. Employers with annual payrolls of over $400,000 are required to submit their health tax payments to the Ontario Minister of Finance on a monthly basis. Employers with annual payrolls of less than $400,000 are required to submit their payments on a quarterly basis. To reduce the administrative burden on small businesses, the 1992 Ontario budget announced that "employers with total annual Ontario remuneration not exceeding $200,000 and employers with once-a-year payrolls will be permitted to remit Employer Health Tax once a year, with their annual EHT returns" (Ontario *Public Accounts* 1992, 35). Self-employed individuals must remit their health tax to the Ontario Minister of Finance on a semi-annual basis.

TABLE 8A.8
Revenue from Retail Sales Tax in Ontario

	1971–72	1981–82	1991–92
RST revenue ($ millions)	759	2853	7487
% of provincial own-source revenue	18.9	19.6	21.7

Source: Ontario, *Public Accounts*, 1972, 1982, 1992.

Retail Sales Tax

A retail sales tax of 3 per cent was first introduced in Ontario in 1961. Since then the rate has increased several times to its present rate of 8 per cent. Since its introduction, the sales tax has been among the top four sources of revenue for the Ontario government, making up almost 20 per cent of revenue in any given fiscal year.

Sales taxes are levied by nine provinces. Alberta and the two territories do not levy a consumption tax of this kind. The federal government also levies a sales tax, called the Goods and Services Tax (GST), which is set at 7 per cent. Table 8A.9 sets out sales tax rates for the provinces and territories as well as the federal GST.

Description

Retail Sales Tax Base

The retail sales tax is levied on the sale price of most goods and some services. Although it is associated with the sale or purchase of "tangible personal property," this tax is in fact a tax on the use of a good or service in the province. Thus, items attract retail sales tax when they are sold or resold, and items purchased outside the province attract the tax if they are used in the province. In turn, items purchased in Ontario for use outside the province may qualify for a refund.

Ontario provides the following exemptions from the retail sales tax:

- groceries
- prepared meals costing less than $4
- energy used for heating, cooking, and lighting
- children's clothing

TABLE 8A.9
General Retail Sales Tax Rates across Canada, 1993

Province/territory	%
Newfoundland	12
Prince Edward Island	10
Nova Scotia	10
New Brunswick	11
Quebec	8
Ontario	8
Manitoba	7
Saskatchewan	9
Alberta	None
British Columbia	7
Northwest Territories	None
Yukon	None
Federal Goods and Services Tax	7

Source: "Provincial Budget Summary – 1993," *Arthur Andersen Tax Forum,* 5(6).

- footwear costing $30 or less
- prescription drugs
- specified reading material (books, newspapers, subscriptions to periodicals)
- production machinery and equipment
- certain aids for the physically disabled
- certain equipment and materials used by commercial farmers, fishing crews, and trappers
- purchases by status Indians

Beyond the exemption for most services, the majority of exemptions are provided to meet social policy objectives. Some purchases are also exempt for jurisdictional reasons. Since the retail sales tax is meant to be a tax on the use of a good or service in the province, it makes sense that visitors from the United States or abroad who purchase items here are not liable for the tax.

TABLE 8A.10
Rate Structure of Ontario's Retail Sales Tax, 1993

Rate (%)	Good/Service	Comments
5	Transient accommodation and car insurance premiums	Other services or goods provided along with transient accommodation at a single price (e.g., recreational camps) are taxed at the 5% rate
8	General rate	General rate applies to a small number of services, including telecommunication services (including telephone and television services), insurance premiums other than for cars, labour to repair or install goods that are taxable, and parking services
10	Alcoholic beverages sold through licensed establishments and admission to events over $4 per person	"Events" include movie theatres, concerts, sporting events, amusement parks, hotels, hostels, camps; some exemptions include live theatre and charity events
12	Liquor, beer, or wine sold through retail stores	

Source: Ontario, Ministry of Finance.

Rate Structure

Although the general Ontario retail sales tax rate is 8 per cent, there are a number of different rates for selected goods and services as well as a number of excise taxes that are collected under the sales tax legislation.

Administrative Structure

The retail sales tax is administered by the Ontario Ministry of Finance through individual vendors. Every person or business that sells taxable goods or a taxable service is required to obtain a vendor's permit, and there is a fine for failure to do so. Vendors are obligated to collect the applicable tax from purchasers and to hold the tax in trust as agents of the province. Normally a vendor will remit all the tax he or she has collected on the 23rd of the following month. In some cases, such amounts are relatively small and the filing period may be adjusted so that the filing is done bi-monthly, quarterly, or semi-annually. The province pays compensation to vendors to help offset the costs associated with collecting and remitting the tax. The compensation is 5 per cent of the tax, to a maximum of $1500 per year. Failure to file a return on time will result in an automatic penalty of 10 per cent of the amount of tax due up to a maximum of $1000.

Property Taxes

History

Property taxes were first collected in Ontario by local governments in 1793 (Smith Committee 1967, 28). Over the years, municipalities established their own systems of valuing property. As a result, similar properties were taxed differently and there were often great disparities in assessment between areas (Ontario Ministry of Revenue 1991b). In the 1960s a committee appointed to examine Ontario's tax system (the Smith Committee) recognized these inequities and recommended that the province take over responsibility for property tax assessment. As a result, in 1970 Ontario assumed the assessment function. Since then, the province has attempted to establish a single method for assessing property based on the market value of the property. While some progress in this direction has been made, Ontario still does not have a consistent or uniform property tax assessment system.

Description

Property Tax Base

There are three property-based taxes levied in Ontario: a residential property tax, a commercial and industrial property tax, and a business occupancy tax.

- RESIDENTIAL PROPERTY TAX applies to all owner-occupied or rental property and is paid by the homeowner or tenant. Residential properties include single-family dwellings, multiple residences, such as apartments or rental townhouses, condominiums/cooperatives, mixed-use residential/commercial rooming houses and retirement homes, and cottages and recreational properties.
- COMMERCIAL AND INDUSTRIAL PROPERTY TAX applies to all non-residential property and is paid by the owner of the property or by commercial and industrial tenants through their rents. Commercial

properties include office buildings, medical/professional office buildings, plazas, commercial condominiums, commercial conversions, single-storey commercial buildings, first-storey commercial with upper-level residential properties, purpose-built and free-standing restaurant buildings, fast-food restaurants, automotive commercial buildings, gas stations, owner-occupied establishments, and special use commercial buildings, such as instant teller booths. Industrial properties generally include all properties used for manufacturing, fabricating, tooling, retrofitting, repairs and related activities, warehousing, or wholesaling. Industrial properties may take any one of the following forms: free standing/single occupant buildings; industrial malls with multiple tenants; multiple storey industrial buildings with multiple tenants; industrial condominiums; older multiple storey/single occupant buildings; large industrial complexes with a multiplicity of buildings; special use industrial/heavy industrial buildings; and mini-storage properties.

- THE BUSINESS OCCUPANCY TAX applies to all residential or non-residential property occupied by a business. To calculate the tax, the market value of the property is multiplied by a rate that varies according to the type of business occupying the property. The business occupancy tax is paid by the business operator rather than the owner of the property.

Assessment

Since 1970, property tax assessment has been carried out by the provincial government. In theory, these assessments are based on market value, where market value is defined as "the amount that the land might be expected to realize if sold in the open market by a willing seller to a willing buyer" (Assessment Act, 1990, s. 19). The property tax base then should be the market value of all residential and non-residential property. However, in most municipalities property is assessed at a percentage of market value. This percentage varies from municipality to municipality depending on the base year used when the municipality was assessed. Within each municipality this percentage also varies for different property "classes" or types of property – for example, single-family residential, multi-residential, commercial, and industrial.

TABLE 8A.11
Ontario's Business Occupancy Tax Rates, 1993

Rate (%)	Type of property
25	Car parks
30	Race tracks, telephone and pipeline companies, most small retail businesses
50	Most offices of professionals; radio stations, newspapers and magazines, printers, stock or commodity exchanges, department stores, retail chains with 5 or more outlets in Ontario
60	Manufacturers, mines, smelters and concentrators
75	Wholesalers, financial institutions, brewers and distillers

Source: Ontario, Assessment Act, *Revised Statutes of Ontario 1990*, c. A31.

Rate Structure

Municipalities determine the rate at which property is taxed, or the mill rate. Mill rates represent the amount of tax to be paid per $1000 of assessed property value. According to Ontario legislation, the mill rate for residential property must be 85 per cent of the rate for commercial and industrial properties, and the mill rate applied to industrial properties must be 100 per cent of the mill rate applied to commercial properties.

The rate structure for the business occupancy tax varies with the type of business. The tax is calculated by multiplying the commercial and industrial tax on a property by a percentage that varies with the type of business. The percentages of the commercial and industrial tax levied as the business occupancy tax for major categories of property are set out in table 8A.11.

Administrative Arrangements

While provincial governments conduct property tax assessments, property taxes are levied and collected by local governments. Local governments, however, do not have complete control over the property tax revenues they collect. Under provincial legislation, school boards have a direct claim on local property tax revenues. Each school board determines its revenue requirements and effectively tells the local government how much in local property tax revenues it requires.

TABLE 8A.12
Ontario's Gas and Fuel Tax Rates, 1993

Type of gas/fuel	Cost in ¢ per litre
Gasoline	14.7
Aviation fuel	2.7
Propane	4.3
Diesel fuel	14.3

Source: Canada, Department of Energy, Mines and Resources, *Federal and Provincial Petroleum Product Taxes,* 7 (July 1993).

Gasoline, Fuel, and Motor Vehicle Taxes

The first Ontario tax on gasoline was introduced in 1925 at a rate of 3 cents per gallon. Today, drivers in Ontario face a wide assortment of taxes and fees, including levies on gasoline for automobiles and propane, licence fees, vehicle registration fees, and commercial licences. In addition, a special "gas guzzler tax" (the tax for fuel conservation) on the purchase of automobiles with a low fuel efficiency rating was introduced in 1989. The taxes on gas, other fuels, and fuel inefficient cars are levied under the Gasoline Tax Act, the Fuel Tax Act, and the Retail Sales Tax Act, respectively.

Description

The gasoline tax is levied on gasoline, propane used as transportation fuel, and aviation fuel. Generally, any fuel for a vehicle required to be licensed under the Highway Traffic Act or used for pleasure is taxable under the Gasoline Tax Act.

The fuel tax applies to diesel fuel and gaseous or liquid substances that can be used to power internal combustion engines. Fuel used in vessels of visiting armed forces, and marine vessels, fuel used for any objectives other than to operate a licensed motor vehicle, and fuel purchased in Ontario for use outside Ontario is exempt from fuel tax. Railway fuel is taxed at a reduced rate where the equipment is operated in conjunction with a public transportation system. Residential and commercial heating fuel are also exempt from tax.

TABLE 8A.13
Rate of Tax for Fuel Conservation, Ontario, 1993

Highway fuel consumption ratings (L/100 km)	Tax on passenger vehicles ($)	Tax on sport utility vehicles ($)
Over 18.0	7000	3200
15.1–18.0	4400	1600
12.1–15.0	2400	800
9.5–12.0	1200	400
9.0–9.4	250	200
8.0–8.9	75	75
6.0–7.9	75	0
Under 6.0	100 rebate	0

Source: Ontario, Ministry of Finance.

The tax for fuel conservation is a levy on the sale of an automobile with a highway fuel consumption rating equal to or greater than six litres per 100 kilometres. The legislation also provides a $100 rebate for passenger vehicles with a highway fuel consumption rating of less than six litres per 100 kilometres.

9 Who Pays Taxes in Ontario?

Determining the distribution of taxes under the current tax system is an important step in designing reforms to enhance tax fairness. Information on the way the burden of taxation is distributed among individuals and families in different economic circumstances is necessary to understand the fairness of the current system and to point to areas for reform. Unfortunately, determining this distribution is not straightforward. As we will see later in this chapter, a comprehensive view of who pays taxes requires many assumptions to be made and conclusions to be drawn, all of which lead one to interpret the final results with caution.

Nevertheless, these studies of who pays taxes – tax incidence analyses as they are called – contribute to our understanding of the impact of the current system. They also use the best analytical tools and techniques available. For this reason, the commission's research program included a tax incidence analysis of the Ontario tax system. Some results from this study are reported in this chapter and provide the necessary "fairness audit" of the tax system now in place.

Following the ability-to-pay criterion, judgments about the fairness of taxes are generally based on their relationship to taxpayers' incomes or wealth. We therefore begin with a brief overview of the distribution of income and wealth in Ontario. This is followed by the results of our "fairness audit" for all families and individuals and, finally, by an indication of the impact of taxes on different types of families.

Distribution of Income and Wealth in Ontario

A frequently used way to portray the distribution of income is to divide families and unattached individuals into 10 income-based categories, each containing one-tenth of total family units. Each group is called a decile group. The first decile group includes the tenth of the population with the lowest incomes, and the tenth decile includes the tenth of the population with the highest incomes.[1] In 1991 the top two income decile groups (that is, the highest-income 20 per cent of family units) received about 43 per cent of the total income of all households and unattached individuals. By contrast, the two decile groups with the lowest incomes received just under 5 per cent of total income.[2] Figure 9.1 shows that, in Ontario, the proportion of income from all sources, including transfers, received by each decile group has changed somewhat from 1971 to 1991. Over the 20-year period shown, the proportion of total income received by the poorest 10 per cent of families and unattached individuals has increased slightly from 1 per cent of total income to about 1 1/2 per cent; the proportion received by the second decile group has remained almost the same; and the proportion of income received by each of the third to the seventh decile groups has declined. In contrast, the one-tenth of families and unattached individuals with the highest incomes received a higher share of the total income in 1991 than in 1971. These patterns indicate that the distribution of income in Ontario was more unequal in 1991 than it was in 1971, and that over the last 20 years the proportion of income received by middle income earners has declined.

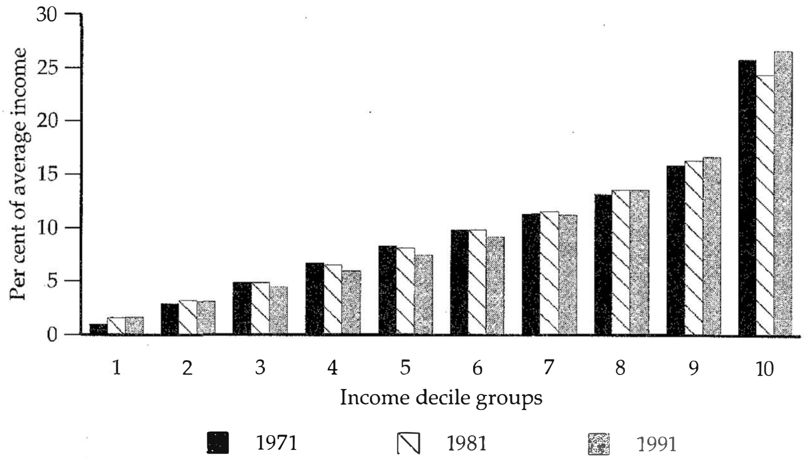
---

[1] The estimated income ranges for the 10 decile groups in Ontario in 1993 are:

1	Under $12,952	6	$44,599–$53,104
2	$12,952–$20,076	7	$53,105–$62,957
3	$20,077–$28,345	8	$62,958–$76,425
4	$28,346–$35,839	9	$76,426–$99,950
5	$35,840–$44,598	10	$99,951 and over

[2] Data in this section are from Statistics Canada, Household Surveys Division, Survey of Consumer Finances, unpublished data.

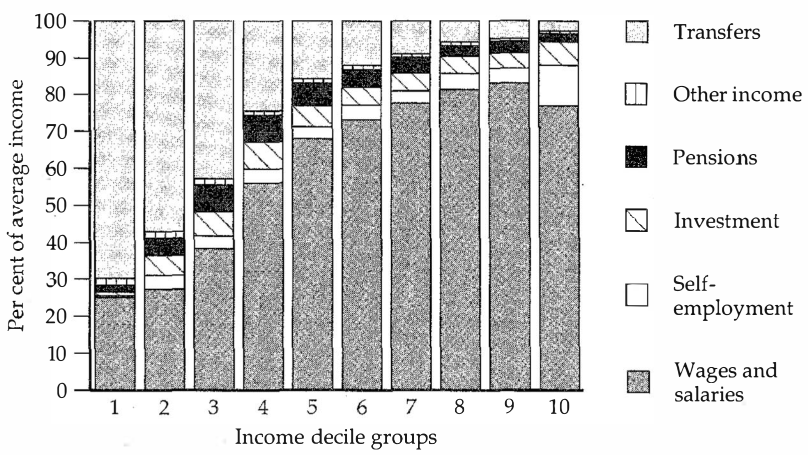
FIGURE 9.1
Distribution of Pre-tax Income of Families and Unattached Individuals by Income Decile Group, Ontario



Source: Statistics Canada, Household Surveys Division, Survey of Consumer Finances, unpublished data.

Low-income people tend to receive their income from quite different sources from high-income individuals. In 1991 government transfers to individuals (payments of unemployment insurance, social assistance, and Canada Pension Plan benefits) made up more than half the income of Ontario families and unattached individuals in the two lowest decile groups, while wage and salary income made up about one-quarter of their total income (figure 9.2). In each successive decile group, wages and salaries represented larger proportions of income to a maximum of 83 per cent in the ninth decile group, while transfers represented successively smaller proportions of total income. For the families and unattached individuals in the highest income group, the proportion of total income made up of wages and salaries was 77 per cent of total income, while income from self-employment constituted 11 per cent of total income and investment income contributed about 6 per cent.

FIGURE 9.2
Sources of Income of Families and Unattached Individuals by Income Decile Group, Ontario, 1991



Source: Statistics Canada, Household Surveys Division, Survey of Consumer Finances, unpublished data.

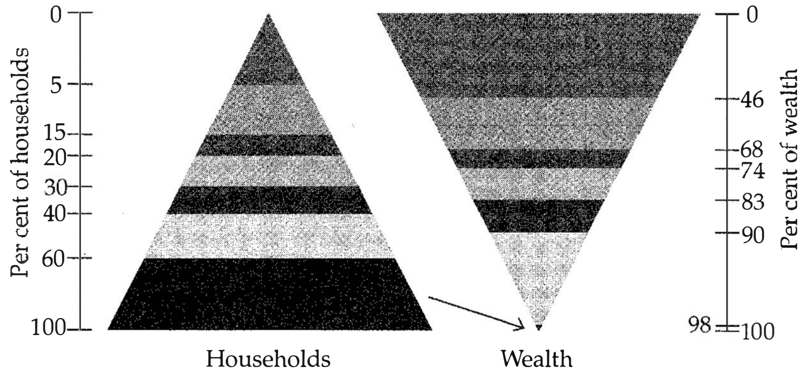
Distribution of Wealth in Ontario

The distribution of wealth in Ontario is more unequal than the distribution of income. For example, in 1989 the wealthiest 20 per cent of households held 74 per cent of household wealth, while the 20 per cent of households with the highest pre-tax income received 42 per cent of income in the province.[3] Even more strikingly, the wealthiest 5 per cent of households held 46 per cent of household wealth in the province, and the wealthiest 1 per cent of households held about 23 per cent of household wealth (FTC calculations based on special tabulations and Ernst & Young 1990).

---

[3] FTC calculations based on special tabulations from Statistics Canada, Survey of Consumer Finances, and Ernst & Young (1990). Wealth is much more difficult and costly to measure than income. As a result, there are fewer studies of wealth than of income or earnings. The data on the distribution of wealth used in this report are from a study by Ernst & Young (1990), which estimated the net wealth of Ontarians for 1989 by updating data from a 1984 Statistics Canada survey. Wealth is generally defined as the market value of assets minus liabilities at a given time.

FIGURE 9.3
How Wealth Is Divided: Distribution of Household Wealth in Ontario, 1989



Source: Fair Tax Commission calculations based on Ernst & Young, *The Wealth Report* (Toronto, 1990), vol. 2, app. N.

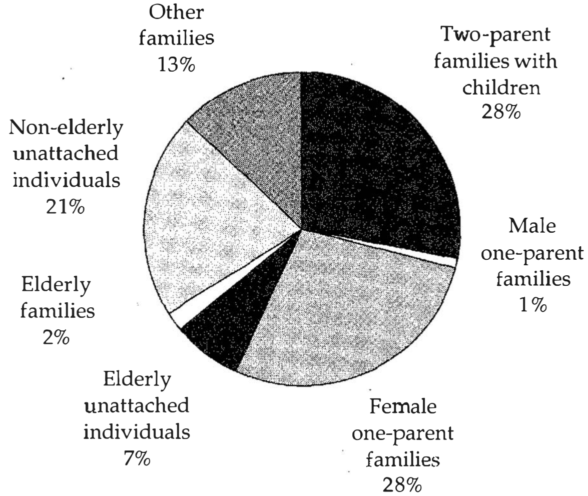
Note: The definition of household in the Ernst & Young study includes all persons – even if unrelated – who share a common dwelling.

Low-Income Individuals in Ontario

In 1991 just over one million people in Ontario, or 10 per cent of the population, lived in low-income households. The low-income measure used in this report is the after-tax low-income cut-off (LICO) calculated by Statistics Canada based on family/household size and the population of the area of residence. For instance, the LICO is different for rural areas and urban areas and is different for urban areas with different populations (Statistics Canada 1993m, 5). The LICO is the most widely used standard of low income and, in our opinion, the most credible. As a measure of low income, the LICO falls in the mid range of other frequently used standards (Wolfson and Evans 1990).

The incidence of poverty among individuals varies for different kinds of households. In 1991, 57 per cent of women and children living in sole-support mother families were poor and were almost six times as likely to live in a low-income household as the rest of the population. In the same year, almost a quarter of unattached individuals had a low income. Couples with and without children were the least likely to live in poverty in 1991. For example, only 7 per cent of couples with children had a below LICO income.

FIGURE 9.4
Distribution of Low-Income Individuals by Household Type, Ontario, 1991

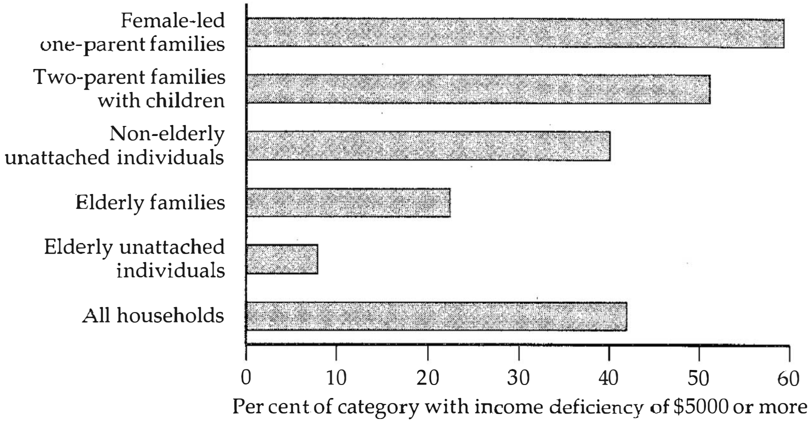


Source: Statistics Canada, Household Surveys Division, Survey of Consumer Finances, unpublished data.

Figure 9.4 shows the distribution of low-income Ontarians by household type in 1991. Almost 60 per cent of low-income individuals live in families with children, almost half that group consisting of female-led one-parent families. Almost 30 per cent of low-income Ontarians lived alone in 1991, about a quarter of them being 65 years and older.

Variations in the depth of poverty experienced by low-income individuals and families are, to a large extent, correlated with household structure. The depth of poverty is measured by the amount by which family income falls below the after-tax low-income cut-off, described as the household's level of income deficiency. The level of income deficiency is not adjusted for household size. In Ontario in 1991 the average income deficiency for below LICO households was $5200. Figure 9.5 shows that, in 1991, 42 per cent of all low-income households in Ontario had an income deficiency of more than $5000, but that low-income families with children had

FIGURE 9.5
Depth of Poverty by Household Type:
Low-Income Households with After-Tax Income Deficiencies of $5000 or More, Ontario, 1991



Source: Statistics Canada, Household Surveys Division, Survey of Consumer Finances, unpublished data.

greater income deficiencies than individuals living alone. In particular, poor elderly people living in families and alone did not experience the depth of poverty of families with children.

Measuring the Impact of Taxes

The measurement of taxes is complicated because, in the final analysis, who actually bears the burden of a tax depends, in part, on how market prices, wages, and interest rates are affected by the imposition of a tax. Taxes levied directly on people or on institutions such as corporations and other types of businesses lead to changes in economic behaviour. Individuals acting on their own or as decision makers for a business will tend to change their decisions (or choices) in response to a tax. These altered decisions, which affect the behaviour of people and firms in markets (for example, work behaviour in paid labour markets, savings and investment choices in capital markets), may result in the tax effectively being passed on to someone else. This occurs because, as markets adjust to the changes in behaviour, prices of goods and services, wages, or rates of return on investments may be affected.

If the taxes levied on a business are reflected in the form of higher prices for the goods it sells, then the taxes are ultimately paid by consumers. If the taxes levied on a business are passed backwards in the form of lower wages, then employees ultimately pay the taxes. If the taxes levied on the business are shifted to shareholders or the investors who own the capital invested in the business, then capital owners ultimately pay the tax. Ultimately, taxes on institutions are paid by people.

Similarly, the effect of the imposition of a payroll tax will ultimately depend on behavioural responses and the relative market power of employers and employees. The imposition of a payroll tax increases labour costs for employers. The cost of the tax could remain with employers, resulting in lower profit for the owners of the business; alternatively, the cost could be shifted, through lower wages, to workers. In the short term, when employment contracts (both formal collective agreements and informal agreements) are in place, firms will likely face a reduction in profits. In the long term, however, faced with added costs per worker, firms will attempt to reduce their labour costs either by negotiating for lower wage rates than would be the case in the absence of the tax or by laying off workers. If the reduction in labour costs is not achieved through lay-offs, a decrease in the wages of workers who remain employed is likely.[4] These lower wage rates result in workers bearing the burden of the tax. In the final analysis, the share of the costs borne by workers and by employers will depend on their relative market positions.

Similar processes come into play when considering income or capital taxes on corporations. Under certain market conditions, changes in behaviour will result from the imposition of corporate income taxes. In the short term, the tax will reduce the rate of return on capital invested in corporations. In the long term, however, owners of capital will change their behaviour in response to the reduced rate of return they are receiving on their capital. If the Ontario tax rate is higher than the tax rates in other jurisdictions, investors will move

---

[4] This reduction will be in inflation-adjusted or real wage rates rather than nominal wages. As a result, the reduction could be brought on by a slowdown in the growth of wage rates, not by a drop in the level of wages.

their capital to different locations where the after-tax income from capital is higher. This movement of capital out of the province will reduce the pool of capital available in Ontario. As Ontario corporations compete for this smaller pool of capital, they will bid up the rate of return. This increase will continue until the after-tax rate of return on capital is equal to the after-tax rate of return outside the province, and an investor will receive the same after-tax rate of return on investment in or outside Ontario. However, the resulting outflow of capital will have reduced the level of investment in Ontario, which in turn will have reduced the productive capacity of the economy. The result will be lower productivity than would otherwise have been the case. This, in turn, will both increase the cost of consumer goods and decrease the wages paid to workers. As a result, in this scenario workers and consumers bear the burden of the corporate income tax.

A different set of market conditions would result in a different adjustment to the imposition of a tax on corporate income. Once again, in the short term, a corporate income tax would reduce the rate of return on capital. However, if markets for capital are local rather than international and interprovincial, then the decrease in the rate of return would not result in capital moving outside the province. Instead, capital would move from the corporate to the unincorporated sector of the economy. Thus, while the aggregate amount of capital would remain the same, the after-tax rate of return to all capital would fall and the tax would be borne fully by the owners of capital.

The imposition of a residential property tax can set into motion a similar range of market responses. Economists think about property taxes as split into two portions: one portion based on the land, and the second based on the buildings. The property tax that is based on the value of the land will tend to reduce its value or the price that will be paid for it in the future. Because the total amount of land is fixed, the tax cannot be shifted by the owners. However, the portion of the tax based on the value of the building can set behavioural changes in motion. In the short term, the imposition of the property tax will result in a decrease in the rate of return on capital invested in structures. In the long term, in response to the tax, investors will move their capital out of buildings and into other forms of investment. This investment could be either in Ontario or outside the province. This change will decrease the supply of residential rental accommodation and the supply of commercial/industrial space. In the case of the residential property tax, this means an increase in rents through which tenants will bear the cost of this share of the property tax.

Once again, different market conditions could result in different responses. If capital markets are not seen as international, and the total amount of capital available did not change with the rate of return, owners of residential rental accommodation would move their capital to other forms of investment that were not subject to property tax and had a higher rate of return. The increase in the supply of capital to these other forms of investment would reduce the rate of return in these other sectors. Eventually, the rate of return to capital would be equal among the different uses. As a result, all capital owners, not just those who owned residential rental accommodation, would bear the burden of the tax.[5]

These examples illustrate that a range of scenarios could be developed about the way markets respond to taxes. Even from this brief discussion, it is clear that there is considerable room for debate and disagreement among economists about market responses to corporate, property, and sales taxes. For other taxes such as personal income tax and payroll taxes, however, there is widespread agreement about their incidence.

Thus while one must proceed with caution and try not to read too much into the results, tax incidence studies can provide information about the distribution of taxes. Incidence estimates of individual taxes show which elements of the current tax system are regressive (where the tax accounts for a decreasing share of income as income rises) and which elements are progressive (where the tax accounts for an increasing share of income as income rises). Estimates of the incidence of individual tax bases can also be used to provide information on the impact of a variety of potential policy changes on the distribution of taxes.

We undertook a study that estimated the incidence of taxes paid by Ontarians in 1991 (Block and Shillington n.d.). These estimates

---

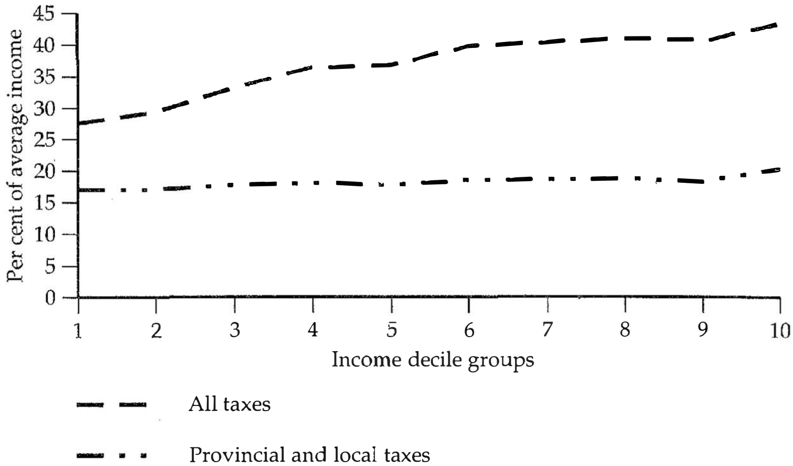
[5] In the case of the commercial/industrial property tax on structures, the tenants (businesses) would be intermediate bearers of the tax. Further behavioural responses would result in the tax ultimately being shared among consumers, employees, and the owners of the business.

included four cases that encompassed the range of shifting assumptions put forward by economists. The "standard" case reflected the general consensus about what tax-shifting assumptions are appropriate given the characteristics of Ontario's economy. A critical characteristic for these incidence estimates is that Ontario is a small, open economy in which capital is internationally and interprovincially mobile. The result that emerges from this mobility assumption is that the rate of return to capital is set internationally. This means that should the rate of return in Ontario drop below this international level, there would be capital outflows from the province until the amount of capital had fallen sufficiently to raise the after-tax rate of return to the international level. The (standard case) incidence assumptions for each of the major tax bases are outlined below:

- Taxes on corporations are split among the owners of the corporations, workers, and consumers.
- Personal income taxes are borne by the individuals on whom they are assessed.
- Property taxes on owner-occupied residential property are paid by the owners.
- Taxes on residential rental accommodation are split between owners and tenants; taxes on commercial and industrial properties are split among owners, consumers, and workers.
- Sales and excise taxes are borne by consumers of taxed goods.
- Payroll taxes are split between workers and employers.

The other cases used different assumptions about the incidence of corporate, property, and payroll taxes. These estimates provided information about how the distribution of taxes across income groups would change when the assumptions change. These results showed that the overall incidence of the tax system did not change significantly with the changes in assumptions.

FIGURE 9.6
Incidence of Taxes, Ontario, 1991



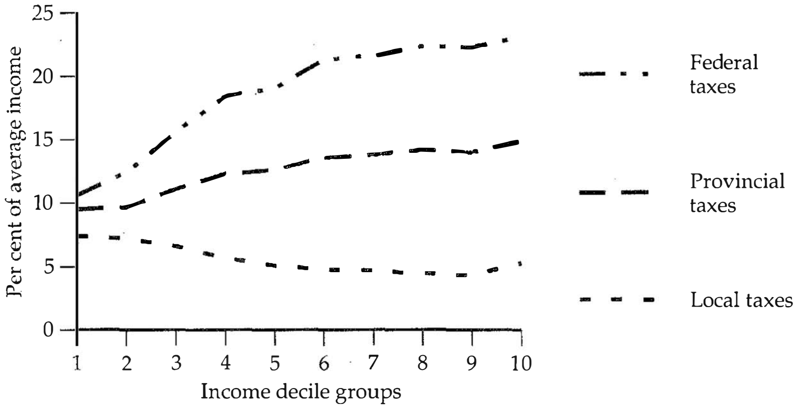
Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

Incidence Estimates

Incidence of Taxes by Level of Government

Figure 9.6 shows the incidence of the total tax system on Ontarians, as well as the combined impact of the provincial and local tax systems. Each data point shows the average percentage of household income paid by each decile group of the households in the province. The total tax burden of Ontarians had a progressive profile over the first six decile groups in 1991. The average total tax rate for the first decile group is about 28 per cent, rising to about 40 per cent for the sixth decile group. The total tax system is roughly proportional over the next three decile groups, with an average total tax rate of about 40 per cent. For the highest income group the average rate is about 43 per cent. The combined provincial and local tax system is roughly proportional over the first nine decile groups because of the interaction of the regressivity of the local tax system and the progressivity of the provincial tax system.

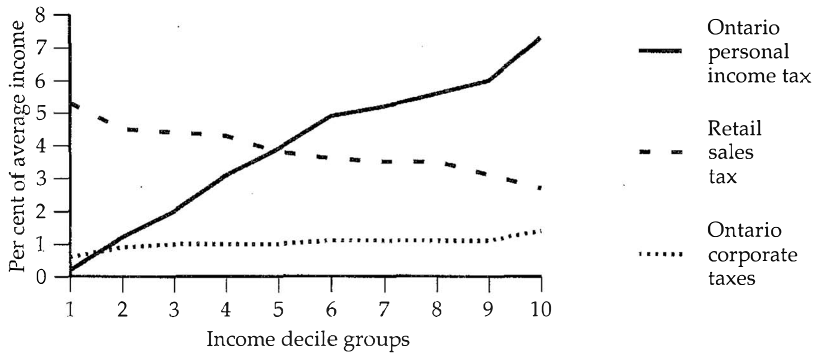
FIGURE 9.7
Incidence of Taxes by Level of Government, Ontario, 1991



Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

Figure 9.7 compares the incidence of federal, provincial, and local taxes. It shows that the economic burden of local taxes falls over the first nine decile groups and then rises in the tenth decile group. On average, local taxes represent about 7 per cent of income in the first decile group, falling to about 4 per cent in the ninth group, then rising to about 5 per cent in the tenth group. Provincial taxes are mildly progressive over the first six decile groups. Provincial taxes account for about 10 per cent of average income in the first decile group, rising to about 14 per cent in the sixth decile group. The average rate fluctuates between 14 and 15 per cent between the seventh and tenth groups. Federal taxes are also progressive over the first eight decile groups. The average tax rate rises from about 11 per cent in the first group to 22 per cent for the eighth group. Between the eighth and tenth decile groups the average federal tax rate fluctuates between 22 and 23 per cent.

FIGURE 9.8
Incidence of Selected Provincial Taxes, Ontario, 1991



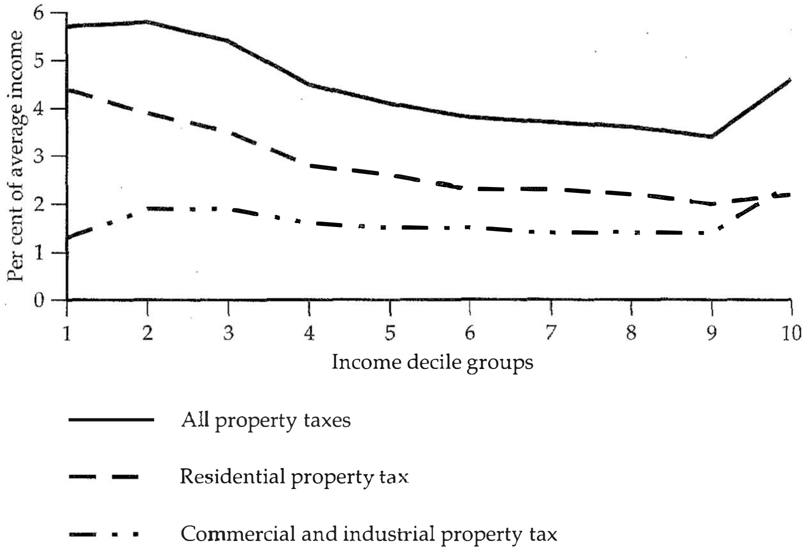
Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

Incidence of Taxes by Tax Base

The incidence patterns in figures 9.6 and 9.7 result from the combination of varying incidence patterns across tax bases. Figures 9.8 and 9.9 compare the incidence patterns of the major Ontario taxes. Figure 9.8 shows that Ontario's personal income tax is progressive overall. While the average percentage of income paid in personal income tax is less than 1 per cent for the first decile group, it rises to 7 per cent for the tenth group. The figure also shows that the retail sales tax is regressive across all income ranges. While the tax accounts for about 5 per cent of income in the first decile group, this drops off to about 3 per cent of income in the tenth group.

In the context of internationally mobile capital, corporate taxes (on both income and capital) are roughly proportional. Because the burden of the tax does not fall entirely on holders of corporate capital, the average corporate tax rate fluctuates around 1 per cent across all income ranges. Portions of the burden also fall on owners of other forms of capital, on workers, and on consumers.

FIGURE 9.9
Incidence of Property Taxes, Ontario, 1991



Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

Figure 9.9 shows that residential property taxes are regressive across all deciles except the last. While the tax accounts for 4 per cent of income in the first decile group, it drops off to 2 per cent of income in the ninth group, rising to just above 2 per cent in the tenth group. Property taxes on commercial and industrial property show a more proportional pattern up to the ninth decile, with the tax representing between 1 and 2 per cent of average income in the first nine decile groups. In the tenth decile group, commercial and industrial property tax represents about 2.5 per cent of average income. This increase results from the assumption that a substantial proportion of these taxes is borne by capital and thus affects income from capital.

Conclusion

The combined local and provincial tax systems in Ontario appear to be proportional, as the share of income paid out in taxes does not vary with income levels. However, total tax incidence estimates mask differences in progressivity across tax bases. There are progressive, regressive, and proportional elements in the Ontario tax system. This mix points to two possible directions for reform: increasing the progressivity of individual tax bases, or shifting the relative shares of the progressive and the regressive elements of the tax system.

Family Types

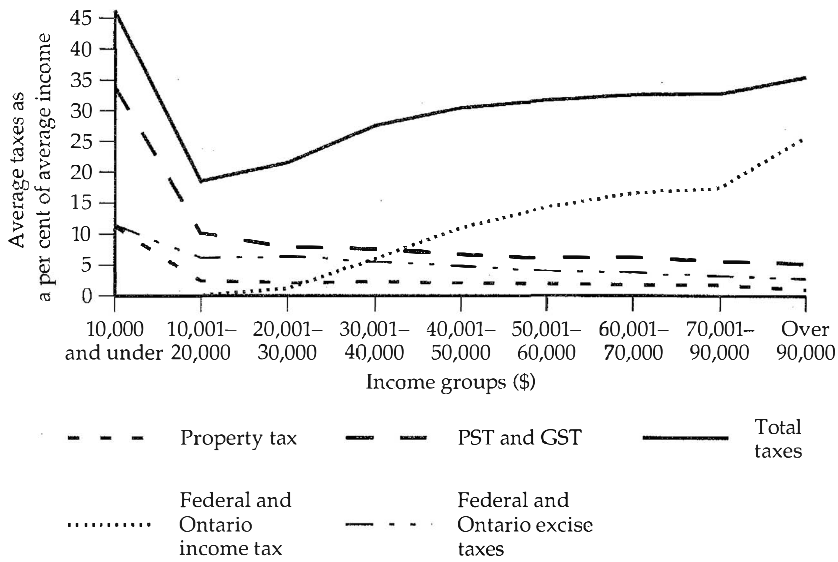
To complement the analysis of taxes by income groups, we also examined the impact of taxes on particular types of families and unattached individuals. In this section we consider the impact of only those taxes that we pay directly, including the personal income tax, the provincial sales tax, the federal Goods and Services Tax, the residential property tax, and Ontario and federal excise taxes.

It is important to note that the federal GST rebate for low-income taxpayers is not shown in the sales tax line of the figures, and so the proportion of income paid in sales tax is inflated for the first few income groups. The GST rebate (as well as the provincial property and sales tax credits) is, however, accounted for in the line showing total taxes.

In general, those in higher income groups pay a greater proportion of their income in federal and Ontario income taxes, while those in lower income groups pay a greater proportion of their income in taxes on consumption, including excise and sales taxes. Residential property tax makes up less than 5 per cent of the income of all but the lowest income groups in all family types.

In 1993 the average income of couples with children in Ontario was $71,153. Figure 9.10 shows that at this income level, a couple with children in Ontario directly pays about 33 per cent of their income in taxes. In the lowest income range, from $0 to $10,000, a couple with children pays an astounding 46 per cent of their income in taxes, much of it in sales tax. However, it is important to note that very few families with children are in this income group, since

FIGURE 9.10
Distribution of Taxes Paid by Couples with Children, Ontario, 1993



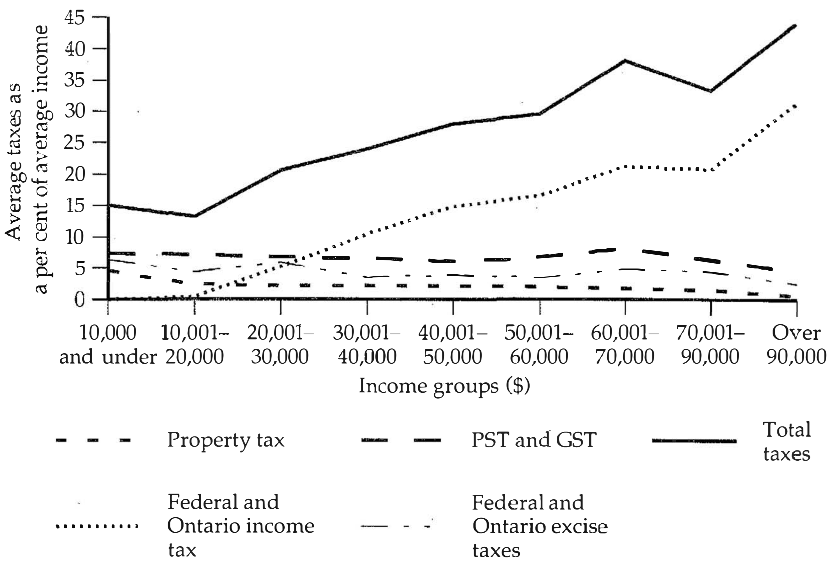
Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

couples who have children and are on social assistance receive more than $10,000 per year. At the lowest income group, this category probably includes those living outside the cash economy.

In 1993 the average income of single parent families in Ontario was $36,477. Figure 9.11 shows that at this level of income, the single parent family directly pays about 24 per cent of income in taxes. Below an income level of $20,000, single parent families spend 13 to 15 per cent of their income on taxes. Single parent families with income of over $90,000 pay 44 per cent of their income in taxes.

The average income for elderly unattached individuals in 1993 was $19,916 (Statistics Canada 1992d, 100). Figure 9.12 shows that at this income level, the elderly unattached individual in Ontario directly pays about 12 per cent of his or her income in taxes. However, at income levels of $10,000 and below, the elderly unattached

FIGURE 9.11
Distribution of Taxes Paid by Single Parent Families in Ontario, 1993

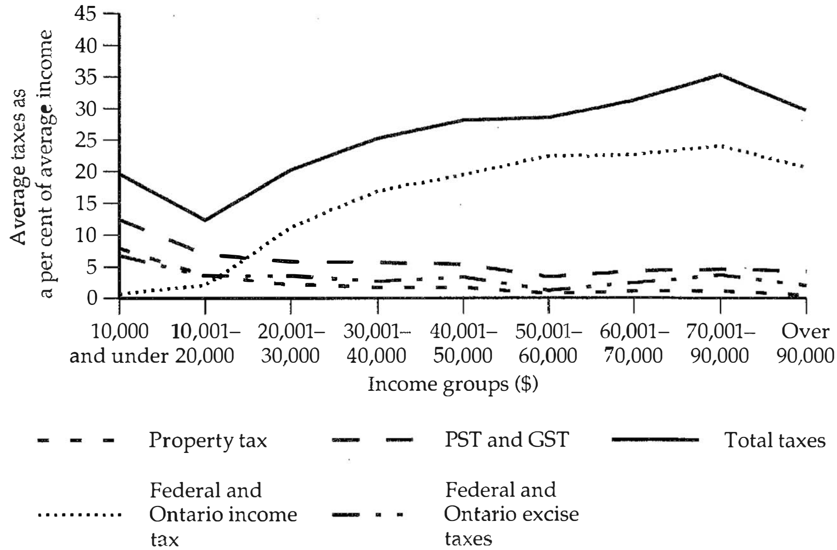


Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

individual pays about 20 per cent of his or her income in taxes, largely in sales taxes and residential property tax. Interestingly, those in the income bracket above $90,000 pay less of their income in taxes than those in $70,000–$90,000 bracket.

In 1993 the average income of non-elderly unattached individuals in Ontario was $25,471. Figure 9.13 shows that non-elderly unattached individuals at this income level directly pay about 30 per cent of their income in taxes levied at the local, provincial, and federal levels. Just over half of the taxes paid are in the form of federal and Ontario income tax. Non-elderly unattached individuals with a higher than average income pay an increasing proportion of their income in personal income tax, but a lower proportion in sales tax, excise taxes, and property tax. The total taxes directly paid as a proportion of income reaches 38 per cent for those unattached

FIGURE 9.12
Distribution of Taxes Paid by Elderly Unattached Individuals in Ontario, 1993



Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Database and Model (SPSD/M).

individuals with income of $90,000 or more. Those with lower than average income pay a smaller proportion of their income in income taxes, but pay proportionately more in taxes on consumption, although the sales tax level has not been adjusted for the GST rebate.

The national average income of Ontario couples without children in 1993 was $55,897. Figure 9.14 shows that in this income range, about 32 per cent of income is directly paid in taxes, 19 per cent of that in income taxes and 6 per cent in sales taxes. Couples without children pay a greater proportion of their income in income taxes than couples with children in the same income ranges and, except in the very lowest income range, about the same level in sales taxes.

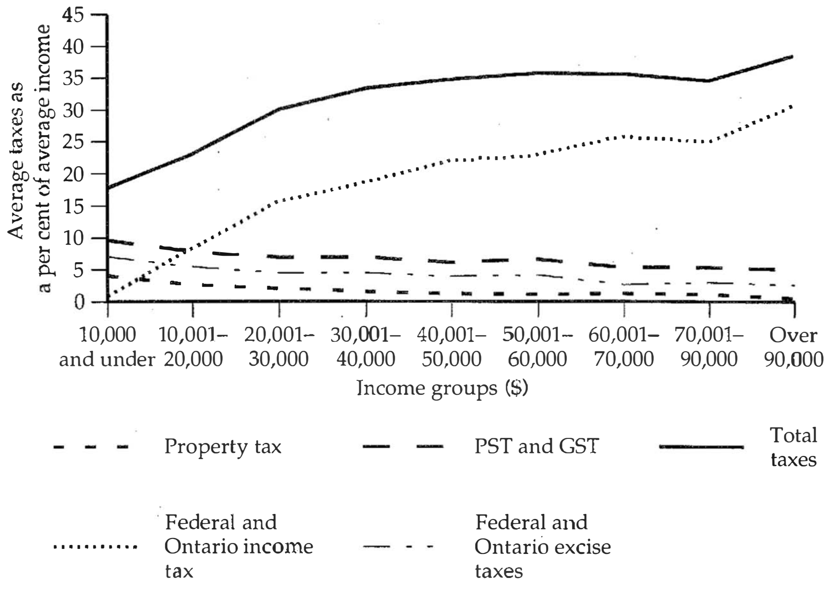
Table 9.1 summarizes the major results from the analysis of the direct impact of taxes on family types.

TABLE 9.1
Ranges of Tax Impacts by Family Type, Ontario, 1993

	Impact of total taxes for average income	Impact of total taxes in lowest income range	Impact of total taxes in highest income range
		Taxes as % of average income	
Couples with children	33	46	35
Single parent families	24	15	44
Unattached individual (non-elderly)	30	18	38
Elderly unattached individual	12	20	30
Couple without children	32	27	38

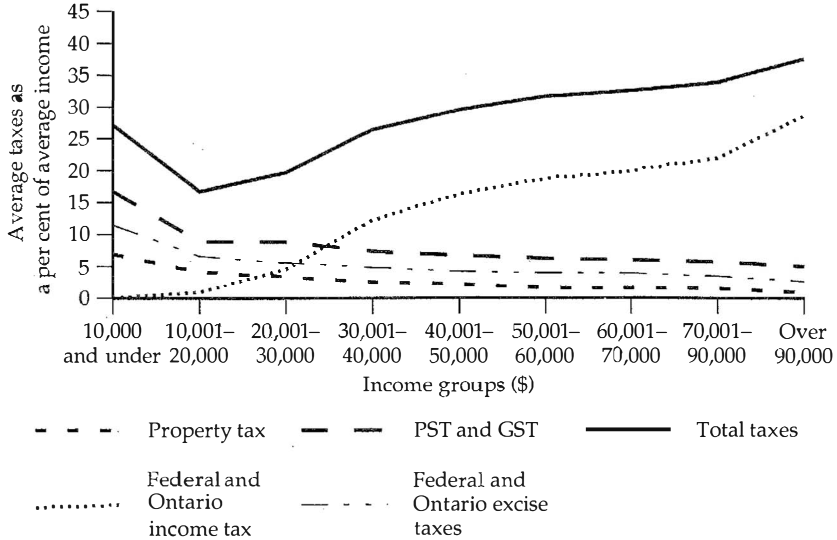
Source: Fair Tax Commission estimate based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M) and Statistics Canada, *Income Distributions by Size in Canada*, 1991, Cat. 13-207.

FIGURE 9.13
Distribution of Taxes Paid by Non-elderly Unattached Individuals in Ontario, 1993



Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

FIGURE 9.14
Distribution of Taxes Paid by Couples with No Children, Ontario, 1993



Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

10 The Stage for Tax Reform

In the preceding chapters we set the stage for our consideration of specific fairness issues in the Ontario tax system. In particular, we developed the notion of tax fairness to the point where it can serve as a guideline for developing recommendations for tax reform; we examined the economic and institutional context in which tax reform initiatives would be pursued; and we audited the fairness of the current tax system.

The idea of tax fairness is best captured by the ability-to-pay criterion – namely that, overall, the amount of taxes people pay should be related directly to their economic capacities as measured by their incomes. Two distinct principles emerge from this criterion: taxpayers with comparable economic capacities should pay comparable amounts of tax, and taxpayers with greater economic capacities should pay appropriately more than taxpayers with lesser capacities. Within this general pattern, there is room for specific taxes to be determined in accordance with the benefits people derive from selected public services. Indeed, there is room for reliance on these benefit taxes to increase in some areas.

Tax reform in Ontario cannot succeed if governments do not take into account the economic responses of taxpayers (both individuals and corporations) to tax changes. These long-standing concerns with issues such as decisions involving savings, investments, and participation in paid labour markets have taken on a new dimension with the rapid internationalization of many markets. This "globalization" of national and subnational economies further circumscribes tax policy in the 1990s and beyond.

The current tax system in Ontario can most aptly be summarized as not being strongly related to taxpayers' incomes. Certainly individual taxes exhibit clear patterns: income taxes tend to be progressive while property taxes tend to be regressive. Yet overall we have not found any strong patterns that one could characterize as being regressive or progressive. The most one could fairly say is that the combined provincial-local tax system is basically proportional, while the pattern for total taxes (including federal taxes) is progressive over the lower half of the income spectrum and, thereafter, basically proportional. Moreover, as we shall see in later chapters, in some cases, particularly the retail sales tax and property tax, there are significant tax differences among taxpayers at the same income levels.

What broad conclusions can be drawn from these foregoing discussions? First, it is clear that the tax system, as it stands, does not correspond very well to a fair system in which overall tax responsibilities increase along with the taxpayer's ability to pay. Second, the fiscal system is under increasing pressure from international market forces, creating a challenge as to how we can generate the revenues needed to maintain levels of public services in areas such as health care, education, and social services. The fiscal system is also subject to pressures of a different sort as governments grapple with their large deficits. Thus the federal government has cut back significantly on its transfers to Ontario, and provincial transfers to local governments – particularly for education – have not kept pace with costs.

One response to the dilemma of maintaining public services in the face of increasingly mobile tax bases is to increase reliance on benefit taxes, which are directly or indirectly related to the levels of consumption of these public services. Benefit taxes also have an advantage in terms of conserving scarce resources and fostering more efficient production and use of these services. However, as we have seen, while they do have a place in the overall mix of taxes, benefit taxes do not promote the objective of an ability-to-pay system. Indeed, they may in some circumstances run directly counter to this objective.

In subsequent chapters we analyse areas where benefit taxes can and should be used, and in some cases we argue for expanded reliance on these taxes. These include areas such as:

- municipal services such as water and sewer,
- environmental concerns, and
- transportation services.

We also discuss and develop recommendations about when benefit-type taxes would not be appropriate mechanisms to fund public services. These areas include:

- primary and secondary education,
- social assistance, and
- children's services.

More generally, however, we are convinced that the tax system of Ontario can be reformed to reflect better the ability-to-pay criterion. The constraints imposed by tax base mobility and the responses of individuals and businesses are real and must be accommodated, but they do not deprive the Ontario government of room to act. In the following parts of the report, we develop recommendations that collectively promote the ability-to-pay criterion while paying healthy respect to the constraints. These recommendations address the criterion in terms of:

- the overall pattern of taxation relative to incomes,
- the more equal tax treatment of individuals with comparable levels of income, and
- the relationship between the tax system and the social assistance system, particularly with respect to low-income workers.

KEY ISSUES IN TAX FAIRNESS

Part Four
Enhancing Democratic Accountability

11 Improving Accountability in the Tax System

We begin our discussion of specific recommendations for tax reform by addressing the subject of democratic accountability, for two reasons. First, tax fairness begins with democratic decisions and can only be maintained to the extent that the democratic process makes decision makers accountable for the fairness of the system as a regular part of the process of government. An unfair process will tend to produce unfair results. The most unfair process is one in which access is privileged and decision makers are not accountable for their actions. Second, issues of process are important in their own right. Our system of government depends on voluntary acceptance by individuals of their obligation to pay tax. People are more likely to accept decisions that are made openly and that they feel they can influence and understand.

In public hearings, formal submissions, and letters from individuals, we heard a great deal about accountability of government. This degree of attention, however, did not produce agreement, even on exactly what is meant by accountability, much less on how it might be improved. As a federal royal commission (the Lambert Commission) that investigated the issue in the 1970s put it, "accountability, like electricity, is difficult to define but possesses qualities that makes its presence in a system immediately detectable" (Canada Royal Commission on Financial Management and Accountability 1979, 9).

In our consultation process, public concern with accountability took a number of different forms. For some, government spending was "out of control." By this they meant that government had become too large, or that the priorities reflected in the combination of government-provided services in Ontario were "wrong," or both. For others, the dissatisfaction was more directly focused on taxation. Their complaint was that the total tax burden placed upon them by all governments was too heavy and, particularly, that it did not adequately reflect their changed circumstances in the recession of the early 1990s. A third variation on the theme of accountability focused on the process through which tax policies were formulated and administered. Many people and groups felt they were shut out of the process; the process was designed for and responded to the input of others.

Not all these matters fall within the mandate of the Fair Tax Commission, the concerns with public spending being the clearest example. Nevertheless, other issues of accountability have important implications for the tax system. Several such issues are taken up in this part of the report.

In this chapter, we address how government accountability can be strengthened insofar as the tax system is involved. The chapter discusses the overall tax policy process, sets out our general position on tax expenditures, and examines recent calls for greater earmarking of tax revenues.

The Tax Policy Process

Why Process Matters

There are many reasons for Ontarians to be concerned about the tax policy process. In a democratic system, *how* policies and decisions are made is often as important as *what* decisions are made. That is especially true for areas such as tax policy, where the substance is obscure or confusing, yet the impact of the decisions is significant and personal. Process and procedure are important in influencing people's sense of the fairness of their tax systems.

The tax policy process matters in several ways. The government in general, and the minister of finance in particular, are accountable to the legislature and, through the legislature, to the people of Ontario. Accountability in this context means that ministers must face the questions and scrutiny of the elected members. The presentation of the budget is probably the most important opportunity for accountability that any government faces. But accountability in a parliamentary system also carries with it the corresponding right of the government to govern. Hence, there is a corollary right of the government to be able to fashion a budget and secure its passage in a reasonable time period, in part because citizens and businesses are dependent upon the predictability associated with firm budgetary decisions.

Process matters in that fairness of access to political leaders is itself a valued feature of representative and participative democracy. As a result, all groups in society who wish to participate in tax policy choices and decisions should have a reasonable chance to do so. Tax choices reflect and alter political power. In this sense, they influence the legitimacy of the tax system and of government itself. In fact, the capacity of the government to collect revenue is dependent in the long run on such an ongoing sense of legitimacy.

In a modern society and economy, where complex interdependencies and relationships are the norm, a fair process is important to public acceptance of the system. The tax policy process must contain opportunities for the scrutiny and application of independent and objective data and analysis.

How Tax Policies and Decisions Are Made

The tax policy and decision process must be defined flexibly (Doern et al. 1988). In its broadest context, the process includes four processes: the multi-year process through which basic federal-provincial tax and fiscal agreements are forged; the annual process leading to the budget speech given by the provincial minister of finance in which tax measures are announced or changed; the everyday process through which tax decisions are administered and revenue is collected, with appropriate appeal measures for taxpayers; and periodic general tax reform exercises such as the work of the Fair Tax Commission. Although all these processes are important, the focus here is on the annual process leading to the budget speech.

The Ontario tax policy process must be set in the context of the major influence of decisions of the federal government. Though Ontario is Canada's largest and richest province, it is not a tax or budgetary island. When Ottawa gets a cold, Ontario sneezes, if not first, then often the loudest. The federal influence is both substantive and procedural. In recent years, the substantive influence has been through the harsh reality of federal budget cuts, and caps or freezes of transfer payments to the provinces, and in federal tax changes that limit Ontario's room to move on tax policy. The timing of the Ontario budget is influenced by the need for the provincial government to consider the contents of the federal budget, usually tabled late in February, before presenting its own budget. Ontario budgets and budget processes can also be influenced by other federal-provincial fiscal arrangements (the first of the four processes identified earlier), including periodic tax agreements and federal tax reform initiatives such as the flattening of the rate structure in 1987 and the introduction of the Goods and Services Tax in 1990.

The Nature of Budget Secrecy

Budget secrecy is a central feature of the Ontario tax policy and decision process. It is a British parliamentary practice originally designed to prevent individuals from profiting personally because of privileged prior knowledge of the contents of a budget speech. It is a concept forged in the 19th century at a time when the main revenue sources were tariffs and excise taxes. Lindquist (1985) and Maslove et al. (1985) analyse its rationale. The doctrine holds that if a budget leak occurs, the minister must resign. In theory, the resignation should take place whether or not someone has actually been able to gain financially from prior knowledge.

Budget secrecy has three important political effects. First, it protects the minister of finance from excessive and unrelenting pressure. Second, it basically excludes all but two cabinet ministers (the minister of finance and the premier) from what is arguably the cabinet's most important annual decision. To avoid a budget leak, discussion and consultation must be severely restricted within the government as well as outside it. Third, it enhances the drama of the budget speech as a political occasion.

Budget secrecy in Ontario is influenced by the larger British tradition and by developments at the federal and provincial levels. In 1983, when some pages of the Ontario budget were found by a journalist in a waste bin, charges arose that a budget leak had occurred. Opposition critics called for the resignation of the treasurer. This event led to a legal review within the government of what the precedents said about the practical meaning of the principle. The legal review concluded it was quite erroneous to assert there is a clear tradition that the leak of any budget information must lead to the resignation of the financial minister. Accordingly, the treasurer of the time was advised that resignation is appropriate only in the case of improper financial gain or a grave indiscretion on the part of the minister concerned.

The almost comical nature of a federal incident, also in 1983, where a television camera caught a glimpse of the finance minister's speech page with some data on it, helped prompt more discussion of budgetary reform. As a result, subsequent federal discussion papers advocated a substantial loosening of the concept.

The Expenditure and Tax Budget Cycle – and the Key Players

The annual expenditure, tax policy, and decision process spans most of the year and involves a set of key players whose roles start with a wide-ranging set of interactions in the early stages of the expenditure process, but end with a concentration of power in actual tax policy choices.

Within the government and bureaucracy, the annual cycle starts in the fall with an expenditure review and allocation process culminating in the tabling of the budget and expenditure estimates in the legislature in the spring. This process involves all ministries and ministers, with particular responsibilities resting with the Treasury Board and the Policy and Priorities Board of cabinet (which consists of the premier, the minister of finance, the chair of the management board, and five senior cabinet members).

MINISTER OF FINANCE, PREMIER, AND MINISTRY OF FINANCE. In contrast to the multi-minister, multi-departmental nature of the expenditure part of the budgetary process, the tax and revenue side is firmly centred on the minister of finance and the premier and within the Ministry of Finance. The ministry is clearly the analytical centre of operations both in judging Ontario's economic outlook for the coming budget and in setting out the fiscal framework – the net stimulus or restraint and deficit or surplus that will guide the budget as a whole.

WHITTLING DOWN THE "PRESSURES" LIST. The internal process is characterized by the need to sift through a list of ministerial requests and pressures. Often described as the "pressures" list, the requests typically reflect additional funding required for existing programs and/or unfunded expenditure priorities identified by the ministry.

The list is reviewed, aided by evaluation provided by key Ministry of Finance staff, and is gradually whittled down by a process of ultimate political judgment in the context of the fiscal plan by the Treasury Board and the Policy and Priorities Board of cabinet.

The overall tax and revenue cycle is shorter than that of the spending side of the budget plan. Revenue projections and economic analysis are ongoing within the Ministry of Finance, but it is not until early in the new calendar year that pre-budget consultations with interest groups occur and specific tax and revenue measures begin to be considered seriously. One reason for this timing is that the Ontario government prefers to wait for the federal government's budget to be tabled (usually in mid to late February) to determine whether adverse or favourable federal measures might alter provincial budgetary and fiscal plans. A federal budget may also serve as a target of political blame should circumstances warrant, as they often do.

The tax budget cycle culminates in the presentation of the minister's budget speech, usually in April or May of each year, but its overall cycle is shorter than that of the spending side of the operation. The process begins in earnest only in late fall and early winter.

PRE-BUDGET CONSULTATION AND INTEREST GROUPS. Pre-budget consultation with interest groups can, in one sense, be considered to be going on all year in that groups are constantly lobbying ministers for favourable policies and fiscal measures (Doern n.d.). But it occurs formally in the dozen or so weeks immediately prior to the budget speech. Historically, consultation in the pre-budget period has been a fairly ritualistic affair. The minister of finance typically meets *in camera* with groups that have requested consultations or have been invited by the minister to give their views. These views are expressed either through written briefs or verbally, or both. Typically, written briefs are not made public. Many ministers have had a strong preference for one-on-one in camera sessions. This is partly because of tradition, but some ministers have simply felt that one-on-one sessions allow them a chance to engage people in discussion.

Such sessions are ritualistic in the sense that, although the minister of finance can engage in general discussion with the groups, he or she cannot reveal, or even hint at, possible tax changes for fear of breaking the rules of budget secrecy. This does not mean that such consultations have no value for either side. Good information is often exchanged and the minister can gain a real sense of the group's fears and concerns. The government's overall views about the economy can also be communicated to such groups, often quite frankly.

While pre-budget consultations were once confined mainly to business interest groups, by the 1980s those involved spanned both the business and social sides of the political continuum. As many as 80 groups and interests, including policy institutes, have been involved, though the numbers depend on the time available and the format used.

THE LEGISLATURE AND PRE-BUDGET HEARINGS. The legislature's role in the tax budget process is essentially four-fold. First, as a centre for partisan party politics and criticism, the legislature's main opposition parties offer comment and criticism prior to the budget speech. They are also often an important conduit for key interest group criticisms. Second, opposition parties may occasionally suggest preferred tax alternatives (other than reduced taxes) or worst-case tax choices to avoid. The minister of finance has to take some political notice of these pressures, but is often disposed to think of them as posturing by his or her political adversaries. Ministers of finance almost never consider the opposition parties' views to be objective advice. Third, the legislature and its committees scrutinize and ultimately approve tax measures. The formal role of the legislature arises quite late in the budgetary cycle, after the government has already reached its decisions. Even the pre-budget hearings held by the Standing Committee on Finance and Economic Affairs often occur quite late in the decision process. Fourth, the governing party's caucus often supplies the frankest and most brutal criticism, in part because meetings are *in camera* and in part because discussions are, as it were, "within the family."

The budget, however, is also fundamentally a matter of "confidence" according to parliamentary rules. Party whips exert maximum party discipline since defeat on a budget measure implies the defeat of the government. The debate over the budget speech is the main order of business of the legislature for the first few days following the budget speech. But it continues intermittently throughout the session until a final vote is taken months later. Tax bills are also subject to a full process of three readings in the legislature and its committees, with the average tax bill taking two months for approval.

TABLE 11.1
Submissions to Pre-budget Hearings of Standing Committee on Finance and Economic Affairs

Year	Written submissions	Groups appearing	Dates
1987	70	30	Early February–late March
1988	40	20	15–23 February
1989	70	41	8 January–9 March
1990	54	40	15–25 January
1991	90	60	21 January–8 February
1992	[a]	20	10–12 February, but November 1991 hearings held for transfer institutions [b]

Source: G. Bruce Doern, "Fairness, Budget Secrecy and Pre-budget Consultation in Ontario: 1985–1992," in *Taxing and Spending: Issues of Process*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

a. Data not available in source.

b. Institutions receiving provincial transfer payments include municipalities, school boards, hospitals, universities, and colleges.

Since its establishment in 1986, the Standing Committee on Finance and Economic Affairs has also been a player in pre-budget consultation. Table 11.1 illustrates some of the basic facts about the committee's pre-budget processes. These data show widely varying levels of activity. Both the number of written submissions and the number of actual appearances by interest groups before the committee fluctuate from year to year. The period for the consultations ranges from less than a week to more than eight weeks.

The views of the MPPs on the process they were a part of is perhaps better revealed by some of the contents of their own reports on the hearings. For example, in 1988 the hearings involved meetings on both the budget and on federal tax reform. The 1989 hearings were preoccupied less with the budget as a whole and more with the then recently tabled Social Assistance Review Committee Report. Throughout this period the committee noted that there were some groups it wanted to hear but could not, and that groups from the Greater Toronto Area overwhelmingly dominated the hearings. The 1990 hearings involved, for the first time, testimony and discussion with firms and institutions that were involved in economic and financial forecasting (Doern n.d.).

THE MEDIA AND THE BUDGET PROCESS. The media is involved in the budget process in three main ways. First, in the run-up to the budget, the media tends to focus on the inherent partisan conflict involved in budgetary politics. Second, especially through the business press, it is an important conduit for how "the market," including international financial markets, views the government's overall financial and economic credibility and soundness. This reporting is more often centred on the substance rather than the political process of budgetary policy, albeit slanted to the fiscal concerns of business. Third, just prior to and on budget day, it contributes to the theatrical nature of the budget speech. It is especially carnivorous in the degree to which it seeks to find a "leak," an infringement of budget secrecy. The coverage of real or imagined leaks can often detract from the content of the budget itself.

Media coverage, mainly in the print media, will occasionally follow the pre-budget consultations, but not consistently or extensively. In part, this sporadic coverage is a function of print space or time, but it is also because the parade of interests lining up for the *in camera* sessions with the minister of finance is not perceived to be newsworthy. This coverage did not appear to change in 1992, when the process became more public.

THE TAX POLICY COMMUNITY. A final but by no means unimportant set of players in the tax budget process is the tax policy community (Good 1980). This community consists primarily of tax lawyers, accountants, and financial experts who not only represent corporate and other clients, but also are among the few who actually understand and work with the details of the tax system and its laws. The tax community often presents briefs to governments, as well as interacting frequently with government tax professionals.

Efforts to Reform the Tax Policy Process

The 1985 Reforms: Strengthening the Legislature's Role

In its first economic statement to the legislature in July 1985, the government of David Peterson indicated its intent to reform the pre-budget consultation process. In October 1985 the provincial treasurer, Robert Nixon, presented a discussion paper to the legislature outlining his proposals for reform (Ontario Ministry of Treasury and Economics 1985). The recommendations for reform were cast primarily in terms of the Ontario legislature's role in pre-budget consultation. The minister expressed his wish to open up and demystify the process and particularly wanted to give the process a multi-year focus. The institutions that receive provincial transfer payments – universities, colleges, municipalities, school boards, and hospitals – had long been advocating that their funding be decided upon earlier in the year and be presented as five-year commitments.

The proposals dealt with both revenue and expenditure issues and centred on a recommendation that a new Standing Committee on Economic and Fiscal Affairs be struck to:

- receive the Ontario Economic and Fiscal Outlook report;
- hold pre-budget hearings;
- review all tax legislation arising from the budget; and,
- prepare a recommendation on the overall level of provincial revenues, expenditures, and net cash requirements (Ontario Ministry of Treasury and Economics 1985, 9).

The outlook report would provide basic background information on the economy and on the fiscal outlook. It would be widely distributed to groups prior to their presentations in the pre-budget hearings. The proposals expressed the hope that participation in the hearings would be encouraged from groups "that have not previously taken part and from private individuals" (Ontario Ministry of Treasury and Economics 1985, 9). Hearings would occur both in and outside Toronto and be open to the media.

The standing committee would also be asked, among other things, to prepare guidelines on budget secrecy. The discussion paper acknowledged from the outset that the "convention of budget secrecy imposes restrictions on open consultations" and that the new proposals were intended to "minimize the effects of the convention by holding open pre-budget hearings and sharing information." However, the discussion paper also asserted that "budget secrecy cannot be eliminated entirely from the budget-making process" (Ontario Ministry of Treasury and Economics 1985, 8, 9).

There is little doubt that the 1985 reform proposals were viewed by the government as a genuine effort to reform pre-budget consultation. But the reforms were still firmly rooted in the de facto strictures of budget secrecy.

The 1990–92 Reforms: Ending the "One-on-One" Process?

While an early objective of the present government was to reform the budget process, it had to do so in the context of a deep and lingering recession, and a deteriorating situation for public revenues and the deficit (Daigneault 1993). The first budget speech by Minister of Finance Floyd Laughren, on 29 April 1991, drew attention to three elements of the budget process which the government set out to reform. First, the minister announced that a cabinet treasury board would be established because the budget control system "inherited from previous administrations simply cannot do the job." He said that "there was no effective mechanism for examining the structure of entire programs," nor any clear responsibility for expenditure management. Second, he argued that it was important "to look for new ways to involve members of the legislature and the general public, as well as our employees, in contributing to the solutions needed" in program review and reform (Ontario Ministry of Treasury and Economics 1991c, 16).

The third reform was to the pre-budget process. The minister of finance simply said he intended "to ask for the views of the Standing Committee on Finance and Economic Affairs on ways to open up the budget process to involve more public participation" (Ontario Ministry of Treasury and Economics 1991c, 16). In fact, in the run-up to the 1991 budget speech itself, Laughren had sought to widen the scope of public participation, primarily through an effort to meet with a broad range of social interest groups. Many such groups had not participated in previous budget cycles; they were added to the list of economic, business, and established social interest groups that had been regulars in the process.

But it was prior to the 1992 budget that evidence of these new reforms was really apparent. The 1992 pre-budget process differed in three ways from any previous Ontario, federal, or other provincial budget: in the nature of the information that underpinned it; in the nature of the forums and meetings held with interest groups; and in the internal evaluation of the process.

Pre-budget information consisted of three documents. First, an economic outlook paper was released in December 1991 as the pre-budget consultation program was announced (Ontario Ministry of Treasury and Economics 1991d). Written as an "accessible" document, it set out the general state of the Ontario economy. Second, a fiscal outlook paper was released late in January 1992. It set out data on the revenue and expenditure forecasts for the government's finances, including estimates of "what would happen with Ontario's finances under a 'no-change' set of assumptions" (Ontario Ministry of Treasury and Economics 1992d, 9). Third, although too late for actual consultations, was a budget guidebook (Treasurer of Ontario 1992). It included summary information on the fiscal situation, a description of the budgetary process, and a copy of Premier Bob Rae's 21 January television address about the state of Ontario's economy.

The consultations in 1992 were markedly different. Rather than one-on-one sessions, various discussions were held. The major sessions in which the minister of finance participated were usually three-hour meetings, with interaction among representatives of up to a dozen interest groups.

Discussions were organized along sectoral or thematic lines, including, for example, training, health, industrial renewal, agriculture and food, and many others. Sessions had to deal with both the spending and tax sides of the fiscal equation and were chaired by the appropriate line ministers, with the minister of finance present at all sessions.

In addition to the thematic sessions, roundtable discussions were held between the minister of finance and selected members of groups such as the Premier's Council on Economic Renewal and organizations such as the Ontario Business Advisory Committee. Some ministers, at the invitation of the minister of finance, also held pre-budget consultations, including Culture and Communications, Municipal Affairs, and Housing. The legislature's Standing Committee on Finance and Economic Affairs also held pre-budget hearings prior to the 1991, 1992, and 1993 budgets.

Minutes were kept of the sessions with the minister of finance. The minutes were copied to those who attended and to the government's budget steering committee. The minister of finance wrote to participants after the budget had been tabled, indicating the government's decisions on the recommendations made at each forum.

Should Budget Secrecy Be Ended?

While these efforts at reform are important initiatives, the issue of budget secrecy remains a key to a more open tax policy process.[1] Budget secrecy is intended to ensure that individuals do not have the opportunity for private *financial* gain owing to prior, exclusive knowledge of specific tax decisions. It is the duty of the minister of finance to see that such opportunities do not arise. If they do occur through a budget leak, then the minister is obliged to resign. As we have seen, the immediate effect of this principle is that it causes the tax budget decision process to be confined to a very small set of players – namely, the minister of finance and the premier, and their immediate senior officials and advisers. Therefore, decisions on the tax budget are not discussed among a wider set of ministers as are other expenditure and regulatory choices. As a result, they do not benefit from the expertise resident in various ministries with responsibility for policy areas to which the budget measures relate. Nor can the tax deliberations benefit from full and open consultation with interest groups.

There are three arguments against budget secrecy that address inconsistencies in practice and undemocratic effects that arise from its non-observance or selective observance.

First, ministers generally do not resign when a violation occurs or is believed to occur. Therefore, the principle is not honoured and has no real political consequences other than embarrassment and an opportunity to score partisan points. Second, such a principle should not be the basis on which ministers in an elected government are excluded from involvement in some of the most vital decisions any government must make. The exclusion of ministers and ministries has, over the years, resulted in several budgetary "mistakes" that might have been avoided through broader ministerial consultation. Third, other types of government decisions – such as expenditures, regulations, and loan guarantees – may offer equal opportunities for financial gain through prior knowledge, but these decisions are made more openly and without apparent concern about such gains.

---

[1] The Public Policy Forum, in a recent report proposing a broad range of reforms to the federal government, argued that the elimination of budget secrecy was the single most important reform.

The central case for budget secrecy is that it prevents persons from profiting by arranging their affairs with prior knowledge of budget changes. However, the case depends on showing that when secrecy is violated, the ultimate culprits – namely, those who actually could and do gain from prior knowledge – are caught and suffer the consequences. This implies a legal and investigative certainty and capacity that does not exist, in part because budget secrecy is a convention and not a statutory rule. The core principle of budgetary secrecy is often likened to insider trading issues in securities markets. In a broad sense there are similarities in the spirit of the principle, but not in the legal apparatus to enforce it. The legal system comes into play in insider trading, and both the persons giving and receiving the illegal information are investigated and could, if guilty, suffer the consequences of the law.

What would a tax decision process without budget secrecy look like? In principle, such a process might look much like other expenditure and regulatory decision processes. In short, many ministers and ministries would be involved, but one would be ultimately responsible. Consultations would occur over quite detailed tax possibilities. At some point, the main minister responsible would announce the decisions and table legislative bills. Outside interests and individuals would participate and be consulted by both the minister and the legislative committee. Business and social interest groups would lobby other ministers as well as the provincial minister of finance. The tax policy community would continue to represent clients and interact with tax professionals in the government. As the day of the announcement approached, these outside interests or individuals might second guess what the decision might be. Some may guess correctly and others may not. In theory, at the point of announcement, no one would have prior knowledge.

If this is a rough portrait of a tax decision process without budget secrecy, the natural question is: What is the problem with it? What other features would have to be considered either in principle or in relation to the practical politics of cabinet government? For example, if budget secrecy disappeared, would other forms of secrecy replace it? The answer is yes.

In cabinet parliamentary systems, the budget is a central feature in want-of-confidence rules, whereby the government must maintain the confidence of the house. Defeat on any major piece of legislation, especially on the budget, normally results in the defeat of the government. Party discipline is the vehicle through which confidence is maintained. Therefore, regardless of budget secrecy provisions, the premier and minister of finance would undoubtedly have to ensure that the central political leadership's view of overall tax and expenditure positions prevailed.

In addition, budget rules in Parliament are such that tax provisions are deemed to take legal effect immediately on being announced and tabled in the legislature. Accordingly, tax budgets in particular have a reasonably fixed and quite consequential point of announcement. In this sense they are different from expenditure and regulatory decisions. Because of these announcement realities, and especially because of the central issue of confidence, the government will inevitably be somewhat secretive in that it will want an orderly announcement at a specific time. It will not want its decisions to dribble out in a way that would both look, and be construed as, politically disorganized or incompetent.

Another link with defined announcement times is that some tax measures have to be considered and announced in relation to the exact kinds of economic behaviour or results it is hoped they will produce in the time period envisaged. For example, a temporary reduction in the sales tax on automobiles should have a date of announcement timed to encourage economic activity at a certain time. The intention is not to have citizens postpone current purchases knowing that a tax reduction is coming later. These policy realities may also cause a government to limit knowledge of an impending change, but that is not the same issue as preventing a few individuals from acquiring prior knowledge for private financial gain.

Beyond these features of cabinet government there is also the issue of cabinet secrecy, which is based on a wider set of principles tied to the desire to promote cabinet solidarity and genuinely responsible government. Thus, cabinet discussions and some cabinet information are kept secret so as to ensure that there is a frank internal discussion, including a full airing of often sharp divisions of opinion among ministers. But, once decided, cabinet decisions are to be defended in public by all ministers as definitive government policy, even by those ministers who previously disagreed with them in cabinet. There is little doubt that these norms of secrecy would also apply to the budget process, but they would not constrain it as much as direct budget secrecy principles do.

There is no principled reason why the doctrine of budgetary secrecy should continue. This is not only because of the issues previously discussed, such as the failure of ministers to resign and the almost comical nature of recent alleged budget leaks, but also because of the relative lack of importance of preventing private financial gain compared with other democratic principles. This view is strengthened when one considers the further fact that often no effort is made by any institution involved to pursue those who actually might have gained from such prior knowledge, and from the simple fact that ministers do not resign. Our view is that the principle of preventing private gain from prior knowledge should not be elevated above other principles, such as opportunities for elected cabinet ministers to be involved in and informed about a key decision of the government, and full discussion of actual and detailed tax decision possibilities. Particularly when tax policy decisions affect other policy areas, it is counterproductive to ignore the expertise in other ministries. The important contributions to the working groups made by officials from ministries other than finance give evidence of this potential benefit.

There is little to be gained by adhering to a principle that is not only discredited but unenforceable. More importantly, there are positive gains to be made by having tax decisions made to some degree in a comparable way to other decisions such as those in the regulatory and expenditure realm. The caveat "to some degree" must necessarily be added because a total absence of secrecy is neither possible nor desirable.

Such a new tax budget process could begin in the late fall with the tabling of economic and budgetary outlook papers. Business groups, social groups, and the tax community would lobby the government and be consulted by the government in three ways: normal discussions with various line departments and ministers whose programs affect them; pre-tax budget hearings held by the Legislature's Standing Committee on Finance and Economic Affairs; and pre-tax budget hearings with the provincial minister of finance in which tax issues are directly and openly discussed.

Within the government, the tax budgetary process would involve broad discussion among ministers and officials on other important policy matters. As budget day draws closer, the provincial minister of finance and the premier would stop consultations, and the work of writing the budget would be completed. The budget speech would be given and the usual legislative procedures would follow.

This process would be more open and fair, but would not open the interest-group floodgates. This is because of other features of cabinet government and of the inherent political importance of the budget. First, cabinet secrecy (as distinct from budget secrecy) would still put strictures on ministers and discipline them into reasonable collective choices. Second, the premier and minister of finance have powerful political leadership imperatives that would propel them to keep the number of players involved within reasonable bounds. Third, the announcement of tax measures would have to involve some significant confidentiality to ensure the orderly presentation and passage of policy.

RECOMMENDATION 1

Ontario should apply the rule of budget secrecy only to the details of tax changes that might enable an individual to derive financial gain through prior knowledge.

In general, the process of budget policy making should be carried out under the same restrictions as those applicable to other policy questions requiring cabinet decisions.

Improving Pre-budget Tax Consultation

The Ontario budget process as a whole has become fairer over the last decade. There have been, on balance, more opportunities for interest groups to present their views. These groups encompass a wider set than a decade ago, when business groups were the most often consulted. The legislature has had a more extensive opportunity to express its views and to hear those of Ontario citizens. Most of this improvement has come from the work of the Standing Committee on Finance and Economic Affairs. Further improvement in the legislature's role might be achieved through the holding of pre-budget hearings by the Standing Committee outside Toronto as well as in Toronto, and through televising some of the Standing Committee hearings, especially those where independent experts on the budget are testifying.

The 1992 experiment of having various interest groups present briefs for the response of both the minister of finance and other interest groups has the potential to supply a more accurate picture of consensus and division about the economy. We recognize that this innovation may be a product of the particular economic times and of the personal style of the minister of finance. But we believe these changes have continuing merit. Interest group representatives have applauded the spirit of the new format but also indicate that their support for it could evaporate unless it is accompanied by information and equal opportunities to participate.

RECOMMENDATION 2

Public multi-group presentations to, and discussions with, the provincial minister of finance should be a regular part of the Ontario tax policy process and form the basis of Ontario's budget considerations. The list of participants and any formal presentations made in such discussions should be made public by the minister.

The consultation process should be effectively open in that members of the public should be able to find out easily who is participating – and when and where. Any documents related to these consultations, whether produced by the Ministry of Finance or the intervenors, should also be made readily available. Meeting a formal requirement of being available to the public is not sufficient; convenient access is also required.

Public Finance Information: Maintenance and Access

Information is a critical ingredient in the development of a fair taxation policy process. In the past decade, two developments have contributed to a significant improvement in the quality of information available to participants in the budget process in Ontario. First, the documents now published by government in conjunction with the budget process provide a more objective foundation for public debate than existed previously. Second, more and better information is available from outside sources, both from the specialized business press and from the greater involvement of those who possess independent analytical and forecasting competence. The Standing Committee on Finance and Economic Affairs has played a particularly useful role in facilitating the involvement of independent analysts in the process.

Despite these improvements, the shortage of consistent publicly available data continues to be an impediment to informed debate on budgetary issues in Ontario. The sources of data available for budget analysis in Ontario are fragmented, and access to them is strictly limited. In some tax areas, the relevant information is not collected by Ontario at all, but is available only through the federal government. For personal and corporate income tax analysis, for example, the government relies on data collected and supplied by the federal government. In many other areas, the relevant data are the property of individual line ministries. In the local government finance area in particular, information collected by different ministries is generally difficult to compare consistently and is often collected and maintained in a form that makes it unsuitable for use in policy analysis.

The Fair Tax Commission's own work was hampered by the inadequacies in the base of information available concerning public finance in Ontario. In some cases, we had to devote significant resources from our budget to developing new sources of data and making existing sources more consistent. In other areas, it was simply not possible to develop the information necessary to take the analysis as far as we would have liked.

Both the internal decision-making process of the government and the constructive involvement of the public would be better served by a more coherent and consistent approach to data collection, database management, and the provision of information to interested outside researchers and the public.

RECOMMENDATION 3

Ontario should establish a central agency responsible for:

- **maintaining all government databases related to provincial or local public finance,**

- **ensuring consistency and comparability of those databases, and**
- **publishing information about public finance in Ontario.**

Access to provincial data sources should be provided to outside researchers and the public, subject to the personal privacy provisions of the Access to Information Act and any federal/provincial agreements with respect to confidentiality.

Accounting for Tax Expenditures

In addition to raising revenues, the tax system incorporates a series of spending programs delivered in the form of tax relief or tax deferrals. These provisions, which are not integral to defining and making operational the tax itself, are referred to as tax expenditures. Conceptually, all tax expenditures are substitutes for direct spending programs – that is, it is possible to design a direct expenditure program dedicated to the same policy objectives as the tax expenditure. In many cases, public policy has moved from one type of instrument to the other as political, economic, and financial circumstances have changed.

For example, the tax credit programs governments use to encourage firms to increase their research and development spending could be replaced by direct grant programs. Instead of the tax expenditure, a firm could be required to pay whatever taxes it owes, and the government could issue a cheque to the firm for the amount of its research and development grant. The grant program could be designed so that the effect on the firm and on the government's finances would be identical to the tax expenditure situation. The tax expenditure alternative could then be seen as purely an administrative efficiency – the two amounts are netted against each other, and only one cheque is written.

Similarly, the child care expense deduction is a tax expenditure. Rather than providing a tax deduction to parents, which costs the government forgone revenues, the government could, in principle, decide to write cheques to all parents incurring child care expenses. Alternatively, the government could choose to spend equivalent amounts providing child care spaces, which could then be made available to parents at a reduced (or zero) cost.

For the purposes of the commission, the policy objectives pursued by tax expenditures are not at issue. Rather, our concerns centre on using tax instruments to accomplish these objectives. Specifically, the concerns are threefold.

First, is a tax expenditure a fair and efficient means to pursue the policy objective, compared with direct spending instruments? For example, some tax expenditures, because of the manner in which they are integrated into the tax structure, deliver greater benefits to higher-income individuals than to lower-income individuals. Take the child care example again. Because the provision is in the form of a deduction from taxable income, it is of greater value to higher-income parents in higher marginal tax rate brackets. It is difficult to conceive of an acceptable direct subsidy system that would operate in such a fashion. It is inconceivable that the government would choose to write larger cheques to richer parents than it provides to low-income parents incurring the same child care expense; yet that is precisely the effect of the tax deduction. In terms of efficiency, certain tax expenditures that are intended to shift behaviour in some socially desired direction (for example, more research and development spending, more investment in Canadian corporations) deliver benefits to recipients who are already engaged in the targeted activity. In effect, the measure provides windfall gains rather than altering economic behaviour; in this sense the measure operates inefficiently.

The second concern is the process by which tax expenditures are developed and enacted compared with the process for direct expenditure programs. This issue goes to the heart of the accountability question. Generally speaking, direct spending programs emerge from decision-making processes that are relatively open (within the confidentiality requirements of cabinet-parliamentary government). Interest groups are often consulted in program design; several government ministries may be involved in fashioning the program; the authorizing legislation is debated in the legislature, often with a wide range of intervenors appearing before the relevant legislative committee; the spending authorization must receive, at minimum, pro forma legislative approval on an annual basis; and the provincial auditor may examine the probity and effectiveness of the program after the fact. In contrast, tax expenditures, because they are presented as tax policy rather than as spending programs, are developed in secrecy as part of the minister of finance's budget process. Other ministries are often excluded and their potential contributions are lost, even if the objective of the tax expenditure involves their mandates; consultation outside government is severely restricted for fear of violating what have become rigid budget secrecy requirements; and once the tax program is enacted, it need never be renewed, examined, or audited.

Third, tax expenditures may interfere with the desired properties of the tax system. These properties, including fairness and efficiency, among others, were discussed in chapter 4. Those advocating greater scrutiny of tax expenditures question how they affect the accountability, the development, and the integrity of tax systems. Advocates of greater scrutiny worry about policy makers overlooking tax expenditures as a possible means of reclaiming lost revenues. As a result, they maintain, tax expenditures tend to lead to gradual corrosion of the tax base. Further, tax policy makers have to raise tax rates on the remaining tax base or search for new streams of income or bases to tax. Finally, the result is a more complex tax code which becomes increasingly difficult for governments to administer and for taxpayers to understand.

There is nothing wrong with tax expenditures per se. Rather, what is at issue is the comparative advantage or disadvantage of tax expenditures over other policy instruments. In specific policy situations, this advantage should be demonstrated through more transparent accountability provisions and processes.

Currently, Ontario does not publish information on tax expenditure on a regular basis, although such information has been assembled to assist the work of the Fair Tax Commission (Block and Maslove n.d.). The federal government has published tax expenditure data, but not on a regular basis. These innovations are more prevalent in the United States than in any Canadian jurisdiction (Lindquist n.d.).

Recent changes in how tax decisions in Ontario are made hold promise for some tax expenditure reforms. The traditional budget process is not conducive to the kind of cross-ministerial perspective that should be brought to bear on the design of tax expenditures. The recent effort to bring line ministries and various stakeholders into the process on a sectoral basis is an important step in the right direction. If tax expenditures, old or proposed, are put on the table, and if discussion is well informed, final budget decisions can be influenced. However, this scenario in turn depends on curtailing budget secrecy.

We have concluded that improvements in the manner in which tax expenditures are developed, administered, and evaluated depend upon two reforms. First, the tax policy process in general must be more open and accessible to a broader range of inputs from inside and outside government. These reforms were the subject of the previous section. Second, tax expenditures should be developed and evaluated using criteria that recognize that they are, in fact, spending programs which happen to be delivered through the tax system.

Accordingly, we recommend several measures to enhance tax expenditure accountability. The recommendations seek, where possible, to work within existing processes and capacities. A multi-dimensional approach is suggested to draw attention to tax expenditures and to encourage broader analysis and debate of their effectiveness and of alternatives. Although we recognize that the Taxation Policy Branch of the Ministry of Finance will always be the lead unit and the centre of expertise for tax policy, and that it has in recent years been more receptive to outside contributions, we believe that other ministries with responsibilities in the relevant spending areas have a role to play in the design and evaluation of tax expenditures. Finally, we have also tried to make recommendations that can be institutionalized easily and will be embraced by any government, regardless of its views on the merits of particular tax expenditures.

Criteria for Tax Expenditures

RECOMMENDATION 4

Programs should be delivered through the tax system only if they satisfy the following criteria:

a) The rules for determining eligibility for the subsidy are so simple and easy to apply that application for the subsidy can be built into a tax-filing process based on self-assessment by taxpayers.
b) The program can be administered effectively by the Ministry of Finance rather than the government department normally responsible for the policy area.

c) There is a high degree of certainty the program will not be abused.

d) It is appropriate for the subsidy to be delivered on an infrequent basis in conjunction with the filing of tax returns and the payment of tax refunds.

e) Where monitoring and auditing are considered necessary, appropriate provisions are built into the design of the program.

f) The potential for costs to escalate in an open-ended program can be addressed effectively in the design of the tax expenditure program.

g) The tax expenditure program can be designed so that it does not affect the operation of the general rules governing the tax system.

If there is doubt as to whether a program should be delivered directly or through the tax system, it should be delivered directly.

The Form of Tax Expenditures

Where it is determined that tax expenditures are the most appropriate form of spending, they should be designed to parallel an equitable, efficient direct spending program.

RECOMMENDATION 5

To ensure that the benefits from tax expenditures in the income tax system do not increase with income, tax expenditures should be delivered in the form of a tax credit rather than a tax deduction.

To ensure that tax expenditures are fully equivalent to grants, they should generally be taxable. They should also generally be refundable and therefore paid whether or not the taxpayer has taxable income.

We recognize that there may be some cases where refundability of tax credits may not be appropriate. For example, a tax credit to business obviously should not be structured so that "businesses" are formed primarily to receive the refundable credit. In these cases, the presence of taxable income may be a good test of a bona fide business activity. A non-refundable credit (in effect, one that does not exceed tax otherwise owing on business income) would be a means to enforce this test.

Tax Expenditures in the Budget Process

The decision process for tax expenditures should be made systematic and essentially parallel to that for direct spending decisions.

RECOMMENDATION 6

All tax expenditures should be dealt with in the government's budget-making process in the same way as direct spending programs designed to achieve the same objectives.

a) Information on tax expenditures should be made available to pre-budget roundtables and consultations.
b) The relevant government department should be involved in the design and review of each tax expenditure program.

Monitoring Tax Expenditures

In general, our goal has been to suggest process changes for tax expenditures that would mirror the process of analysis, review, annual accounting and approval, and periodic audit to which direct expenditures are subjected. In the present system, tax expenditures tend to disappear from public view and scrutiny as soon as the budget bill that creates them is passed by the legislature. We believe this absence of scrutiny is inappropriate in any circumstances. It is particularly difficult to justify at a time when direct expenditure programs are under intense public scrutiny.

Our recommendations seek to establish a process for the evaluation and monitoring of tax expenditures that places these types of expenditures on the same footing as direct expenditures. We see no reason why tax expenditures should be exempted from annual and periodic reviews as part of the regular expenditure-budgeting process. Ontario should publish, as part of its budgetary estimates, a tax expenditure account that provides extensive information about the purposes, costs, and benefits of tax expenditure programs. This would automatically trigger an annual review of tax expenditures by the provincial auditor. To strengthen the point, the provincial auditor should be mandated specifically to subject tax expenditures to the same type of performance audit to which direct expenditures are subjected.

RECOMMENDATION 7

a) Tax expenditure programs should be monitored to ensure that they continue to satisfy criteria for delivery through the tax system as opposed to the direct expenditure system.

b) Ontario should include tax expenditures in annual program reviews. In addition, tax expenditures should be subject to periodic in-depth evaluations on a rotating basis on the same basis as expenditure programs.

c) Legislation should be introduced to expand the authority of the provincial auditor to audit tax expenditures on a basis that mirrors the process for direct expenditures.

d) Corporations should be required to disclose the benefits received from all tax expenditure provisions in the same way that benefits received from direct spending programs are disclosed.

e) Ontario should publish an annual tax expenditure account. This account should include:

- **the objectives of each tax expenditure;**
- **its statutory basis;**
- **an estimate of revenue forgone;**

> - **a description of the relationship between the tax expenditure and corresponding direct expenditure programs; and**
> - **summary tables showing the distribution of benefits from the tax expenditure among different categories of beneficiaries.**
>
> **The purpose of the account is to draw attention to tax expenditures and encourage analysis of whether policy objectives are being met or whether other approaches would be more effective and efficient.**

The recommendation regarding corporate disclosure would not mean that the tax returns or financial statements of private companies would become public. If all tax expenditures were in the form of credits, as we recommend, a company would simply file a separate schedule with its tax return, summarizing the amounts of each of the credits it received. In this way, grants paid through the tax system would be made public data in the same way that direct grants are at present.

Revenue Earmarking

Theoretical Issues

A third issue raised in the context of improving accountability is earmarking (Thirsk and Bird n.d.). The general practice in Canadian (and other parliamentary) governments is for tax revenues to be paid into a general fund (the consolidated revenue fund), which in turn is used to finance government activities. Democratically elected public officials are accountable for the taxes they levy and for the funds they spend.

Earmarking, in contrast, occurs where revenues raised from a specific source are dedicated to financing a particular set of expenditures. It is both an old and a new idea. Special purpose taxes predate consolidated revenue fund accounting by centuries (Webber and Wildavsky 1986, 29). Recently, environmentalists have advocated the earmarking of "green taxes" for environmental purposes.

Earmarking has never been in general favour in Canada and other countries with parliamentary traditions because it was thought to dilute democratic accountability. According to this view, "special funds" would weaken the control exercised by Parliament over public spending. Earmarked funds could constitute major elements of total public spending and be largely beyond the control of the elected representatives who were accountable to their electorates.

In recent years this argument has been turned on its head. Dissatisfaction with governments has increased and many people have come to believe that they have little or no power to hold their elected representatives accountable. In their view, earmarking may be the most practical way of solving this fundamental problem because taxpayers know what their payment is being used for. However, the difficulty is in determining how much people want spent and finding a way of linking what is wanted with what it costs and how to pay for it. In effect, under earmarked budgeting, tax collections drive expenditure levels, the opposite of what seems to happen under consolidated revenue budgeting. But like many budgetary concepts, earmarking requires careful examination at the level of definition, actual practice, and potential future use.

Other support for earmarking has emerged, somewhat ironically, from the political-bureaucratic establishment itself and from interest groups seeking new or expanded government spending in specific areas. For them, earmarking has come to be viewed as a way of reducing taxpayer resistance to higher taxes. Individuals may be willing to pay a new tax on the condition that revenues are directed towards a specific purpose. People concerned with the environment often argue that revenues generated by taxes designed to offset the costs to society of environmentally harmful processes, products, or behaviour should be used to ameliorate those costs.

There are many forms of earmarking available to governments. These forms involve greater or lesser degrees of flexibility in the amount of funds diverted, and the purpose for which these funds are used. Under "pure earmarking," for example, revenues from a certain tax or fee flow into a special fund and become the sole, or at least the primary, source of funding for a set of particular expenditures. By contrast, under "notional earmarking," revenues from a certain tax or fee flow into a general fund and finance only a portion of the government service in question. A final form of earmarking, termed "effective earmarking," involves a formal connection between revenues generated and a specific expenditure, even though these revenues first flow into the consolidated revenue fund (Thirsk and Bird n.d.).

A clear distinction should be made between earmarking and user fees. User fees may or may not be earmarked to finance related services. One of the advantages of user fees is that they can create a direct and clear connection between payments made and services provided. Proponents of earmarking have gone a step further arguing that, where fees are based on the cost of supplying additional units of the good or service, earmarking the revenue will result in less waste as the level of services provided coincides automatically with public demand (Thirsk and Bird n.d.; Teja and Bracewell-Milnes 1991).

However, direct user fee revenues are often unlikely to match desired expenditures on the service provided. Earmarked gas taxes, a form of earmarked user fee in the United States, illustrate the potential mismatching between revenues and expenditures. Through the Highway Trust Fund, the federal government in the United States earmarked revenues from gas taxes, which supposedly represent the cost of using transportation infrastructure, for construction of interstate highways. These taxes generated revenues that far exceeded funds required for highway projects, resulting in excess funds which, until recently, could not be directed to other purposes. Under the Intermodal Transportation Act of 1991, individual states are now allowed to direct money from this fund to public transportation and bicycle infrastructure.

Ironically, even though earmarking is often advocated on the basis of efficiency, a fee level based on the cost of supplying an *additional* unit of the service will often generate revenues insufficient to cover costs. If the charge is increased to close the gap between revenues and expenditures, the resulting price for the good or service in question may be too high and could result in a lower level of consumption than is desired. In these cases, although it is possible to levy a fee that generates revenues exactly equal to expenditures, the fee may not be desirable from an efficiency perspective.

Nevertheless, the potential exists for user fee revenues to provide at least a rough gauge of the level of service demanded by taxpayers. Changes in the level of revenues raised by a user fee may signal a public preference for an increased or decreased level of service. For example, decreased revenues from a water user fee may signal a decline in demand for water services. Through these types of revenue signals, earmarking may help communicate the public's preference for specific government activities.

Similar arguments are advanced in favour of earmarking excise taxes related to social concerns like human health or the environment. For example, interest groups often expect the tax revenues to be used for research related to the area of concern. These arguments do not necessarily suggest a form of pure earmarking. Rather, they may suggest a form of notional earmarking as a signal to the public that the government's primary concern is the social issue and that revenue generation is a secondary consideration.

However, governments may run into difficulty with notional earmarking. The issue of the Ontario Tire Tax, which levied a five-dollar tax on each new tire sold, was raised time and again in our public hearings as an example of the provincial government's failure to direct the revenue generated from the tax to the appropriate activity. In this instance, the activity was supposed to be spending money on a recycling program for used tires to avoid incidents such as the tire fire at Hagersville in 1990, which focused public attention on the tax and its obvious shortcomings. The Tire Tax was abolished in the 1993 budget.

Earmarking can also involve much looser connections, but in such cases a logical rationale is more difficult to construct. For example, a tax on smoking could yield revenues earmarked for health care. The problem is that there is no necessarily logical or desirable policy correlation between the level of payments of particular taxes and the level of expenditures on specific services provided. Earmarking could therefore lead to an extreme mismatch between funds required for a particular expenditure and revenues generated by the tax.

Earmarking in Ontario

A review of earmarking in Ontario yields two overall conclusions. First, there is much less use of earmarking in Ontario than in other jurisdictions, but that use is growing. Second, almost all so-called earmarking in Ontario is "notional" in the sense that the revenues flow into the general fund and are sufficient to finance only part of the expenditure in question.

Research conducted for the commission shows there is no pure earmarking at the provincial level in Ontario and only some at the local level. This is understandable at the provincial level where about two-thirds of the spending is supposed to be redistributive. But, more surprisingly, there is also no earmarking of road user charges or other similar charges where such practices might make more sense.

Development charges, which are directed to pay for the capital costs of development, are the only example of pure earmarking at the provincial or municipal levels of government. In past years, governments have notionally earmarked the education portion of property taxes, various environmental levies, and lottery revenues. None of these taxes, however, is very closely correlated with expenditures on the stated programs (Thirsk and Bird n.d.).

However, notional earmarking has increased in Ontario. A number of new taxes and tax increases have been justified as measures to help finance greater expenditure in areas of health, the environment, and transport infrastructure. Provincial lottery proceeds are also loosely earmarked for expenditures in areas such as physical fitness, sports, and cultural activities.

Evaluation of Earmarking

Where earmarking has a real effect on public spending in a policy field it may neither advance policy goals nor contribute to clearer accountability. Indeed, the opposite may occur. With earmarking, the amount of spending on the program may be wrong, in the sense that a responsible government would have set criteria which would have resulted in either more or less spending on the program. The result of earmarking may be to shield expenditure programs from the critical assessment they would otherwise receive from budgetary authorities, which could lead to undesirable rigidities in budget reallocations. This criticism, and the superiority it implies for the consolidated revenue approach, suggests that each instance of current or proposed earmarking must be examined closely.

Earmarking can also be criticized from exactly the opposite direction. Studies show that spending for a particular purpose does not necessarily increase when earmarking is introduced. Furthermore, research does not demonstrate any clear link between revenue increases from a particular tax and earmarking of that tax (Thirsk and Bird 1993). These results can be taken as indications of the ability of governments to transfer revenues easily between departments and programs; money from the consolidated revenue fund that would have been spent on the earmarked program is diverted elsewhere, with the result that earmarking is neutralized. In these instances, earmarking diminishes rather than enhances accountability to the extent that people are led to believe a relationship exists that, in fact, does not.

The case for earmarking is strongest when the payment of the earmarked tax is closely linked to the consumption of a particular public service. Such earmarking may contribute to economic efficiency if the supply of the public service is automatically adjusted to demand, as measured by the amount of revenue collected. Some fairness criteria can also be achieved in the sense that everyone pays the same amount for the benefits they receive.

There are no efficiency arguments in favour of earmarking taxes designed primarily to raise revenue. On the contrary, since the level of revenues raised by these taxes is divorced from the level of expenditures on any particular service, earmarking would tend to result in insufficient funds for some important programs and an over-abundance of funds for others. At the same time, if governments opt for earmarking taxes with the political objective of decreasing tax resistance and boosting revenues, evidence indicates that they may fail in these objectives and jeopardize expenditure goals at the same time.

Our recommendation on earmarking reflects our conclusion that there appear to be few if any advantages, either substantively or in terms of accountability, to loose or notional earmarking. Accountability is not served when revenues are linked only rhetorically to expenditures in order to garner support for the adoption of a new tax. For example, calling the Ontario payroll tax an Employer Health Tax is quite misleading for this reason; it is really a general tax that is no more related to health care spending than any of the other provincial revenue sources.

We advocate greater use of earmarking, on a case-by-case basis, where better user charges can be designed and implemented. In these cases, accountability, efficiency, and fairness goals can be advanced. Areas in which such fees could be implemented include roads and highways, water and sewage, garbage collection, and hazardous products disposal.

RECOMMENDATION 8

Ontario should earmark taxes for specific government programs only where:

- **the benefits from the service can be attributed to individuals;**
- **redistribution is not an objective in providing the service;**
- **public policy does not require that the service be provided as a right;**
- **efficiency and public accountability would be enhanced; and**
- **there is a clear relationship between the earmarked fee or tax and the service to be funded.**

Ontario should not create the impression that taxes are earmarked by using names that describe an expenditure program rather than the base of the tax. Ontario should therefore change the name of its Employer Health Tax.

12 Paying Other People's Taxes: Problems of Compliance

Compliance is an important element in determining how fair the tax system is for three reasons. First, a tax that is paid by some of those obliged to pay and not paid by others who are equally obliged to pay is almost by definition an unfair tax. This is particularly true if a taxpayer's ability to avoid or evade taxation is not random but is linked to a characteristic such as income, occupation, source of income, or social status. For example, a tax that is more easily avoided by higher-income taxpayers or by taxpayers whose income is derived from capital makes the system less progressive or more regressive than it is intended to be. Second, the ability of some taxpayers to avoid or evade taxation while others in similar circumstances pay more undermines both basic fairness and the general willingness of taxpayers to comply voluntarily with tax laws. For example, the abuse of provisions available to the self-employed for tax avoidance may create inequities between employees and self-employed people in otherwise similar circumstances and undermine overall confidence in the fairness of the tax system. Third, every taxpayer's success in avoiding or evading taxation is eventually some other taxpayer's tax increase. This connection has a direct impact on the value-for-money relationship that is central to society's general willingness to be taxed to support common services.

As we noted in the discussion paper released before our consultations in the spring of 1993, "for most people, the idea of tax fairness is closely linked both to the value they place on the services that government provides and to the perception that others are paying less than their fair share of taxes"(5). It is with respect to the latter set of perceptions that issues of compliance are so important. We view these perceptions with concern. The Canadian tax system is to a large degree based on self-reporting and, historically, is considered to have enjoyed a high level of voluntary compliance. This has meant that taxes have been collected in a relatively efficient and unobtrusive manner. If it were to become an entrenched view that there was widespread tax avoidance and/or tax evasion, there could be a trend to less voluntary compliance with the tax law.

When we refer to compliance we refer to taxpayers' ability and willingness to follow the tax rules in paying their fair share of taxation and to the roles of intermediaries in withholding taxes and/or providing information to the government. If compliance can be improved and be seen to be improved, then some real gains in fairness can be achieved. This is the issue addressed in this section.

Tax avoidance and tax evasion are behavioural responses of individual taxpayers to the tax system. Therefore, in coming up with strategies to address these phenomena, it is important to understand the extent of this behaviour in our society and the factors that influence it.

Tax Avoidance and Tax Evasion

Considerable literature is available on factors leading to or deterring avoidance and evasion, estimation of the size and nature of evasion and underground activities, empirical analysis of the characteristics of tax evaders (Brooks and Doob 1990), and assessments of the effectiveness of strategies to increase compliance. The literature on compliance includes studies that draw on the perspectives of several social science disciplines. From the economic perspective, the models view tax evasion as a special form of gambling. The taxpayer is assumed to choose a level of evasion which is optimal in light of the likelihood of detection and the penalties imposed on detected tax evaders. This research suggests that policy directed towards tax evasion is simply a matter of finding the appropriate mix of enforcement activities and penalties, subject of course to financial constraints on the level of enforcement activities and cultural constraints on the acceptable level of penalties (Srinivasan 1973; Allingham and Sandmo 1972; Spicer 1986).

This summary statement of research on one element of compliance brings out starkly the choices faced in this area. Improving the level of compliance probably requires more enforcement activities and higher penalties for infractions, but these both have costs to government and will also be offensive to the public to some degree. For example, additional personnel are required to increase the probability of detecting evasion, and larger fines will induce tax evaders to mount more costly defences, which may also incur more costly prosecutions (Kesselman n.d.). More enforcement means more information requirements, more audits, and, almost certainly, more situations where complying taxpayers are subjected to costs and stress in dealing with the tax administration authorities.

It is important to distinguish as clearly as possible between various types of non-compliance. Jonathan Kesselman, in a study for the Fair Tax Commission (n.d.), distinguishes three types, two intentional and one unintentional. While these types are analytically distinct, they are not always so easily identifiable in practice. One type of intentional non-compliance is tax evasion or the knowing violation of tax law. Evasion includes understating personal income (such as the income from tips, casual work in a home or on a farm, or independent contracting), not paying sales taxes, and not filing an income tax return. Another form of intentional non-compliance is abusive tax avoidance, "behaviour which intentionally attempts to reduce one's tax liability by actions which satisfy the letter of the tax law but which violate its spirit or intent." The third type is unintentional non-compliance, which refers to the "failure of a taxpayer or intermediary to remit the proper amount of tax on account of the complexity, vagaries, or even contradictions of the tax legislation or tax administrative procedures."

Unintentional Non-compliance

Reducing unintentional non-compliance is largely a matter of making the tax system simple enough that people can identify tax provisions that apply to them. As Kesselman (n.d.) points out, the complexity of the tax system has increased with the introduction of provisions to increase fairness or limit what he calls abusive tax avoidance. Unfortunately, increased complexity also increases the chances of unintentional non-compliance. If simplifying parts of the tax system is not possible because such changes would compromise other purposes or goals, one remedy is to ensure the provision of free advice to taxpayers. Unintentional non-compliance can also result from carelessness on the part of the taxpayer. However, if the cost of failing to comply is high, it is likely that individuals will be more careful than when the cost is low.

Intentional Non-compliance

It is in the nature of the tax system that the existence of rules invites taxpayers and their professional advisers to come up with ways around them or with interpretations of them that favour their economic positions. The more complex the rules, the greater the scope for creativity in interpretation. Tax administration has been described as a game of chess between tax professionals who work for tax authorities and whose goal is to clarify rules and make outcomes certain, and tax professionals who advise taxpayers and whose goal is to broaden areas open to interpretation in the tax system and then to support interpretations that favour their clients. In this game of chess, there is a fine but indistinct line between "aggressive tax planning" (which finds the broadest of grey areas in the tax regulations and presents the most favourable interpretation that is still within reason) and straight-out non-compliance with tax laws. Drawing the line has generated its own rules. The distinction between legitimate tax avoidance or tax planning and what is described as abusive non-compliance has found its way into recent Canadian legislation through the establishment of a General Anti-Avoidance Rule (GAAR). This rule attempts to make the distinction on the basis of whether or not the taxpayer's actions in question were primarily motivated by a tax purpose (Kesselman n.d.). There is a correspondingly fine but indistinct line between aggressive enforcement of tax laws and harassment. As the controversy concerning Revenue Canada's enforcement activities towards small business in the 1980s demonstrated, the drawing of this line can be an intensely political process.

One way to make the distinction between compliance and non-compliance easier is to keep the system as simple and as clear, and therefore as certain in its outcomes, as possible. The kinds of rough justice rules described in the next section are one way to simplify the system. Simplifying the basic rules themselves might also be productive.

Addressing a Grey Area: Accounting for Benefits

For most people, payment of tax is relatively straightforward, even if it may be unpleasant. With respect to sales taxes, we are occasionally offered the chance to join the underground economy as a consumer and pay a no-tax price in cash. With respect to income tax, opportunities to avoid tax are limited or non-existent for most people. In Canada, tax on wage and salary income is deducted at source. Pension, interest, and dividend income is automatically linked to taxation records and therefore is automatically known to tax authorities. Most of the commonly used deductions from tax are readily traced. RRSP contributions must be supported by official receipts. Even a child care deduction for a baby-sitter must be supported by reporting the social insurance number of the care-giver. In fact, for most Canadians, Revenue Canada could generate virtually a complete tax return without the taxpayer filing any documentation.

Taxpayers who are self-assessing because they operate a business, either incorporated or unincorporated, and taxpayers who receive perquisites from their employers whose value is not automatically reported to tax authorities face a different situation from most wage and salary earners. They are able to make choices about how they comply with the tax system and therefore have more options open to them for legitimate tax avoidance. Studies of income tax evasion show that "the absence of source withholding [and] information reporting ... is most conducive to evasion" (Kesselman n.d.).

Many of the choices available to taxpayers arise from the fact that certain business expenditures provide a personal benefit to an employee or owner of the business. Examples frequently cited include business meals, attendance at entertainment or sporting events, business or convention travel, home office expenses, and the personal use of a company car or other property of the business. The concern arises because these expenditures are deductible as expenses to the business, but are not recognized as taxable benefits to the individual employees or business operators who benefit from them. This means that employees or business owners receiving such benefits are in a better position than other employees who receive a taxable salary and purchase the same goods or services out of their after-tax income.

The issue of non-taxable benefits such as those described above is a difficult one. In theory, the way to achieve equity between those who receive perquisites and those who do not would be to determine the value of the good or service received and add it to the income of the employee or the business owner for tax purposes. This is done for employees when the employer makes certain payments on their behalf such as premiums for group insurance programs. However, in only a limited number of cases does the employer make specified payments on behalf of the employee.

Many examples are more complex. One relates to meals and entertainment expenses. If the meal or entertainment is a social occasion with clients or staff, the expenditures involved may be equivalent to personal expenditures on such activities for the employee or owner. On the other hand, if the expenses are incurred during regular travel or business, there may be no benefit other than replacement of the presumably lower costs of eating at home. Indeed, there may be a negative element in that the person is forced to be away from family and home. However, to the extent that the benefit is compensation for being away from home, it is equivalent to a bonus and should, in principle, be subject to tax. As a practical matter, it is impossible to differentiate in an administratively effective way among the range of different situations. If taxable benefits were ascribed to employees or owners in all such situations, there would be legitimate complaints about fairness, not to mention the outcry about the administrative headache of attributing such expenses to individuals.

Compliance can also be difficult. For example, employees driving company cars that are available for personal use clearly derive a benefit from this arrangement. In theory, employees could keep records of the personal versus business use and a taxable benefit could be allocated on this objective basis. In practice, this has proved one of the most contentious areas in determining benefits. There are frequent disputes about the extent of the benefit received, and many employees fail to keep adequate records.

The approach that has gradually evolved federally and provincially is to use rules of rough justice that either provide a formula for determining the benefit taxable to the employee or limit the deductibility of expenses involved to the employer. An example of the former approach is the so-called stand-by charge for employees who have a company car available for personal use. A taxable benefit of 2 per cent of the capital cost of the car is assessed for each month the car is available. An example of the latter approach relates to meals and entertainment expenses, where the employer is allowed to deduct only 80 per cent of the cost of meals and entertainment expenses for federal income tax purposes. In Ontario, beginning in June 1993, only 50 per cent of costs of meals and entertainment expenses are deductible for purposes of the corporate income tax, although the limit applicable to unincorporated businesses remains at 80 per cent because such businesses are taxed through the personal income tax and are subject to federal tax policy. The most extreme form of this type of rough justice rule denies the deduction of an expense altogether. For example, since 1971, expenses incurred in using or maintaining such property as hunting and fishing lodges, yachts, and golf courses have been denied except where these are used in an actual business of providing such services for sale.

As noted above, in theory these items should be allowed as deductible expenses to the business and treated as taxable benefits to the employee or proprietor receiving them.[1] This would result in symmetrical treatment between these benefits and other employee benefits that are already taxed. It would also impose the tax on the individuals who are the most direct beneficiaries of the activities. However, this treatment would be difficult to implement. For example, in some cases it would be very difficult to distinguish between benefits enjoyed by employees of a firm and those enjoyed by its customers; if the same approach were not extended to the latter group, the opportunities for abuse would be significant. If this approach were adopted by Ontario alone, compliance costs would be significant for companies operating in more than one province.

We have concluded that the rough justice approach is the most appropriate one to follow in dealing with the difficult issue of employee and owner benefits from business expenditures. The difficulties are compounded because the issues pertain to both the personal and the corporate income taxes, and involve both federal and provincial statutes. Governments should work towards developing a workable and fair set of rules for these expenses. This approach should not be punitive, but should provide a reasonable balance between discouraging use of non-taxable benefits, while allowing continued deduction of a portion of actual business costs.

---

[1] In the case of an unincorporated business, this would amount to the same treatment as disallowance of expenses when the proprietor or partner is the beneficiary.

RECOMMENDATION 9

Ontario should seek the agreement of the federal government to establish and strictly enforce rules applicable to corporate expenditures which provide employees with personal benefits such as meals expenditures. Where possible, the personal element of such expenditures should be attributed as income to those who derive the private benefit.

Where it is not practical to attribute benefit to individuals, the corresponding deductions by the business incurring the expense should be limited.

The same limits should apply to business expense deductions, whether they are claimed by a corporation or by an individual claiming deductions from income from self-employment.

Ontario should seek the agreement of the federal government to disallow any deduction for business entertainment.

Tax Evasion: The "Underground Economy"

When tax avoidance becomes tax evasion, the taxpayer crosses the line between legitimate economic activity and the "underground economy." The underground economy is a phrase used to describe economic activity in which taxpayers fail to report income or sales for tax purposes either completely or in part, and thereby practise tax evasion. By this definition, any kind of business, incorporated or unincorporated, can engage in underground activities.

Taxpayers should be concerned about the extent of such activities. They lead indirectly to higher taxes on legitimate business activities and undermine the fairness of the tax system as it affects individuals. However, as Kesselman (n.d.) points out in his study for the commission, it is individuals who benefit: the "main beneficiaries of income tax evasion may be purchasers of goods and services produced by evaders (as well as those workers who are particularly efficient at evasion)." Since it is individuals who often benefit from evasion, the challenge facing tax authorities and society in general is to make the public aware of the costs to everyone of the underground economy.

Comments in the commission's public meetings and consultations suggest that the public believes that the underground economy is an important and growing problem. While we agree that the underground economy is important, we decided at the outset to limit our general research on this issue. This was partly because previous research has had difficulty in providing useful information on the size and the nature of such activities. It also was partly because we would not be in a position to obtain and analyse the crucial internal information on compliance at the federal level (through the personal income tax and the Goods and Services Tax); there were therefore strict limits on what could reasonably be achieved.

The introduction of the GST by the federal government was of particular interest to those concerned about tax evasion through underground economic activity. The federal government argued that a multi-stage form of sales tax would increase compliance: the paper trail created by the system of credits and invoices would aid enforcement, and the availability of credits for taxes paid on inputs would support voluntary compliance.

Critics argue that compliance is not necessarily assured by the multi-stage character of the GST; in some cases it has the opposite effect. The independent contractor or self-employed person who provides a service or good without acknowledging a sale avoids paying income tax on the profit and collecting and paying GST on the sale price. Thus, the GST actually increases the marginal tax associated with moving "above ground" and increases the reward associated with functioning underground. This effect is somewhat moderated for those businesses with high cost inputs because the GST credit for these inputs is of significant value.

The net effect of these influences would determine the actual change in compliance. One recent study concluded that the effect of higher tax rates has dominated and that there has been an increase in the underground economy since the introduction of the GST. The study also noted that:

> One cannot pretend that any precise estimate of the underground economy can be achieved. The actual increase in the underground economy could be either larger or smaller than the number estimated ... How-

> ever, the preponderance of the evidence suggests that the federal government was over optimistic when it predicted that introduction of the GST would actually reduce tax evasion. This suggests that enforcement of the GST will require considerable additional auditing effort and other measures to increase compliance. (Spiro 1993, 6)

The public has a right to expect that evasion and underground activities not lead to a loss of the essentially self-assessing nature of the tax system. As Spiro (1993, 6) observes, "any increase in the underground economy represents a decline in respect for legal modes of behaviour and a weakening of the social contract among Canadians." Accordingly, we believe that increased attention to the problem of tax evasion is warranted at present. Because of the importance of this issue for the legitimacy of the underlying values of the tax system, the benefits from more stringent enforcement would outweigh the financial and other costs involved.

One approach to the problem is to focus on the kinds of income or activity in which tax evasion is prevalent. The study by Kesselman for the Fair Tax Commission points out that tax evasion is more common when no tax is withheld and when reporting of information is not required. Changes in administration could introduce improvements. In Australia, for example, tax evasion in the home renovation business has been addressed by requiring that the person contracting for the work withhold the tax payable on the work. A similar example might be to require applicants for building permits to indicate the name of the contractor performing the work on the permit. Although this kind of approach may not be appropriate in Ontario, it illustrates the point that enforcement measures may have to be tailored to meet possible underground economy activities.

Another approach is to return to the basic factor that influences tax avoidance behaviour – the taxpayer's perception of the risks and rewards associated with tax avoidance which pushes or crosses the limits set by law. If aggressive tax avoidance or tax evasion represents a gamble by the taxpayer, the enforcement response should be to increase the probability of inappropriate or illegal behaviour being discovered and/or to increase the potential loss associated with being caught – to make the odds less favourable to the taxpayer and to increase the amount at risk for the taxpayer.

There are a number of ways to raise the probability that tax evasion will be detected. The most obvious is to increase the numbers of taxable transactions subject to audit. The higher the proportion of tax returns or retailers or border crossings that is subject to audit or inspection, the greater the risk that illegal behaviour will be discovered. Over the years, the provincial auditor has recommended increased audit coverage in particular for the retail sales tax and for corporate taxes.

The coordination of enforcement activities associated with different taxes can also increase the probability of detection. Among the advantages to the government of raising revenue for public services through a mix of taxes is the fact that it is difficult for taxpayers to organize their affairs to avoid many different taxes simultaneously and the fact that information collected in connection with one tax can be used to enforce improved compliance with others.

The most obvious way to increase the amount at risk to the taxpayer in tax evasion is through the fines imposed for evasion. The evidence suggests, however, that with relatively low audit or inspection rates, and therefore relatively low probabilities of detection, fines have to be very large to ensure greater compliance (Kesselman 1993, 15). Since the most common penalty is nothing worse than a requirement that tax owing be paid, possibly with a modest penalty for late payment, the structure of fines would have to be altered dramatically to achieve any appreciable result. It will be important to assess the effectiveness of recent initiatives in Ontario that increased the penalties for non-compliance for a number of taxes (Ontario *Budget* 1993, 34).

Adverse publicity, with the attendant impact on the taxpayer's public reputation, could also be made part of the enforcement process. The problem associated with both of these measures, however, is that draconian fines and wide publicity would likely generate public opposition. Publicity concerning efforts to enforce compliance generally, however, is potentially effective. Because audit rates can never reach 100 per cent, much of the benefit from enforcement efforts will inevitably flow from changes in the behaviour of taxpayers who are not audited, but who believe that they will be. Strategic targeting of audit activities and publicizing cases of detection will influence taxpayers' perceptions. If taxpayers believe that the odds of tax evasion being detected and punished have gone up, it will likely decrease.

Better coordination of tax policies generally would also help deter evasion. For example, the treatment of home offices is an enforcement problem in the income tax system. Taxpayers not only get the benefits of office space available to them at very low marginal cost, they are also able to deduct a portion of the costs of operating their homes in determining taxable income. At the same time, for municipal tax purposes, they continue to treat their properties as entirely residential. One approach to limiting abuse of this provision would be for municipalities to recognize home offices as legitimate commercial property uses in residential areas and to tax them accordingly. The federal government could then require evidence that the commercial tax rate has been paid on the portion of the residential property claimed as a home office. The double bind faced by the taxpayer in this instance would be similar to that created by the rule that requires child care expenses to be supported by the social insurance number of the care-giver.

As the examples above suggest, however, there are many creative ideas for tax enforcement that would not be acceptable to the public. Enforcement of tax compliance must rest on a resolution of the tension between the need for revenue and the public policy need to encourage compliance on the one hand, and the government's sensitivity to criticism by the public as a result of tougher rules or more aggressive enforcement on the other.

Finally, it is also clear that there needs to be more cooperation among governments and within branches of government. Currently, the federal and Ontario governments exchange audit information on corporate tax returns. There seems to be scope for increasing this exchange of information to include payroll taxes. In many cases, evasion encompasses several tax sources, and this type of activity should be given the greatest priority and attention. For example, in looking at the implications of changing the tax mix on tax evasion, Kesselman (1993, 4) notes that activities most likely to evade income and taxes are "ones that operate on a small scale, receive payment by cash (or small cheques), escape tax withholding and information reporting, and sell their goods or services to the household sector." The federal government seems to be moving in the right direction in this respect with its intention to integrate its administration of sales and income taxes. In addition, every effort should be made to ensure greater cooperation federally and provincially in identifying and prosecuting underground activities. This would be accomplished more easily if a single national sales tax is established as recommended by the commission. Administration and compliance issues particular to the operations of the provincial retail sales tax and the GST are dealt with in chapter 24.

RECOMMENDATION 10

Ontario should improve compliance by:

a) simplifying rules and administrative procedures to make compliance with tax laws easier for taxpayers;
b) increasing rates of audit and penalties to increase the risk associated with non-compliance;
c) making the public aware of the enforcement of tax compliance;
d) improving cooperation among tax authorities within the provincial government and among levels of government to enforce tax compliance;
e) emphasizing cooperative efforts with other levels of government in identifying underground economic activities; and
f) devising special enforcement, reporting, and withholding requirements to address compliance problems in particular areas of the underground economy.

13 Strengthening Ontario's Role in Income Tax Policy

The personal income tax is the largest single source of revenue for both the provincial government and the federal government. It also plays an important role as a mechanism for delivering social and economic policies. Despite the importance of the personal income tax for both levels of government, however, personal income tax policy and administration are dominated by the federal government. Through the federal-provincial Tax Collection Agreements for the administration of the personal income tax, Ontario cedes to the federal government its constitutional authority to impose its own taxes on personal income, agrees to link its personal income tax to the federal personal income tax, and relies on the federal government for the collection and administration of the tax. While federal administration of personal income tax collection conserves the administrative resources of governments and the compliance resources of taxpayers, the agreements limit Ontario's ability to design the income tax to meet its own needs and social goals.

In this chapter, we review the extent to which Ontario's policy flexibility is limited by the Tax Collection Agreements, consider the extent to which these limitations are appropriate given the importance of the income tax in Ontario's revenue system, and present recommendations for changes to the agreements which will enhance Ontario's policy flexibility while maintaining the benefits for Canada of unified income tax administration.[1]

---

[1] Some history of the Tax Collection Agreements is provided in chapter 6.

The Federal-Provincial Tax Collection Agreements (TCA)

Under the current agreement the federal government defines the types of income subject to tax; deductions from income, exemptions, and non-refundable tax credits; and tax rates, tax brackets, and indexation factors.[2] The provincial personal income tax (PIT) rate is calculated as a percentage of the Basic Federal Tax.

Under the terms of the agreements, the federal government bears all the costs of administration including forms, processing, audit, collection, and prosecutions. The federal government retains moneys from interest in arrears on overdue taxes, fines, and penalties levied on both federal and provincial amounts of income tax. As a fee for processing claims filed for Ontario's tax credits, the federal government charges 1 per cent of all credits processed. Ontario, in turn, must follow the federal model in its legislation, regulations, and interpretations. Ontario accepts as final all decisions of the minister of national revenue without the benefit of consultation or discussion. The federal government has complete power over interpretations and advance rulings. There is no interest credited to Ontario on Ontario PIT collected but not yet paid to the province, but neither is there interest charged on overpayments of Ontario PIT. The federal government assumes all bad debts for PIT assessed but not collected. Ontario receives all of the amount assessed, regardless of whether it is collected or not.

The federal government agrees to audit 2 per cent of all Ontario tax credit claims. There is no provincial input into the federal audit strategy, which is implemented primarily for federal results. Enforcement and investigation strategies are the responsibility of the federal government; objections and appeals are the sole responsibility of the federal government. The federal government conducts any actions, suits, or prosecutions on behalf of Ontario. Ontario may assist the federal government in the conduct of any matter related to the action.

---

[2] Material from this section comes from Ontario, Ministry of Revenue (1991a).

Benefits and Constraints of the TCA

The benefits of the TCA to Ontario include:

- charge-free processing, audit, collection, and prosecution;
- provincial tax amounts being based on tax assessed, whether collected or not; and
- cost-reduced processing of provincial tax credit schemes.

Another benefit, argued by the federal government among others, is that the tax harmony achieved by the TCA promotes the free flow of resources and the efficient allocation of capital and labour, thereby increasing Canada's competitiveness in world markets and stimulating economic growth (Canada Department of Finance 1991c, 5).

The restrictions that the Tax Collection Agreements place on provincial tax policy making relate to the definition of the base, the setting of rates, and the use of tax credits. The fact that tax policy is developed without provincial participation is also a significant issue for many provinces. An important constraint on Ontario's ability to reform aspects of the personal income tax is the exclusive federal power to define the base.

The provincial income tax rate is a single rate levied on the Basic Federal Tax. As a result, Ontario must accept the federal government's definition of taxable income. Some provinces have received permission to levy a very low flat tax on net income, but even that is federally defined. For instance, Saskatchewan and Manitoba levy a flat tax of 2 per cent of net income while the Alberta government levies a flat tax of 0.5 per cent of taxable income. These taxes are in addition to the basic provincial rate.

In order to increase the progressivity of the personal income tax at higher income levels, some provinces levy a PIT surtax. Ontario's surtax as of July 1993 is 20 per cent of provincial tax between $5500 and $8000, and 30 per cent of provincial tax in excess of $8000 (Ontario *Budget* 1993, 21). All the other provinces that levy a surtax calculate the amount on the provincial tax, except Manitoba, which levies its surtax on net income, and Saskatchewan, which levies the surtax on the sum of provincial tax and the province's flat tax.

Ontario must receive federal approval for any tax credit scheme that induces investment or investor location exclusively in the province. Ontario has received approval for property and sales tax credits, the Ontario Home Ownership Savings Plan (OHOSP) credit, which is income tested, and the Ontario Investment and Employee Ownership Tax Credit. Other provinces offer credits for investment in provincially based companies (Hartle 1993). In Quebec, a deduction is allowed for strategic investments that encourage investment and entrepreneurship in the province. Hartle concludes that it will be "increasingly difficult for [Ontario] to abstain from introducing similar provisions" (1993, 86).

Provinces can initiate tax reduction programs for those with low incomes. Ontario has a basic Ontario tax reduction of $205 and a reduction of $395 for each dependent child under the age of 19 and each dependant with a disability (Ontario *Budget* 1993, 21).

Under the existing arrangements, the federal government denies the provinces a role in the development of PIT policy. Not only are the provinces not consulted on possible changes to the PIT, but the federal authorities do not give the provinces prior warning of PIT changes. Some argue that the parliamentary rules regarding budget secrecy make it impossible to consult the provinces on substantive matters. However, the federal government could announce its intention to consider certain tax structure changes in advance of the budget and consult on these proposals without compromising the important aspects of budget secrecy (Hartle 1993, 88–89).The issue of budget secrecy is discussed at greater length in chapter 11.

The Cost of a Separate Personal Income Tax for Ontario

The idea of Ontario establishing its own independent personal income tax system is not a new one. The issue was studied most recently by the Ontario Economic Council in the early 1980s. If Ontario were to adopt a separate PIT as Quebec has done, the province could design a PIT system more sensitive to its needs and priorities. In addition, operating its own PIT would allow the province to ensure that the taxation of business income is consistent for income of an incorporated business, taxed under the corporate income tax, and income of an unincorporated business, taxed under the PIT. There are, however, potentially significant costs associated with a separate PIT, including administrative, compliance, economic, and political costs.

Administration and Compliance Costs

The primary reason Ontario agreed in 1936 to allow the federal government to collect its PIT was that the province could reduce administrative costs. The Ontario government continues to benefit under the TCA from savings in administrative costs, while Ontario taxpayers save in compliance costs.

The most easily measured costs to Ontario if it were to establish its own PIT would be the additional administrative costs. Substantial development and operating costs would be incurred to establish a separate PIT for Ontario. Cost estimates to administer a separate Ontario PIT were developed by the Ontario Economic Council (Hartle 1983, 180–92) and the Ontario Ministry of Revenue (Hartle 1983, app. 4A). These estimates are presented in table 13.1. (Note that the estimates are in 1982 dollars.)

In addition to the cost of operating the system, Ontario's costs would include the bad debts on taxes owing, which the federal government absorbs at present. However, it is possible that interest penalties the province could collect might offset these losses. This has been Quebec's experience (Thompson 1984, 191). Finally, even if Ontario established its own PIT, the cost of running the federal PIT would continue to be borne by all Canadians, including Ontarians.

Compliance costs which are incurred by taxpayers or by third parties, such as employers, would also increase. If Ontario established a separate PIT, there would be set-up and ongoing compliance costs for both employers and taxpayers. These costs would be in addition to the costs of complying with the federal tax system.

Taxpayers incur the following compliance costs:

- the cost of gathering and reporting tax information, including phone calls, travel, and postage;
- if they choose, the cost of engaging professionals to complete their tax returns, engage in tax planning, or appeal decisions of the authorities;
- opportunity costs (forgone leisure and labour) for individuals who do their own tax planning and complete their own returns; and
- psychic costs including anxiety and, as Adam Smith noted, "vexation" (Sandford 1973, 3).

TABLE 13.1
Estimated Administrative Costs of an Ontario Personal Income Tax (1982 $)

Basis for estimate (1982)	Annual costs ($ millions)	Start-up costs ($ millions)	Person years
Ontario Economic Council estimate	75–100	60	3775–4125
Ontario Ministry of Revenue estimate based on Revenue Canada costs[a]	116.3	31.5–36.5	3764
Ontario Ministry of Revenue estimate based on Revenue Canada costs[b]	56.1	29.2–34.2	1800
Ontario Ministry of Revenue estimate based on Quebec Revenue costs	70.5	29.8–34.8	2350

Sources: Douglas G. Hartle, "The Federal-Provincial Tax Collection Agreements: Personal Income Tax Coordination," in *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, 1993), 192; Letter from T.M. Russell to D. Hartle, 26 Nov. 1982, in Douglas G. Hartle, *A Separate Personal Income Tax for Ontario: An Economic Analysis* (Toronto: Ontario Economic Council, 1983), app. 4A.

a. This estimate was derived from the estimates for Revenue Canada Taxation.

b. This estimate was derived using an estimated cost of $1.22 for every $100 tax collected in 1981–82 by Revenue Canada Taxation.

On the basis of the Quebec experience, the Ontario Economic Council estimated that the additional marginal cost of completing the provincial return is about 25 per cent of the total cost of preparing the combined federal and provincial returns. Adding together the cost of an estimated number of returns being completed professionally and the implicit cost to those who do the work themselves, the Ontario Economic Council estimated total costs in 1982 of $75 million to $225 million (or a best guess of $150 million) for taxpayers in Ontario to complete a separate PIT form (Hartle 1983, 210).

Cost of compliance to third parties (employers) of a separate PIT include:

- the one-time cost of the computer system or software necessary to calculate both the federal and Ontario deductions and the additional costs each time the rules are changed;
- the annual cost of calculating the appropriate amount of income to deduct from employees, remitting that amount to the government, and reporting the total to employees at tax time;
- the cost for those firms that provide assistance to their employees in completing tax forms; and
- the cost of complying with a government-initiated audit.

In a study prepared for the Fair Tax Commission, Erard and Vaillancourt (1993) develop estimates of the additional costs of compliance (for taxpayers and third parties) if Ontario levied a separate PIT. They determine that an Ontario PIT system, similar in structure and complexity to the current Quebec system, would result in an additional $370 million per year in compliance costs. Start-up costs would be about $275 million. Under a modified separate PIT system that continued to rely on federal administration but with provincially determined credits and rates, the estimated increase in ongoing compliance costs would be approximately $38 million per year. Initial start-up costs would be $129 million (Erard and Vaillancourt 1993, 161). Table 13.2 summarizes their results.

Economic and Political Costs

If Ontario established a separate PIT, other provinces might follow Ontario's lead. Without another coordination mechanism, this could result in a patchwork of tax systems across the country, something that could hamper the flow of capital and labour across provincial boundaries. It might also produce intense competition among provinces for mobile capital and skilled labour, which could result in "beggar-thy-neighbour" tax policies.

TABLE 13.2
Compliance Costs of an Ontario Personal Income Tax

Groups	Changes	Scenario 1 Ontario PIT system similar in structure and complexity to Quebec PIT system	Scenario 2, case 1 Ontario PIT system with federal taxable income base; Ontario administration of provincial PIT system	Scenario 2, case 2 Ontario PIT system with federal taxable income base; federal administration of provincial PIT system
Ongoing compliance cost change: taxpayers	Average change per taxpayer	$23.04	$5.46	$5.19
	Total change	$167.8 million	$39.8 million	$37.8 million
Ongoing compliance cost change: employers	Average change per taxpayer	$27.59	$27.59	$0.00
	Total change	$200.9 million	$200.9 million	$0.00
Ongoing compliance cost change: financial institutions	Average change per taxpayer	$0.53	$0.53	$0.00
	Total change	$3.8 million	$3.8 million	$0.00
Ongoing compliance cost change: all groups	Average change per taxpayer	$51.16	$33.58	$5.19
	Total change	$372.5 million	$244.5 million	$37.8 million
Total start-up costs: all groups	Average start-up cost per taxpayer	$38.10	$31.94	$17.69
	Total start-up costs	$277.4 million	$232.6 million	$128.8 million

Source: B. Erard and F. Vaillancourt, "The Compliance Costs of a Separate Personal Income Tax System for Ontario," in *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, 1993), 161.

There could also be a political cost if Ontario established a separate PIT (Hartle 1993, 87). Given the relative fragility of national unity at this time, Ontario's withdrawal from the TCA could be taken as yet another symbol of national disintegration.

Instead of establishing a separate PIT, a viable option would be to renegotiate the TCA to secure Ontario's participation in decisions to change the PIT and develop rules regarding measures by which Ontario can pursue policy goals (Hartle 1993). In 1954 when Quebec established its separate PIT, the federal government was insisting on rigid uniformity in its arrangements with the provinces. In 1991 the federal government released a discussion paper on the TCA. In the preface to the paper, the minister of finance expressed concern about "the implications for complexity and tax harmony should provinces choose to establish separate tax systems" (Canada Department of Finance 1991d, i). However, the paper did raise for discussion several possible changes to the agreements:

- The definition of taxable income would remain under the federal government's jurisdiction; however, the federal government indicated that it might be prepared to allow provinces to levy their tax on taxable income rather than the Basic Federal Tax.
- The provinces would be able to define a multi-rate tax structure on federally defined taxable income with no limit to the number of brackets and rates.
- Provinces would adopt the federally defined block of non-refundable tax credits but would be able to establish their own value for the credits, set their own income thresholds and reduction rates, determine whether the unused portion of non-refundable credits may be transferred to related individuals, and determine how all of the above change with time.

In light of recent federal willingness to consider changes to the TCA, it is less likely that Ontario would need to establish a separate personal income tax to achieve its tax policy goals (Hartle 1993).

We conclude that if the TCA can be amended acceptably, Ontario will be able to accomplish most of its social and economic objectives while remaining within the agreements. The additional powers that Ontario potentially could exercise through a separate PIT are not sufficient to justify the higher administration and compliance costs involved.[3]

Although the 1991 federal discussion paper contains the basic framework of an acceptable new arrangement, we recommend several specific changes.

RECOMMENDATION 11

Ontario should seek amendments to the federal-provincial Tax Collection Agreements that permit it to:

a) levy its tax directly on the income base rather than the "tax-on-tax" arrangement currently in place;
b) determine the number of income tax brackets and the rates applicable to them independently of the federal government; and
c) define and determine the value of its own tax credits independently of the federal government.

If either order of government wishes to offer tax expenditures at the expense of the PIT base, it should bear the full cost of these programs and not place the other government in the position of having to carry a share of the cost without having any input into the tax expenditure decision.

RECOMMENDATION 12

Ontario should seek amendments to the federal-provincial Tax Collection Agreements that allow both levels of government to determine tax expenditures independently by:

---

[3] The Fair Tax Commission responded to the federal discussion paper in December 1991. The recommendations made in this chapter and elsewhere in this report, if enacted, would address the issues we raised in that position paper.

a) ensuring they are in the form of tax credits rather than deductions, exemptions, or exclusions from the base; and/or

b) empowering the provincial government to define an "adjusted income" base that would enable it to add items back into its base that the federal government chooses to exclude.

The provincial personal income tax relative to the federal government's is much larger than it was in 1962, when the Tax Collection Agreements were first signed. As a result of this increased provincial prominence, we believe that Ontario (and other participating provinces) should have greater input into tax policy and administration. Ontario should be able to determine, along with Ottawa, the audit strategy to be followed for tax returns from its jurisdiction. Further, more regular consultation and consensus building should precede tax policy changes that would affect the provinces. This could be done through meetings of federal and provincial ministers of finance and their officials.

RECOMMENDATION 13

Ontario should seek amendments to the federal-provincial Tax Collection Agreements that give it a role in income tax policy and administration by:

a) providing for direct input by the provincial government into the audit and enforcement activities of the federal government involving Ontario taxpayers; and

b) institutionalizing formal consultation in advance of any federal decision affecting the definition of the income tax base.

Part Five
Defining the Tax Unit Fairly

14 Equality of Women and Men

The drive for equality of women and men has been one of the dominant movements of the 20th century in Canada. It has challenged virtually every aspect of our economic, political, and social life. By drawing attention to inequality between women and men, it has affected the way we deal in public policy with family relationships, the raising of children, and the role of women in the workforce. By focusing attention on the different impact on women and men of provisions that appear to be gender neutral, it has also affected the way we think about fairness.

The equality of women and men raises important questions for the design of the income tax system. The most fundamental issue is the choice of the family or the individual as the unit of taxation. With the individual as the unit, individuals are taxed solely on the basis of their own income. As an alternative, the income subject to tax might be the aggregated income of a larger unit defined by marital/partnership status or by membership in a particular group relationship or "family." The choice of the tax unit and the way the tax system deals with the presence of and the incomes received by other family members have important implications for the treatment of women and men.

The Canadian and Ontario personal income tax system (described in the appendix to chapter 8) is based on the individual as the unit of taxation, with some modifications based on the marital/partnership unit. In this chapter, we explore the philosophical and economic foundations for the choice of tax unit, examine the tax benefits and burdens currently associated with conjugal and family status, and identify those areas in need of basic reform to improve fairness in their treatment of women and men.

Individual or Family Income – Which Should Be Taxed?

Who Controls Income and Who Benefits from It

Traditionally, the choice of tax unit reflects acceptance of a theory of either control of income or benefit from income. Government may assess tax in relation to income over which the taxpayer exercises control; this implies that the person who earns the income is the relevant unit and that tax should be assessed on the individual. Alternatively, taxpayer units could be defined to reflect the shared enjoyment or benefit couples or families derive from sharing household income. The latter approach places minimal importance on the individual rights of members of the group and makes some basic assumptions about how couples and families share resources.

The 1966 Royal Commission on Taxation (Carter Commission) looked at the control/benefit issue and assumed that families pool income and share living expenses, providing cost savings unavailable to those who live alone. It endorsed the family (husband, wife, and minor children) as the appropriate tax unit on the grounds that it best reflected ability to pay.

Individual and Familial Rights and Obligations

In our view, the choice of tax unit raises issues somewhat broader than the question of who controls income and who benefits from it (although arguments around this question were considered). The choice of tax unit also involves questions concerning individual rights and can have a profound impact upon their enjoyment. It reflects what we as a society think about various kinds of relationships, what we assume about how these relationships function, and how we value these relationships as individuals and as members of a democratic society. It is also a mirror of our beliefs about what economic consequences can or should flow from our relationships to others and theirs to us.

At one level, the choice of tax unit reflects values contained in the general law – for example, family law, the law of contract, trust law.

The financial implications of such laws may have an impact upon our ability to pay tax, and therefore on the factors determined to be relevant to tax law. These legal obligations are based in part on judgments reflecting societal views on a variety of issues, including the meaning of family and the rights and obligations that flow from conjugal and familial relationships. For example, they currently have an impact on how we define conjugal relationships for tax purposes in relation to sex (the requirement that a spouse must be of the opposite sex) and the presence or absence of contractual relationships (marriage or common law).

A family can be defined by conjugal status, biological relationships, or shared economic reliance. The definition of family should be responsive to the changing social patterns that reflect the various ways people choose to live. Because tax provisions have been crafted to address and respond to the rights and responsibilities imposed by the general law, tax law not only reflects but reinforces the values upon which the general law is based. It is imperative, therefore, that we recognize that the choice of tax unit and tax definitions can either promote fairness or compound inequity embedded in the general law.

Since the introduction of income tax in Canada in 1917, the individual has been the unit of taxation (Lahey 1992, 2). That choice has been modified by provisions to reflect the impact of family support obligations on the individual's ability to pay, the shared economic reliance of the family, the ability of families to use their relationships to avoid tax, and the needs of efficient tax administration. Although there are a number of exceptions, "family" has been defined traditionally, largely restricting tax benefits and burdens to married persons and their children. As a result of the Charter of Rights and Freedoms, the validity of these provisions has been called into question. Since 1985, when the equality rights section (section 15) of the Charter was proclaimed operative, provisions applicable to couples and families have been subjected to judicial scrutiny to ensure they do not offend the principles of the Charter. Underlying these challenges is the recognition that the tax system is not purely a means of collecting moneys to fund the activities of government, but that it serves as a mechanism for reinforcing traditional values or stereotypes.

Court challenges of the tax treatment of women, and common law and same sex couples, have illustrated how social and legal policy does not reflect the changing composition of families. In the February 1992 federal budget, the government introduced a provision, effective 1 January 1993, that common law, opposite sex couples would receive the same treatment as married couples for tax purposes.[1] Further tax changes may result from the 1992 decision of the Ontario Human Rights Tribunal in the Leshner case, which found the province's failure to extend survivor benefits to gay and lesbian couples discriminatory. In many cases, Charter challenges to tax law have attempted to spearhead proposals for change in the general law.

In highlighting the value judgments regarding individual and familial rights and obligations underlying the choice of tax unit, we do not mean to obscure the fact that the choice is also a function of the principles of taxation described earlier in our report – horizontal and vertical equity, economic neutrality, simplicity, administrative ease, and so forth. However, these fiscal elements should not obscure the value judgments such a choice reflects.

Income Pooling in the Household

Much of traditional tax policy analysis has been based on the assumption that income is pooled in the household. However, although the study of intra-family distributions of income has been limited, the evidence available suggests that a complex process of resource allocation within families results in a variety of arrangements. It confirms that not all women in couple relationships have complete access to, or equal control over, the income of their spouse. As a result, the assumption in traditional tax policy analysis that all income is pooled may be inaccurate (Woolley 1991, 13).

Some countries – for example, the United States and the United Kingdom – use the married couple as the unit of taxation.[2] Advocates of using this method argue that the appropriate measure of ability to pay for family members is total family income. However, using the

---

[1] Under the new definition, a spouse includes both married and common law spouses. A common law spouse is defined as a person of the opposite sex with whom an individual is currently cohabiting in a conjugal relationship. The two individuals must have had such a relationship for at least 12 months or must be the natural or adoptive parents of a child.

[2] For a description of their models, see Lahey (1992).

couple rather than the individual as the unit of taxation appears more equitable only if one assumes that income is pooled. Given this assumption, using the individual as the tax unit in a progressive tax system results in couples with the same joint income, but split differently between them, facing different tax liabilities. Couples with only one earner appear to face the greatest burden. However, it has been shown that single-earner couples may have greater ability to pay than two-earner couples with the same income. This conclusion is based on the increased work-related costs of double employment and the reduced income in kind that results from spending fewer hours in home production activities (Lazear and Michael 1990).

Changes in Family Living

In addition to the individual and the marital/partnership unit, a "family" or other defined group could be considered an appropriate tax unit. However, the growing diversity in the living arrangements of Canadians makes it difficult if not impossible to base a tax system on any one definition of a family unit.

Although most Canadians live in families,[3] the proportion of Canadians living in families is declining (La Novara 1993, 12–14). In 1971, 87 per cent of all Canadians lived in a family as a spouse, parent, or never-married child, and by 1991, the proportion had declined to 83 per cent. Seniors, especially women, are much less likely than younger people to live in a family; in 1991 just 44 per cent of women aged 65 and over lived in a family. Of the 17 per cent of the population not living in a family, the largest proportion lived alone (8 per cent of the total population). Presumably, the figures for single person households will increase with rising life expectancies and increased pressure on traditional families.

The structure of families has also changed considerably in recent decades (La Novara 1993, 12–14). Married couples still account for

---

[3] The "census family" as defined by Statistics Canada refers to a married couple or a couple living common law (with or without never-married sons and/or daughters of either or both spouses/partners), or a single parent of any marital status, with at least one never-married son or daughter living in the same dwelling (Statistics Canada 1993e, 229).

the majority of families, but the proportion has declined to 77 per cent in 1991 from 80 per cent in 1986. The number of common law families has increased to 10 per cent of all families in 1991 from 7 per cent in 1986. The number of one-parent families, most of which are headed by women, has increased, partly because of increases in the divorce rate, and also because of a growing incidence of never-married women raising children on their own. One-parent families accounted for 9 per cent of all families in 1971, and represented 13 per cent by 1991. Family size has declined; in 1991, 35 per cent of families in Canada did not have children living with them.

As these figures show, there really is no form of family that can be described as typical. The ways in which the tax unit might be modified to take into account personal relationships, in light of the variety of family structures, are addressed below in the sections on the marital credit and on child support, and in chapter 16 on the role of the tax system in social policy.

Labour Supply

Economic literature on the impact of taxes on individuals' willingness to seek paid employment suggests that two offsetting factors are at play. One effect – the income effect – is that a lower take-home wage because of taxation tends to increase labour market supply as (primarily) women strive for a target income level after tax. The other effect – the substitution effect – is that labour market supply tends to decrease because the lower take-home wage makes non-market activities relatively more attractive. These two effects influence behaviour in opposite directions, and the net impact is not clear. However, there is some evidence that women's participation in the paid labour market is more sensitive to variations in wages than is men's.[4]

Married women's labour force participation rates in Canada have in fact been increasing over the past 20 years, likely as a result of

---

[4] Many researchers have attempted to measure the net effect of income taxes on labour supply decisions. Estimates of the size of the responses vary across studies. For an overview of these results, see Munnell (1980, 261) or see individual studies: Killingsworth and Heckman (1986). For a Canadian focus, see Nakamura and Nakamura (1981) and Woolley (1991).

economic necessity rather than tax considerations. The participation rate of married women in Canada in 1992 was 61 per cent (62.9 per cent in Ontario); that of married women 45 years and over was 41.7 per cent; and that of married women between 25 and 44 was 75.9 per cent (Statistics Canada 1993h, table 3, B-8; table 4, B-10). If the couple is used as the tax unit, women's employment income may bear higher marginal tax rates than it would with the individual as the tax unit, thus creating a disincentive to women's participation in the labour force. A spousal tax unit increases the relative attractiveness of domestic activities and strengthens the disincentive for women to engage in paid labour.

Effect of the Tax Unit on the Autonomy of Women

The choice of tax unit should be founded on broad social principles and values as well as ability-to-pay principles. To lump a woman's income with that of her spouse conflicts with the goal of women's autonomy.

We agree with the statement that:

> Income tax legislation should not interfere in social relationships. For the state to enter the realm of marital or family units has underlying it a perpetuation of patriarchal values which are anachronistic and untenable in a society that is heading, somewhat hesitantly, into an era of equality. (Maloney 1989, 187)

As the Australian Asprey Committee[5] noted:

> The adoption of a compulsory family unit basis must be rejected on grounds of general social principle. At a time when women are playing an ever greater role in the economic and other affairs of society, the withdrawal of this right would certainly be regarded as a retrograde step. (Munnell 1980, 261)

---

[5] K.H. Asprey chaired the Australian Taxation Review Committee, which reported in 1975.

Concerns with neutrality also underlay the recommendation of the Canadian Advisory Council on the Status of Women that recognition of marital status in the Income Tax Act should be reduced to a minimum (Canadian Advisory Council 1987).We noted with interest a suggested variation on the individual as tax unit, proposed by Julie Nelson of the University of California, which attempted to address issues of neutrality and equity such as those that arise in the context of the Canadian model. Nelson suggests that rather than accepting "the (presumably autonomous) individual" or "the (presumably unitary) family" as the proper unit of taxation, one should consider people as individuals-in-relation, and look at the relationships, economic or otherwise, that we consider to be important for tax purposes (Nelson 1991, 22). In the Nelson model, the tax unit is defined as an individual earner plus his or her dependants. Earners receive a tax credit for each dependant. Dependants are defined as persons who are unable to support themselves for reasons such as youth, advanced old age, or chronic disability and who therefore rely on the earner for economic support. Under this definition, as a departure from the Canadian model, dependants do not include productive, able-bodied adults.

The Nelson model enhances fairness since tax payable ceases to depend on living arrangements and marital status. Moreover, this system increases neutrality with respect to paid labour supply and divisions of labour within households. If a couple chooses to have one partner engage exclusively in domestic labour and the other partner exclusively in paid labour, they do not receive a tax subsidy unavailable to a couple in which both partners engage in paid labour (Nelson 1991).

In our judgment, the argument that a couple should be the unit of taxation because of its ability to pool income and share expense is not persuasive. We view as a serious concern the impact of taxation based on family resources on a woman's willingness and ability to work outside the home. We cannot ignore the damage that would result from masking the individual economic contribution made by women and sublimating rather than encouraging their economic individuality within the family unit. Taxation should respect, support, and encourage a woman's economic autonomy.

RECOMMENDATION 14

To continue the recognition in the tax system of the economic independence of men and women, the individual should be retained as the unit of taxation in both the federal and provincial income tax systems.

The Marital Credit

Although the Canadian income tax, for the most part, takes the individual as the tax unit, exceptions to the rule are made to:

- recognize conjugal and family relationships and legal obligations imposed by other branches of law (in particular the family laws of each province), which may have an impact on ability to pay tax;
- recognize the economic mutuality of families and to encourage and protect the family as a form of social organization;
- prevent tax planning;[6] and
- permit the efficient administration of the act.

In the present income tax law, special provisions have been made to reflect the impact of family support obligations on the individual's ability to pay. Such provisions include the credit for married status, the equivalent-to-married credit, the dependant credit, and the child care expense deduction. (The dependent child credit was eliminated beginning in 1993.) These provisions raise two questions: What relationships, if any, should be taken into account in determining ability to pay? In what way are the relationships relevant?

The marital credit was of particular concern to the commission. The credit is available to a taxpayer supporting a spouse earning a

[6] Familial bonds, dependencies, and shared interests are also the foundation on which tax reduction is based. Many tax-planning techniques to defer or minimize tax depend upon the splitting and shifting of income, capital, and other tax benefits (losses, tax credits, refunds, costs) to others, often family members or controlled entities (corporations, trusts, and so forth). Kroft (1989, 32:4) points out that any shifting or splitting of tax benefits usually requires another person. These other persons or "tax units" are generally members of the taxpayer's immediate family or corporate group. Sometimes intermediaries owned by taxpayers are established merely to permit the taxpayer to obtain a tax benefit.

low income or earning no income. The amount of the credit is reduced by income earned by the spouse with the lower income. In 1993 the maximum value of the federal credit is $914.60. The maximum value of the Ontario portion is $530.47, which gives a maximum total value for an Ontario taxpayer of $1445.07. That amount is reduced as spousal income rises above $538. The credit is primarily claimed by male tax filers with incomes under $50,000. Prior to 1993, it applied only to married couples. Beginning in 1993, it applies to common law spouses.The credit has been defended as a means of compensating women (albeit through their husband's tax returns) for the value of household labour.[7] It has also been argued that the marital credit constitutes an indirect social contribution to the cost of raising children. The latter argument is not supported by the evidence.

Table 14.1 presents a profile of those who claimed the marital credit in 1989. The table also shows that about half the claimants of the marital credit have dependent children; therefore, the other half of these who claim dependent spouses do not have dependent children. Compared with all tax filers, claimants are under-represented at incomes less than $30,000 and over-represented in the other income ranges, particularly those between $30,000 and $60,000. We can see no reason why the tax system recognizes spousal dependency, especially when it no longer recognizes dependent children and when approximately half the couples claiming the benefit have no dependent children. (In chapter 16, we present our views regarding the role of the tax system with respect to children.)

In our view the credit should be abolished as a matter of equity between men and women, and between women who work in the home and those in the paid labour market. The credit implies a social preference to subsidize unpaid work in the home over paid work in the formal labour market. In fact, a study for the Royal Commission on

[7] Supporters of compensating household labour argue that labour provided by women contributes to the economic well-being of the family and can be quantified by comparison with market-based alternatives. It has been argued that valuing home-based labour and compensating women for it with a more generous marital credit, which would be payable to them, could provide women working in the home with income as well as a basis for creating their own pension rights through RRSPs or the CPP.

TABLE 14.1
Claimants of the Marital Credit in Ontario, 1989

Income category ($)	Percentage of all taxpayers	Percentage of married credit claimants	Percentage of married credit claimants with dependent children
(Loss)	0.3	0.3	36
0–9,999	26.5	9.7	43
10,000–19,999	21.9	16.8	34
20,000–29,999	18.8	16.8	39
30,000–39,999	13.5	19.3	58
40,000–49,999	8.2	15.2	61
50,000–59,999	4.6	9.8	62
60,000–69,999	2.2	4.6	62
70,000–79,999	1.1	2.6	64
80,000–89,999	0.6	1.3	56
90,000–99,999	0.5	1.0	45
100,000–149,999	0.9	1.5	59
150,000 and over	0.8	1.2	54
Total	100.0	100.0	50

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file for Ontario, 1989.

the Status of Women suggested that as the wage-earning spouse benefits from this unpaid labour, a value should be assigned to the labour so that it can be included in the tax base (Hartle 1971). One estimate sets the value of unpaid household work in Ontario in 1986 at between 29 and 36 per cent of gross provincial product (Jackson 1992, 3.8).

However, although some see the credit as compensation for household labour, it is not structured as a credit for women's unpaid labour in the home, but as a tax break for dependency. The size of the credit and the fact that it is typically payable to the husband do not reward women for household duties. The credit is available regardless of what labour is performed in the home or who does it. In any event, household labour is not the sole domain of women who are full-time homemakers. Many women assume a double burden when they work outside the home by continuing to provide the bulk of domestic labour in their households in addition to their participation in the workplace. Research shows that, when wives hold jobs outside the home, their combined workload is significantly greater than that of their husbands (Gunderson and Muszynski 1990, 25).

Is it appropriate for the statute to recognize home-based labour at all? Everyone must keep house to some extent or pay for the service. As it is an expense that is incurred independently of earning income, it is not truly relevant to the determination of an individual's tax liability. To so recognize it would incorporate an element of personal expense into the Income Tax Act which is, and should remain, extraneous to the calculation of tax liability. To retain it as a meaningful way of compensating for household labour would contradict basic tax principles and complicate the statute. How should household labour be valued? Should it differ if performed by a man or a woman? What if someone has a particularly small house or is a bad housekeeper? If more than one person in the family performs housekeeping functions, should it be split? What these questions make clear is that the labour necessary for maintaining a household is really not relevant to tax at all.[8]

Assumptions regarding the relationships of adults to each other and the obligations of support between them are clearly changing. Our operating assumption is that the ability of adults to support themselves is unrelated to their relationships. The appropriate solution, then, is to abolish the marital credit. To continue the credit institutionalizes the presumption that one member of the household, usually the woman, is responsible for household work and economically dependent on the earner, generally the man.

The issues raised by the marital credit are also raised by provisions in the Canadian tax system for the transfer of unused tax credits to a spouse. The lower-income spouse is allowed to transfer unused nonrefundable credits to the higher-income spouse. These credits include

---

[8] It is sometimes also argued that the credit may create a disincentive to women's participation in the labour force, and that the effect may be significant given that some studies have concluded that married women's labour force decisions are more sensitive to taxes than are men's (Woolley 1991, 22). While this may have been the case prior to 1988, when the marital provision was in the form of a deduction, a credit provision with a credit rate equal to the lowest marginal tax rates essentially eliminates this concern. Small exemption differences aside, the rate of tax women would pay on their earnings without the marital credit is essentially the same as the implicit tax rate with the credit.

amounts for age (for a spouse who has reached the age of 65), pension income, disability, and tuition fees and education.

RECOMMENDATION 15

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the marital credit and redirect the funds through a reformed credit system.

Ideally, the marital credit should be removed at both the federal and the provincial level. Failing that, Ontario could act alone if the Tax Collection Agreements were amended to increase its flexibility. It should be noted, however, that, acting alone, Ontario could eliminate only about one-third of the marital credit currently available to couples.

In addition to the rules providing for a marital credit and for the transfer of unused spousal credits, there are other provisions that recognize married and common law couples and that may result in a reduction of tax liability. These provisions include the ability to transfer dividend income from Canadian corporations; spousal rollovers of capital property during lifetime or on death; and provisions with respect to spousal RRSPs and the treatment of RRSPs on death. We have not made any recommendations regarding these provisions for the following reasons:

- Dividend income from taxable Canadian corporations can be transferred to the higher-income spouse if, as a result of this transfer, the higher-income taxpayer can increase his or her claim for the marital credit. If the marital credit is eliminated, taxpayers will no longer have reason to use this provision.
- The provision that capital property can be transferred to a spouse or a spousal trust without immediate tax consequences provides relief from liability for the capital gains tax which would normally arise on a profitable disposition of capital property. Instead, the property is subject to capital gains taxation only when sold by the transferee spouse. We considered it unfair to levy taxes which might force the sale of property transferred between spouses

when it may in terms of fairness, if not legally, be the property of both spouses.This is consistent with our position (chapter 19) that a wealth transfer tax should permit the transfer of wealth to a surviving spouse without tax consequences.

- The provision allowing for a deduction of up to $6000 for periodic RPP (registered pension plan) or DPSP (deferred profit sharing plan) transfers to a spousal RRSP (registered retirement savings plan), over and above the normal contribution limit allowed to the contributor, will end in 1994.
- The provision allowing a taxpayer a deduction for contributing to the spouse's RRSP instead of, or in partial fulfillment of, the taxpayer's own tax deductible contribution is intended to provide an incentive to enable the non-income earning spouse or low-income spouse to have independent funds for retirement. It is recognized that the provision may be used by high-income, one-earner families as an income-splitting device, because the funds must be left in the plan for only a three-year period before they are taxed on withdrawal as the non-income earning spouse's income. However, this is not seen by the commission as a sufficient reason to recommend eliminating the provision when it is weighed against the value of encouraging contributions to independent funds for a spouse's retirement. Later (chapter 16), however, we do set out some principles for the reform of the tax treatment of RRSPs more generally.
- The provision that RRSPs left on the death of a taxpayer to a spouse can be transferred to the spouse's RRSP without tax consequences is the equivalent to a pre-retirement survivor's benefit in a pension plan and should be retained.

Child Support Payments and Alimony

In 1990 almost half the marriages in Canada ended in divorce (Statistics Canada 1992g, 44). The present income tax law also makes special provisions regarding support obligations in the case of divorce or separation.

Currently, if one former spouse pays child support to the other, the paying spouse (usually the father) deducts the amount from his income, and the custodial spouse (usually the mother) adds it to hers. In this way some part of the father's income is deemed to be part of the mother's income for tax purposes.

Participants at roundtables set up at our public hearings to discuss women's issues consistently made the point that including child support payments in the recipient's taxable income is unfair. Women gave countless examples of economic hardship caused by the taxation of these payments, and questioned why a non-custodial parent was, in their view, "rewarded" by being allowed to deduct child support expenses from their income, while parents who stayed within the family unit could not.

From a tax policy perspective there are several justifications for the current system:

- If a deduction is claimed by a payer, it follows that the recipient should pay tax on it.
- As a matter of equity, taxpayers with incomes from several sources should pay the same amount of tax.
- A tax deduction offered to a payer may offer an incentive to pay child support, and to a greater amount than if the payment were not deductible.
- Because the tax subsidy goes to the payer (usually a higher-income father) and the income is taxable in the hands of the recipient (usually a lower-income mother), this income is taxed overall at a lower rate than it would be if a deduction did not exist for the payer. As a result, more after-tax income is available for the needs of the children. (Federal/Provincial/Territorial Family Law Committee 1992, 84)

Regarding the first two points, concerns have been expressed about the equity of a tax subsidy to either the payer or the recipient. Should non-custodial parents receive a subsidy for payments made to support their children when no such subsidy exists in the tax system for intact families? Deductible expenses are generally allowable in the Income Tax Act only if they are for the purpose of earning income. Clearly child support is a personal expense. Moreover, the principle of equal treatment of equal incomes does not hold since child support payments are not income for the custodial spouse, but the reimbursement of costs borne by the custodial parent which both parents are obliged to share (Townson 1993, 19).

As for the third point, there is no evidence that the deduction is an adequate incentive to pay. Seventy-five per cent of support payers in Ontario are to some degree in default (Ontario Ministry of the Attorney General 1992). Among other things, this situation contributes to high rates of poverty for single mothers and especially their high rates of dependency on social assistance. Default, however, may have less to do with ability to pay than other factors such as dissatisfaction with access and child custody, or the separation or divorce agreement in general (Canadian Institute for Research, cited in Zweibel 1992, 15). At most, removing the deduction might marginally aggravate the non-payment problem. Furthermore, the availability of the deduction, which has existed since the 1940s, may not be taken into account by the courts or by separating spouses in calculating amounts of support (Zweibel 1992, 16).

Finally, with regard to the fourth point, it does not appear, despite their higher incomes, that non-custodial fathers are in significantly higher tax brackets, especially since the reduction in the number of tax brackets in 1988 (Zweibel 1992, 18).

We also examined how the tax subsidy promotes, maintains, or reduces the disparity in income between separated men and women. A 1990 federal Department of Justice study *Evaluation of the Divorce Act*, reported that women were awarded sole custody of their children in three-quarters of cases and that in 98 per cent of cases the direction of support is from the father to the mother. Women and children in general bear the greatest financial consequences of divorce or separation. In 1991, 42 per cent of poor children in Ontario lived in single parent families headed by women, and 44 per cent of such families were poor (Fair Tax Commission calculation based on Statistics Canada Survey of Consumer Finances microdata files). The majority of recipients of support payments[9] in Canada in 1990 (64 per cent) live in single parent families, and support payments represent 18 per cent of the average family income of recipients. By contrast, the majority of payers are unattached or from husband and wife families, and support payments represent only 9 per cent of the average income of payer families (Galarneau 1993). Using hypothetical examples constructed from data in the Department of Justice study, Zweibel (1992, 25–26) has shown that the tax treatment of support

[9] The data used do not distinguish between support payments made on behalf of the former spouse and those made on behalf of the children. It is likely that most payments are on behalf of children, given the current trend in divorce cases.

appears to contribute to rather than decrease this disparity of living standards between custodial and non-custodial parents.

The deductibility of support payments has to be considered in the context of what governments should be expected to do about ensuring that non-custodial parents assume their obligations, legal or otherwise, to support their children. If governments should have a role, there are far better ways of ensuring obligations are met than providing a tax deduction to non-custodial parents. One of the implications of the deduction is that society is providing a public subsidy for those families in which the payments are made, and doing very little for those in which the payments are not made. The high rate of default suggests the need for enforcement, rather than incentive. Ontario's Family Support Plan Amendment Act, which came into effect in March 1992, requires employers to withhold alimony payments (payments for the maintenance of a spouse or children) from the wages of employees delinquent in their payments.

In the final analysis, the tax system is not a particularly appropriate way to solve the problems and conflicts of separated and divorced families. And the well-being of children may suffer if they lose the support of a parent who has the resources, and has an agreement or an order to pay. If the federal government or Ontario wants to provide a cash benefit to parents for the support of their children, it would be far better to do so through federal or provincial child benefits than through a tax subsidy to non-custodial parents.

In summary, we conclude that current treatment of child support payments is inconsistent with the tax unit principles outlined above. A parent's support obligation to their children should not change when a marriage is dissolved. Therefore, there is no reason why the costs of child support for a parent who no longer lives with their family should be deductible, any more than there is for a parent who continues to live in the same dwelling with spouse and children.

The tax treatment of support payments for spouses (alimony) is a related issue. The 1968 Divorce Act distinguishes between orders for support payments for spouses and those for children. In current divorce law, spousal support payments reflect contributions to the spousal relationship through income, property, or domestic labour, although with the current trend in divorce cases favouring financial self-sufficiency of former spouses, spousal support increasingly is neither requested or granted. The income tax treatment of spousal support paid periodically is the same as the treatment of child support. (Lump-sum payments made as a result of the dissolution of a marriage are not deductible.)

In terms of horizontal equity, it would appear that spousal support payments should be deductible by the payer and taxable in the hands of the recipient. However, for women with dependent children who are receiving both spousal and child support, it may be inequitable and difficult to separate the two types of payments for taxation purposes. Under the Ontario Family Law Act, one of the considerations in determining spousal support requirements is ensuring that the economic burden of child support is shared equitably, with the result that the spousal support amount may be partially based on the needs of the children.Furthermore, if spousal support were taxed differently from child support, there would be an incentive for non-deductible child support to be provided in the form of deductible spousal support for tax advantage. Finally, spousal support payments deductible by the payer and taxable in the hands of the recipient would provide an income splitting opportunity not available to married couples.

RECOMMENDATION 16

Ontario should seek the agreement of the federal government to abolish the deduction for child support and alimony payments in the personal income tax. These payments should not be taxable in the hands of the recipient.

We have not recommended that Ontario act alone to abolish the deduction. Federal action applicable to all provinces is necessary because of cases where one parent lives in Ontario and one outside Ontario. If Ontario acted alone to abolish the deduction, then either no taxation or double taxation would result. A supporting parent living outside Ontario could claim a tax deduction, and the custodial parent living in Ontario would pay no tax, with the result that the portion of income provided for support would be untaxed. Conversely, a supporting parent living in Ontario would pay tax on the portion of income provided for support, and the custodial parent living outside Ontario would also pay tax, with the result that the support payments would be subject to double taxation.

A supplementary issue follows from this recommended change. Because existing support arrangements were determined under the existing tax provisions, it would be unfair to apply the new arrangements to them. We therefore recommend that existing arrangements be "grandparented"; that is, current tax law should continue to apply to previously determined arrangements. Over a number of years, this arrangement would be phased out automatically as the children on whose behalf support is being paid become independent.

Part Six
Social Policy Issues and the Tax System

15 Understanding the Tax Transfer System

Most people think of the tax system as a mechanism for taking money from people. Few people consider it a mechanism for giving money to people. But the tax system is an integral part of Canada's income security system. As part of the federal and provincial social policy framework, the tax system provides benefits in various forms to increase the disposable income of specific groups, including people with low income, families with children, people with disabilities, and seniors. Tax benefits stand beside unemployment insurance, old age pensions, disability insurance, child benefits, and social assistance as part of the panoply of programs that provide support to individuals and families for a wide variety of reasons. Tax-related benefits are so much a part of the Canadian system of income security that it is now widely referred to as the *tax transfer system*.

Because of this interrelationship between the tax system and the transfer system, it is impossible to draw a sharp line between tax issues and social policy issues. As a result, a review of this aspect of the tax system must consider the fairness of the system from a social policy perspective as well as a tax perspective. We looked at particular types of income security benefits currently delivered through the tax system, and we considered whether or not the tax system was the best mechanism for delivering those benefits. We also considered general reform options such as a negative income tax or guaranteed annual income, since this particular option is often suggested as a better alternative to the existing complex array of programs and would certainly imply more complete integration of the tax transfer system. As well we addressed the specific issue of the very high benefit reduction rates on earned income faced by people who receive social assistance benefits and the impact of those rates on their ability to move into the labour market. Individuals receiving social assistance and their advocates raised this issue at our public hearings. They questioned the fairness of a tax system that set up financial barriers to breaking out of the poverty cycle and entering the labour market. Why bother going to work, they said, when you end up being financially penalized for earning those few extra dollars?

The Elements of the Tax Transfer System

Direct Transfers

Direct transfers are cash benefits paid to individuals or families and administered outside the tax system. These benefits include programs such as the Canada Pension Plan (CPP), unemployment insurance, Old Age Security (OAS), the Guaranteed Income Supplement for seniors, workers' compensation, and social assistance.

Social insurance programs, like unemployment insurance and the Canada Pension Plan, are the cornerstone of the income security system. Generally financed through earmarked payroll taxes, they provide income replacement for people who qualify because they have made contributions over time and because they have lost their wages owing to unemployment, maternity, retirement, sickness, or disability.

Governments sometimes provide universal transfers – flat rate benefits to all people in an eligible population – as a social right. A program that pays the same amount to everyone is called a demogrant. Because demogrants are often taxable, higher-income people who face higher marginal tax rates actually receive a net benefit after tax which is considerably less than someone with a low income and a low tax rate. Until last year there were several demogrant programs in Canada. In 1992 the federal government abolished the flat rate family allowance program and the province of Ontario abolished the flat rate property tax grant that was paid to most seniors. Although the federal government has retained the flat rate Old Age Security program, the fact that since 1989 high-income recipients have been required to pay back some or all of the benefits they received means that it is no longer a real demogrant. Flat rate benefits can also be provided through the tax system, and several such tax provisions are discussed in chapter 16.

Income supplementation programs, such as the Guaranteed Income Supplement for seniors or Gains A in Ontario, provide a supplement to certain people with low incomes. These programs are often called income-tested because eligibility is determined by a test on a family's level of income, with benefit entitlements declining as income rises. At some point, which varies with the program in question, no benefit is paid because a family's income is too high. Because the tax system is a good mechanism for "income testing," governments are increasingly turning to it to deliver income supplementation benefits. These we call tax-related benefits, although they are really direct transfers which operate either partially or wholly through the tax system.

Social assistance is the system of support for people who have no other income and also lack the means to support themselves. Eligibility is determined through the application of a rigorous test of income, assets, and the costs people in need face. There are two kinds of tax-related benefits: tax relief and refundable tax credits.

Tax Relief Benefits

Benefits delivered through the tax transfer system involve no direct expenditure by the government, but because they reduce the taxes individuals would otherwise have to pay, they result in lower tax revenues for the government. In this sense, they are "tax expenditures." Such benefits may take the form of "credits" or "tax reductions" which are amounts deducted from taxes owed. The value of a credit or tax reduction to a taxpayer is the same, regardless of the taxpayer's income. Other tax benefits or tax expenditures may be delivered through the tax system in the form of a "deduction" – that is an amount, such as the child care expense deduction, which is deducted from income before calculating the tax owed. Because the personal income tax is progressive, the value of a deduction to a taxpayer increases as the taxpayer's income increases. A non-refundable credit is similar to a demogrant, with one important difference: some people receive less than the standard amount or nothing at all because their incomes are so low that they owe little or zero in taxes.[1] Non-refundable credits currently in the personal income tax system include the disability credit, the age credit, the pension income credit, and the medical expenses credit. The Ontario Tax Reduction program for taxpayers with low levels of tax payable is, as its name indicates, a tax reduction program. Major social policy–related tax deductions include the deduction for child care expenses and the deductions for contributions to retirement savings plans. We discuss these measures in detail in chapter 16.

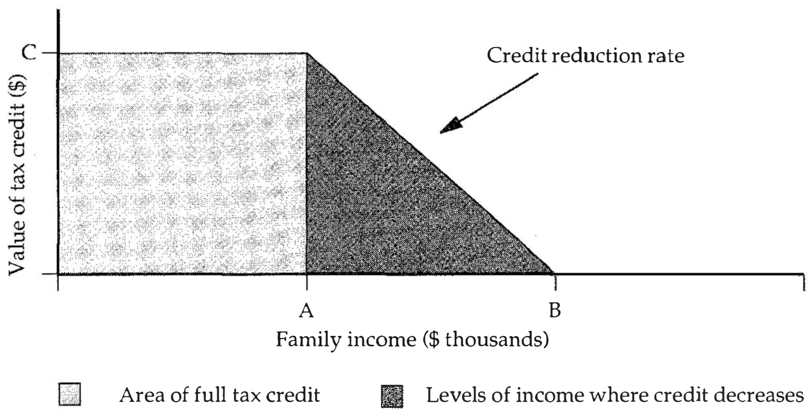
Non-refundable credits reduce taxes for individual taxpayers resulting in lower overall tax revenues. Under the current Tax Collection Agreements, non-refundable credits are determined by the federal government. However, they reduce both federal and provincial tax payable. Ontario's tax loss for each non-refundable tax credit, which amounts to 58 per cent of the federal tax expenditure, is a policy commitment over which Ontario has no influence.

Many people do not see tax relief as a form of government spending but its value for recipients is equivalent to cash benefits provided directly. For a government, tax relief provided to specific groups can achieve the same social policy objectives as if it collected the tax and paid a direct cash benefit. However, a major problem with providing benefits in the form of tax relief is that the real impact of social policies is often hidden from public view. The effect of tax system delivery is to obscure design features of the benefit that would clearly not be considered acceptable in the design of a direct grant program. For example, a flat rate or demogrant program that provided benefits to every senior or every person with a severe disability, but excluded those with low incomes, would undoubtedly be considered outrageous. Yet the fact is that the age and disability tax credit programs have precisely this effect.

---

[1] Some non-refundable credits are transferable to a spouse if they are unused. See chapter 14.

FIGURE 15.1
Elements of a Refundable Tax Credit: Example



A: Credit reduction threshold

B: Break-even point where credit becomes 0

C: Maximum credit amount

Refundable Tax Credits

A refundable tax credit is a benefit paid to a tax filer in the form of a reduction in tax otherwise owing, or a cash payment if the tax filer is not required to pay enough income tax to equal the value of the credit; it declines in value as income rises. Refundable credits are equivalent to income-tested direct transfers that operate under the legal and administrative umbrella of the Income Tax Act. In order to receive a refundable credit a person must file an income tax return, and the tax form is, in effect, the income test. Eligibility and benefit levels are based on the previous year's income. Payments can be made monthly, quarterly, or semi-annually, in which case they are like direct transfers; or they can be paid as part of an annual income tax refund, in which case they are like tax relief benefits.

All refundable tax credits, like all income-tested direct programs, have several basic elements. They have a maximum or base amount that is paid to people who qualify because of their income level. Above a certain level of income (called the credit reduction threshold) the amount paid is reduced by a certain percentage (called a credit reduction rate) as income rises. The credit is reduced to zero for people above a certain income level (called the break-even point) (figure 15.1).

Both the federal and the Ontario governments operate refundable tax credit programs. At the federal level the Goods and Services Tax credit is designed to offset the effects of the regressive GST on low-income taxpayers. Ontario operates the Ontario Tax Credit program, which consists primarily of the Ontario property and sales tax credits.

Concerned about the cost of social programs, governments have been eliminating their universal flat rate benefit programs in particular and reducing social insurance protection in favour of programs that provide benefits only to people with low incomes. Because the personal income tax system measures people's incomes, it is particularly well suited to delivering lump-sum benefits that are income-tested. For this reason, the refundable tax credit has become the instrument of choice for governments interested in supplementing incomes. Interest in tax-related income-testing also stems from a desire to avoid the more demeaning and stigmatizing aspects of the more intrusive needs-testing associated with social assistance.

Refundable Credits and Tax-Back Rates

Each refundable credit has a different threshold, reduction rate, and break-even point. Since recipients at some income levels can be eligible for several credits, reduction rates are added to each other and to the marginal tax rates in the income tax system. For example, a recipient at an income level in excess of $25,921 will face the marginal rate for federal and provincial personal income tax, plus a 5 per cent reduction rate on the federal Child Tax Benefit, plus another 5 per cent reduction rate on the GST credit. In addition, Ontario refundable tax credits have reduction rates of 2 per cent, which is added onto the marginal tax rate for non-seniors with incomes over $4000, and 4 per cent for seniors with incomes over $22,000. The stacking of these reduction rates onto marginal tax rates can give rise to high effective marginal tax rates for some people at relatively low income levels.

Individual versus Family Income

The relevant unit for measurement of income for personal income taxation and non-refundable credits is the individual. Eligibility for refundable tax credits and other income-tested programs is determined on the basis of family, rather than individual, income. Tax transfer programs that are designed to relieve low income almost always supplement family rather than individual income. In the few programs that do not use family income, such as the Ontario Tax Reduction, benefits are provided to some low-income individuals who live in families with other individuals who have high incomes. This results in an inefficient targeting of benefits if the objective is to relieve the hardship associated with low income. Lowering the tax burden of individuals who live in high-income households should not have a higher priority than lowering the tax burden of people with inadequate family incomes. It would be preferable, and certainly less costly, to provide low-income supplements only to families with low family incomes. In considering various tax measures to relieve low income we found that, when benefits are provided to individuals rather than families, the effectiveness of the public expenditure in relieving low income is significantly reduced.

This discussion does, however, bring to the fore what, at one level, appears to be an important inconsistency. We have argued that income tax should continue to be determined on an individual basis, and indeed that measures recognizing marital relationships should be eliminated. Yet, here we argue that income-tested benefits should be related to family income. The argument for the individual as the unit of taxation is based on the view that tax liability should be related to the income that one earns and controls, not the benefits one enjoys through family relationships with other income recipients. However, we cannot ignore the fact that, where individuals live in families, resources available to the family from which it can generate well-being for all family members may be inadequate. For this reason, we take the position that eligibility for benefits designed to supplement low income should be based on family income.

However, it should also be recognized that assumptions about the adequacy of family income should to be treated with some caution. Men earn considerably more on average than women, and it is not clear how this income is shared within family units. If income is not shared among family members, then family income–testing to determine eligibility for income supplements can disqualify individuals in families who might legitimately qualify for an income supplement – for example, a wife who does not have access to the income of her husband. As a society we generally assume that the distribution of income within families is an entirely private matter among family members. Although this assumption may obscure real inequities among family members, it is not likely that the tax transfer system can resolve the problem. The existing system at least acknowledges that distribution of income within families may be a problem by making the individual with the lowest income in the family the recipient of the benefit.

Issues in Tax Transfer Reform

A Negative Income Tax?

The tax transfer system in Canada is large and extraordinarily complex. Responsibility for programs spans three levels of government, different ministries within each level, and different agencies within ministries. Each program has its own rationale, objectives, eligibility criteria, definition of recipient unit, frequency of payment, and tax treatment. There is considerable disharmony among programs, and recipients are often confused about what they are entitled to. At our hearings we heard a great deal of dissatisfaction with many aspects of the tax transfer system. Many of those dissatisfied with the existing system suggested that the entire system be scrapped and replaced with a guaranteed annual income.

The idea of a guaranteed annual income has become an attractive alternative for people dissatisfied with the existing system for many different reasons. Most guaranteed annual income proposals include a significant consolidation of the existing system, including eliminating programs like social assistance and unemployment insurance in favour of a single program that would provide support to people whose incomes fall below a certain level. Guaranteed annual income proposals can take different forms, but they are most often associated with a negative income tax. A negative income tax would be a single large refundable tax credit which would provide a guaranteed level of income to eligible low-income families. Above this floor, benefits would be reduced by some fraction (the recapture rate) of the family's income from other sources.

Because a negative income tax involves a large subsidy, and because families' incomes from other sources fluctuate, negative income tax programs would involve monthly reporting of income, with adjustments to benefits in response to these changes. Refundable credits, being generally much smaller, are usually based on the previous year's income with reconciliation at tax-filing time. While the adoption of a negative income tax would significantly expand the benefit provision side of the tax system, the basic elements of a negative income tax already exist within the tax transfer system.

We were disturbed by the complexity and irrationality of the tax transfer system and concerned about its fairness. In particular there is scope for reform of the system of supports for low-income families and the integration of various low-income credits at the federal and provincial level. Making recommendations for what overall direction social policy reform should take is not within our mandate. However, although a negative income tax may be a useful instrument to achieve certain objectives, it may not be an appropriate way to achieve the variety of objectives of the many different tax transfer programs that now exist. A negative income tax is in essence a program for low-income relief and for adjusting incomes to cover shortfalls in income from wages or other sources on a monthly basis. However, low-income relief is but one of the goals of income security policy. The purpose of a program such as unemployment insurance, for example, is to insure individuals against the loss of wages due to unemployment. The fact that unemployment insurance is paid to individuals regardless of income level reflects the fact that unemployment insurance is designed as a temporary wage replacement program, while a guaranteed income is a program of low-income relief.

Unemployment insurance, disability insurance, child benefits, and many other social programs cannot be collapsed into a single negative income tax without undermining the different objectives of the various programs. In addition, the Canadian income security system, for better or for worse, is divided between federal and provincial governments, each pursuing its own social policy objectives. Although there is disharmony between the two levels on some programs, it does not follow that the solution is to reconfigure the entire system into an income-tested income security system, which is what a negative income tax or guaranteed annual income is.

Social Assistance and the Tax System

Social assistance is a major income security program operated by provincial and municipal governments in Ontario. Ontario spends in excess of $6 billion a year on social assistance. Case loads have increased dramatically over the past several years because of the recession and because of cutbacks in federal unemployment insurance.

Social assistance is poorly integrated into the rest of the tax transfer system. Because social assistance is not taxable, inequities are created between low-income people receiving social assistance who face no tax on their income and working poor people who face taxes on their earnings even though their incomes may be the same as those of people on social assistance. For instance, consider the case of a single person who was employed for the first four months of the year and earned $6000 that was taxable; was on unemployment insurance for the next four months and received $4000 that was also taxable; and then was on social assistance for the final four months and received $2000 that was not taxable. This person's total annual income would be $12,000, but only $10,000 would be considered income for tax purposes. Another person working continuously throughout the year and earning $12,000 would be taxed on the total amount and would pay more tax than the person receiving some social assistance. This is clearly an inequity, and it sends the wrong message to individuals working full time. Low-income earners who appeared at our public hearings complained bitterly about this situation and criticized the government for building this bias into the tax system. Governments, they told us, should be creating incentives for employment instead of creating barriers.

Making social assistance a taxable benefit might appear rational from the perspective of improved integration. However, we cannot recommend it as an objective for the provincial government at this point. There are other forms of income, such as the imputed value of owner-occupied housing, that remain untaxed, and it makes little sense to begin addressing these gaps by taxing the benefits of those who have the lowest incomes. Further, almost two-thirds of whatever taxes were actually paid by social assistance recipients would go to the federal government. This would be unacceptable, especially since Ontario's share of social assistance costs has increased dramatically because the federal government imposed a cap on its cost-shared payments to Ontario in 1990. If the federal and provincial governments reformed the tax system comprehensively so that all income was treated as taxable, the taxation of social assistance might be more appropriate.

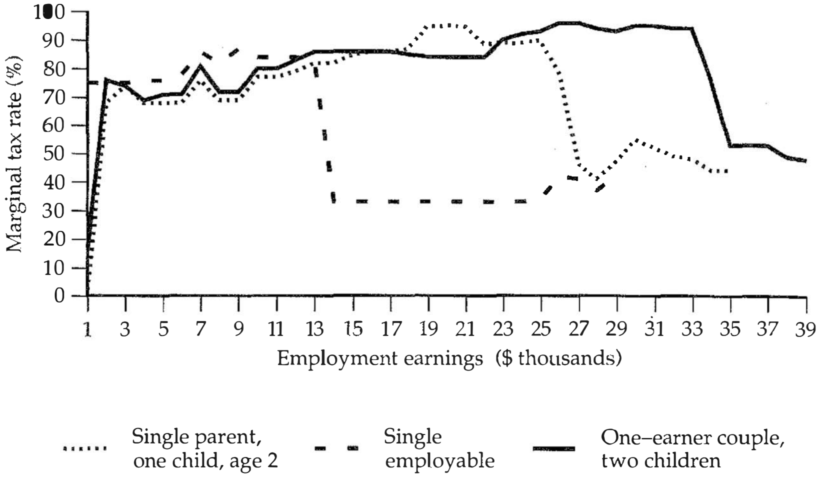
One of the biggest problems with social assistance is that recipients have little incentive to earn income while on welfare, a phenomenon often referred to as the "poverty trap." Recipients face extremely high benefit reduction rates on any income they may earn above social assistance. For each dollar of net earnings above a basic exemption, social assistance benefits are reduced by 75 cents. These administrative tax-backs are part of the social assistance system, not part of the tax system. In addition, social assistance recipients face reductions on other benefits provided by government, often through the tax system, as well as income taxes and social insurance contributions on any wages they earn. The consequence is that many recipients of welfare find it financially prohibitive to move from social assistance to the labour market.

We commissioned a major study to examine the interaction of the Ontario social assistance system and the federal and Ontario tax transfer system.[2] This study, "The Interaction of the Welfare and Tax Systems in Ontario," found that, as people on social assistance try to enter the labour market, they face benefit reduction rates combined with income tax rates that result in effective marginal tax rates on their earned income sometimes in excess of 100 per cent, far in excess of the highest marginal tax rates for high-income earners in the personal income tax system (figure 15.2). This means that a family with one earner and two children would have to earn $33,000 from work in order to increase their disposable income by $5743 over what they receive on social assistance (Battle and Torjman n.d., table 2). Clearly there is little incentive to supplement social assistance income by working. The study found that the welfare tax-back constituted the greatest proportion of the overall tax burden on social assistance recipients with earnings. Although federal and Ontario taxes, including payroll taxes, contribute to the tax burden, these factors pale in comparison to the weight of the administrative tax-back (Battle and Torjman n.d.).

---

[2] The full report (Battle and Torjman 1993) is available in mimeographed form. A shortened version is to be published (Battle and Torjman n.d.).

FIGURE 15.2
Marginal Tax Rates for a Single Employable Person, a Single Parent, and a One-Earner Couple



Source: Ken Battle and Sherri Torjman, "The Interaction of the Welfare and Tax Systems in Ontario: Full Report," final report prepared for the Ontario Fair Tax Commission, mimeo (Toronto, 1993); and data supplied by the Caledon Institute of Social Policy.

The study explored several options for reducing the heavy tax burden on social assistance recipients with earnings and for improving their situations. It found that the most effective way to do both was to reduce benefit reduction by changing the earnings exemptions rates imposed on people on social assistance. However, the cost of doing so would significantly increase expenditures on social assistance as the income level at which recipients could still qualify for assistance would be raised. Reductions in the income tax burden on low-income individuals and families would help alleviate the situation somewhat, but they are insignificant compared with the social assistance benefit reduction rate.

Nevertheless, the study did recommend raising the Ontario tax threshold for low-income individuals and families. The Ontario Tax Reduction typically removes the Ontario tax payable from all social assistance recipients with employment earnings except for single employable persons. For reasons we will explore in chapter 16, the

Ontario Tax Reduction is quite inefficient in targeting its reductions on low-income families. The Battle and Torjman study recommended that Ontario adopt a fully indexed low-income tax credit to remove the Ontario tax burden from all low-income households. Tax relief of this sort would help not only single employable welfare recipients who work, but also working poor individuals and families who receive most of their income from wages and who do not apply or qualify for social assistance supplements through the Supports for Employment Program (STEP). In the case of a family, benefits would depend on the family's situation not that of individual members of the family. Therefore, government expenditures to raise thresholds would be more efficiently targeted. We agree with this general direction for raising tax thresholds for low-income families and individuals and develop it more fully in chapter 16.

Ontario is already taking steps to address the problems faced by people trying to move off social assistance as well as to get rid of inequity between the people on social assistance and people with low earnings. A plan to reform Ontario's welfare system was outlined by the minister of community and social services in July 1993 in the release of a report entitled *Turning Point*. The strategy proposed to create three new programs as alternatives to welfare:

- The Ontario Child Income Program, an income-tested child benefit program paid to all low-income families with children. This program would replace the child benefit portion of social assistance and would be extended to low-income families with children who do not qualify for welfare.
- The Ontario Adult Benefit, which would provide financial assistance to adults, based on need, in a unified system across the province. It would replace the existing welfare system for adults, which is divided between the provincial and municipal governments.
- Job Link, a program of supports to help people in receipt of the Ontario Adult Benefit to get education, training, and employment.

The most significant element of the strategy is the introduction of the Ontario Child Income Program (OCIP). Among our recommendations in the following chapter is a proposal for an Ontario Child Tax Benefit. Our proposal is consistent with the provincial social assistance reform initiative. In fact, we recommend that if the OCIP is instituted, our child tax benefit should be integrated with it rather than continue as a separate program.

16 The Role of the Tax System in Social Policy

The tax system plays an important role in social policy in a number of different respects. As we noted in chapter 15, it is used extensively as a mechanism for the delivery of cash benefits to individuals based on their incomes or other characteristics such as disability or age. It is used as a substitute for direct spending programs to deliver subsidies to individuals in such areas of public policy interest as child care. It is also used as an administrative mechanism for the income testing of benefits provided through other government programs such as the Guaranteed Income Supplement for seniors.

Our consideration of the role of the tax system in achieving social policy objectives was focused on five areas of concern: supports for people with low income, supports for children and child care, supports for people with disabilities, supports for seniors, and supports for retirement savings.

Low-Income Tax Relief

The problem of low or inadequate incomes is a major social policy issue. Persistently high unemployment, economic restructuring, and the growth in the numbers of low-wage jobs have increased the risk that individuals and families in Ontario will have low incomes. Tax transfer policies are critical elements in the struggle to alleviate poverty. This struggle is not only about improving the living conditions of people with inadequate incomes; it is also about fairness in society. The existence of poverty is a symptom of the unfair distribution of society's economic resources.[1] Key questions for the commission were how the tax system currently affects people with low incomes and how tax instruments could be used more effectively to relieve low income.

It may come as a surprise to many people that individuals and families with low incomes pay income taxes. In 1991, there were 524,925 people in Ontario who lived in families with incomes below Statistics Canada's low-income cut-offs and yet paid income tax. Most people in low-income families pay very small amounts of income tax. For example, the average tax paid by families in the $10,000 to $20,000 income range in 1993 in Ontario was $206, 1.4 per cent of their income. Given that the support for the low-income population is a major social policy goal, it is sensible to ask whether these same people should also face an income tax burden. We concluded that, if the ability-to-pay principle means anything, it means that people who have low incomes should not have to pay income tax. A requirement that people with low incomes pay income tax must, therefore, be considered a violation of a commitment to fairness.

There are basically two ways to assure that people with low incomes do not pay income taxes. One way is to increase the basic tax threshold. Tax thresholds, which are the levels of income at which people start paying tax, are created by the combined effect of tax credits (such as the basic personal amount, the married amount, and the equivalent-to-married amount), tax rates, and tax brackets. The individual is the unit of account for the determination of income tax payable; however, low income is almost always measured on total family income. Family income is also the unit of account for income-tested tax transfer programs such as refundable tax credits. Raising the basic tax threshold for an individual taxpayer with low income will in many cases simply reduce the tax payable of someone who has low individual income but lives in a family where the total income is adequate or even very high. The benefits of increasing the tax threshold for individuals, by, for example, raising the level of the

---

[1] The idea that poverty is a relative concept related to the average standard of living of society is widely shared and is embodied in the most frequently used standard of low income in Canada, Statistics Canada's low-income cut-offs.

basic personal amount, are broadly scattered across all income groups. Because raising tax thresholds reduces revenues, doing so is in our view not the most effective use of scarce government funds to relieve the tax burden on people suffering the effects of low income.

The alternative method, which we favour, is by means of family-based refundable tax credits that would effectively remove income tax from low-income families. Because they are refundable, these credits would also augment the incomes of people who have incomes so low they have no tax liability to reduce. Ontario has a system of refundable tax credits and a tax reduction program to relieve the tax burden on people with low income. We believe this system is not well designed and should be reformed.

Ontario Tax Reduction

The Ontario Tax Reduction (OTR) was explicitly designed to raise tax thresholds. It reduces or eliminates the Ontario personal income tax payable by low-income tax filers. For 1993 the Ontario Tax Reduction is computed by totalling a basic amount of $205 plus $395 per child under 19 years of age, plus $375 for any disabled dependant over 18 years of age.[2] If Ontario income tax is less than or equal to this total personal amount, Ontario income tax payable is reduced to zero. If it is more, then Ontario income tax is reduced by three times the amount less two times Ontario income tax. The estimated cost of the Ontario Tax Reduction program in 1992, when the reductions were slightly lower, was $134 million. It is estimated to cost Ontario $151 million in 1993.

There are critical flaws in the Ontario Tax Reduction program which significantly blunt its effectiveness as a low-income tax relief measure. Because the Ontario Tax Reduction is provided to *individual* taxpayers based on their income tax payable rather than the family's income tax, lower-income family members can benefit from the reduction even if they live in families with combined incomes

---

[2] The basic amount of the Ontario Tax Reduction was increased from $175 in 1992 to $205 in 1993 and the child amount was increased from $375 to $395 in the 1993 Ontario budget in order to compensate low taxpayers for the 3 per cent increase in Ontario income tax.

TABLE 16.1
Ontario Tax Reduction (Estimates for 1993)

Family income ($)	Gross tax expenditure ($ millions)	% distribution of benefits
10,000 and under	3.3	2.18
10,001–20,000	12.9	8.53
20,001–30,000	51.1	33.80
30,001–40,000	43.1	28.51
40,001–50,000	16.2	10.71
50,001–60,000	9.2	6.08
60,001–70,000	5.2	3.44
70,001–90,000	4.5	2.98
Over 90,000	5.7	3.77
All tax filers	151.2	—

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

substantially above any low-income threshold. In addition, the Ontario Tax Reduction is based on Ontario tax, not income. This means that higher-income earners who pay little Ontario tax because they take advantage of numerous tax expenditures can also benefit from the program. These features of the program appear to be inconsistent with its intent, which is to relieve the tax burden on people who have inadequate incomes.

Our analysis of the distribution of benefits of the Ontario Tax Reduction in 1993 estimated that just over 10 per cent of the money expended on the Ontario Tax Reduction program, or $16.2 million, actually goes to families with incomes below $20,000 (table 16.1). Just over 16 per cent of the benefit, or $24.6 million, goes to families with incomes in excess of $50,000. The obvious conclusion is that the program is not well targeted. The majority of the tax benefit goes to individuals in families whose incomes are above $30,000.

By far the most important factor influencing this distribution is the use of the individual, rather than the family, as the unit of benefit. The majority of beneficiaries of the Ontario Tax Reduction are people with low individual incomes and tax payable, but these are also people who live in families with combined incomes above the low-income standard.

We evaluated a design for a more effectively targeted Ontario Tax Reduction program based on family incomes rather than individual tax payable. Such a system would, in effect, transform the Ontario Tax Reduction into a non-refundable low-income tax credit. Simulations we performed suggest that with such a design, the proportion of tax benefits going to low-income families would increase significantly and Ontario would pay much less in terms of its tax expenditure for low-income tax relief. However, because refundable credits are a more effective means to address the problem of low-income, we do not recommend that the Ontario Tax Reduction Program be changed. Instead, later in this chapter we propose a replacement for the program.

Ontario's Refundable Tax Credits

Both the federal government and the Ontario government have refundable tax credit programs that provide benefits to low-income families and individuals. Ontario was an early leader in the development of refundable low-income tax credits, establishing its Ontario Tax Credit program in 1972. At the federal level, the refundable child tax credit was initiated in 1978 and has since been replaced by the Child Tax Benefit. The federal government also introduced the Goods and Services Tax (GST) credit in 1991. (Another federal sales tax credit existed prior to the GST.)

The Ontario Tax Credit program currently consists of three components: the Ontario property tax credit, the Ontario property tax credit for seniors, and the Ontario sales tax credit.[3] The Ontario Tax Credit program is designed to compensate people with low incomes for some part of the burden of property and sales taxes. The program has also been used at various times to achieve other specific objectives such as to offset home heating costs. Although it is considered one program, the three components of the Ontario Tax Credit program are calculated separately. The non-senior property tax credit is calculated as $250 plus 10 per cent of occupancy cost (rental payments, property taxes, or college residence fees) and is reduced by 2 per cent for every dollar of combined net annual income over $4000.

[3] Other refundable tax credits in Ontario are the political contribution tax credit, the home ownership tax credit, and the worker ownership tax credit.

The property tax credit for seniors is calculated as $500 plus 10 per cent of occupancy cost and is reduced by 4 per cent for every dollar of combined net annual income over $22,000. The sales tax credit amount is the same for seniors and non-seniors, $100 per adult and $50 per child (under 19), and the reduction rates are calculated in the same way as for the property tax credit.[4]

The Ontario Tax Credits are delivered through the personal income tax system. This means that individuals must file a tax return to receive a benefit either in the form of a tax offset or a refund. A single person earning near the minimum wage, $12,000 per year, and paying $415 per month in rent would have received a net Ontario Tax Credit of $290 in 1992. A single senior with an income of $12,000 and the same rent would receive a net benefit of $700. The maximum benefit under the program is $1000. These credits are not indexed to increases in the consumer price index but are adjusted on an ad hoc basis. Over 2.4 million households received an estimated $860 million in Ontario tax credits in 1992. Just over half went to seniors and over 90 per cent was estimated to go to individuals and families reporting incomes of less than $25,000 per year (Ontario Ministry of Treasury and Economics Taxation Policy Branch 1992, 3, 6).

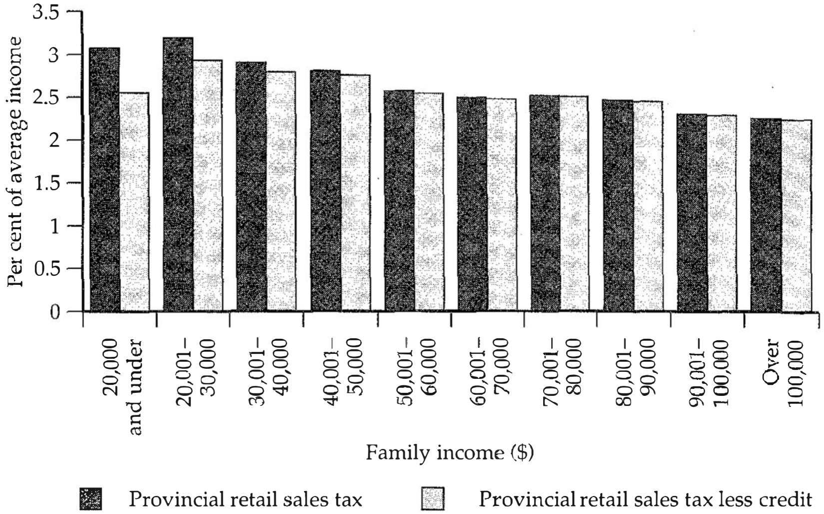
A question for us was whether it is necessary to have three separate refundable low-income credits in Ontario that provide benefits to people with low incomes. We assessed each part of the Ontario Tax Credit program in relation to its objectives, and in relation to low-income relief in general.

The sales tax credit is an income supplement paid to individuals and families and is sensitive to income and family size. It has a basic adult component and a child component. Its relationship to sales taxes paid is remote. Households with annual incomes under $20,000 pay on average just over 3 per cent of their total income in Ontario retail sales tax. The average value of the sales tax credit reduces this to a net amount of approximately 2.5 per cent. At annual incomes over $20,000 the offsetting effect is almost negligible (see figure 16.1).

---

[4] The property and sales tax credits for seniors were converted from flat rate grants in the 1992 Ontario budget.

FIGURE 16.1
Estimated Effect of the Sales Tax Credit in Offsetting the Retail Sales Tax Paid by Ontario Households in 1991

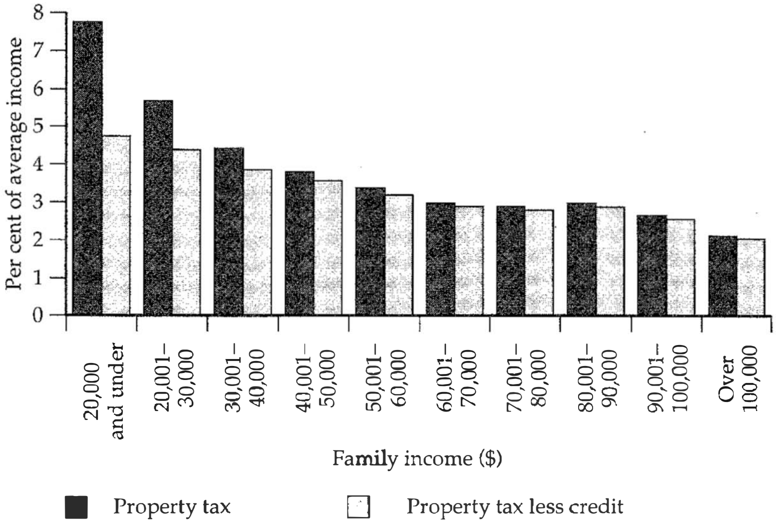


Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M); 1988 data adjusted to 1991 values.

Note: 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. This was done by first adding together the amounts reported on the income tax returns for property tax credit and sales tax credit, enabling the calculation of the 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 the property tax credit. This formula was adopted here for illustration purposes; other allocation formulas could be used as well.

The property tax credit is sensitive to income and occupancy cost. Households with annual incomes under $20,000 pay close to 8 per cent of their total income in property tax either directly or indirectly in the form of rent. After the property tax credit, the estimated

FIGURE 16.2
Estimated Effect of the Property Tax Credit in Offsetting the Property Tax Paid by Ontario Households in 1991



Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M); 1988 data adjusted to 1991 values.

Note: In this example, it is assumed that property tax levied on multi-residential buildings is passed on to the tenants. See also note to figure 16.1.

average net property tax paid drops to just below 5 per cent of total income. There is a significant reduction in effective property tax paid for households in the $20,000 to $30,000 income range as well. This effective reduction tails off quickly over the $30,000 level (figure 16.2).

Although a portion of the property tax credit is based on actual occupancy cost, its value is determined in combination with the sales tax credit to a maximum of $1000. This suggests that the credit's occupancy cost sensitivity is somewhat of an illusion. Nevertheless, there is definite political appeal to specific tax offsets for two visible, unpopular, and regressive taxes. The existence of these offsets also eases pressure for reform, especially of the property tax. In social policy terms, however, there is little difference between the specific sales and property tax offsets for low-income people and a general refundable credit that is designed to increase those incomes. The basic purpose of such a program is to improve disposable incomes of people with low incomes by reducing their tax burden or providing them with a cash transfer. In our opinion, this goal would be better achieved through a simplified refundable tax credit without the unnecessary complication for tax filers of calculating occupancy cost and adding the allowable credit onto the sales tax credit.

A consolidated tax assistance program in Ontario could also replace the poorly targeted Ontario Tax Reduction program. Even if the Ontario Tax Reduction were to be converted to a family unit base, the fact that it reduces tax payable means that such a change would not benefit those low-income families who have no tax payable. It would be preferable to eliminate the Ontario Tax Reduction altogether and achieve low-income tax relief through a consolidated refundable low-income credit.

RECOMMENDATION 17

Ontario should consolidate the adult components of the Ontario property and sales tax credits and the Ontario Tax Reduction program into a new and simplified Ontario Tax Assistance Credit. The credit should be refundable, delivering its maximum benefit to adults below a specified family income level and declining as income rises.

Children and Taxes

Child Benefits

The cost of raising a child or children reduces the discretionary income and ability to pay of the families with children. Various methods are available to estimate the minimum costs associated with meeting children's basic needs, but inevitably the results are subjective. One approach is to work with the low-income cut-off (LICO) estimates published by Statistics Canada, using the LICO increments as a guide (Statistics Canada 1993m, 5). Thus, in 1991 in a city of over 500,000 people, raising one child required an additional $5421 in income for a two-earner couple, raising a second child required an additional $3847, and raising subsequent children required an additional $2710 per child. Each amount is the change in the low-income cut-off for a two-earner couple with an additional child.

Another approach is to estimate the costs associated with raising a child in a specified locale. For example, the Social Planning Council of Metro Toronto provided detailed estimates of the various costs associated with raising children in 1991. The costs included in the estimate are expenditures for food, clothing, personal care, special school needs, recreation, housing, health, baby-sitting, and day care. The cost to a two-parent family of raising an only child, not including day-care costs, ranges from almost $3000 per year for an infant to almost $7000 per year for an 18 year old. Day care adds another $1600 to $12,000 per year, depending on the age of the child and the kind of day care purchased (Social Planning Council 1992, 219). The cost of raising a second or third child is somewhat less than the cost of the first child, owing to economies achieved on items like food and household maintenance. The cost of raising a child over the age of two in a single parent family is somewhat higher than the cost for a two-parent family (Social Planning Council 1992, 216, 219).

For many years the tax system contained a provision that recognized the cost of raising children. Before 1988 the dependent child provision was a deduction and was explicitly based on the principle of tax equity between families with and without children. Families with children have essential child-rearing costs and, it was assumed, have less ability to pay tax than childless individuals and families. Deducting at least part of these costs from income equalized the income on which tax was applied. When the child deduction was converted to a credit in 1988 it became less a tax provision to equalize ability to pay than a social benefit in recognition of the costs of raising children. This non-refundable child tax credit was provided in addition to the flagship child benefit program in Canada – the federal Family Allowance – which paid every Canadian family a flat rate benefit for each child under 18 years of age. Together these programs were based on the idea that children are at least in part a responsibility of society, not just of parents, and that society should contribute to the costs of raising children. In 1978 the federal government introduced an income-tested child benefit program in the form of the refundable child tax credit. Together these three programs constituted the Canadian child benefit system at that time.

Further changes to the federal system of child benefits were introduced in the 1992 federal budget and came into effect in 1993. The new Child Tax Benefit replaced the old federal system of benefits which included the universal Family Allowance, the non-refundable child tax credit, and the refundable child tax credit. Families with net incomes of up to $25,921 in 1993 receive the maximum benefit of $1020 ($85 per month) for each of the first and second children in a family and $1095 ($91 per month) for the third and each subsequent child under the age of 17. Benefits to two-parent families with one child disappear at an income of approximately $66,000. For families with three children, benefits stop at around $88,000. Benefits are paid in monthly instalments and are based on the previous year's income. In this sense the Child Tax Benefit is a tax benefit only in name. Payments are separate from the tax system, and the tax system is used only to measure eligibility for benefits and for a final reconciliation at tax time.

The removal of all fiscal – tax or transfer – recognition for children in families at upper incomes is without parallel among OECD countries (Kesselman 1993, 117).[5] It can be interpreted as the adoption of the idea by the federal government that having children is equivalent to a private consumption decision, like buying a car or a house. From a tax perspective, this federal policy is inconsistent with the fact that recognition of the costs of raising children in single parent families regardless of income has been maintained through the continued existence of the equivalent-to-married credit. In addition, the maintenance of the marital credit reflects a public commitment to subsidize the costs of having a spouse who does not work outside the home, but not the costs of having children.[6] This surely suggests both an inconsistent set of objectives and misplaced priorities.

Ontario has its own system of child-related income supplements that are provided as tax-related benefits. It is also in the process of initiating a new provincial child benefits system. The proposed new Ontario Child Income Program (OCIP) is designed to be an

---

[5] The only exception is the United States. However, the phase-out of tax recognition for children in the United States is at taxable incomes above US$275,000, much higher than Canada's new CTB phase-out of about Can$80,000 (Kesselman 1993, 117–18).

[6] We have recommended removal of the marital credit. See recommendation 15.

alternative to welfare for many families with children. Approximately $1.1 billion was spent through Ontario's social assistance programs in 1991 specifically for the support of children in families who had no other means of support. It is proposed that this component of welfare be rolled into a new income-tested program similar in many ways to the federal Child Tax Benefit. It will mean that working poor and other low-income families who do not qualify for welfare will be eligible for some level of a new provincial child benefit. However, Ontario also operates several other child-related supplements – the Ontario Tax Reduction and the sales tax component of the Ontario Tax Credit program. Unless these are changed there will be several programs in Ontario providing child-related supplements to low-income families.

We would have liked to have been able to recommend to the province that it adopt a universal child benefit program that embodies a commitment to social responsibility for children. Our view is that children are a social responsibility and it is appropriate that this be reflected in some fiscal support for children in families at all income levels, particularly since the federal government has abandoned all such commitments. Fairness demands that families with children should not be worse off because of the costs associated with child rearing than individuals and families without children. However, we also recognize that the costs of a provincial universal child benefits system would far exceed those of a more tightly targeted system where benefits are provided only to families with low incomes. We modelled different designs for provincial child benefit systems that included a universal flat rate benefit. All these models involved large amounts of additional net spending. Since it was not within our mandate to be recommending new social policy spending, we confined ourselves to considering how best to design family income supplementation – given the province's existing commitment only to an income-tested child benefit provision – that would remain within current expenditure commitments.

We developed our recommendations for tax-delivered assistance to children in the context of the programs existing outside the tax system for the delivery of child benefits. The current social assistance system does not deliver benefits to children of working poor families, and as long as it is the only delivery mechanism in Ontario for child benefits outside the tax system, tax-delivered assistance should be retained. If, however, a reform proceeds in the general direction outlined in the government's proposal for an Ontario Child Income Program, we see no reason to retain two delivery systems with the same target population and would recommend that tax-delivered assistance be eliminated.

Given those considerations, we propose an Ontario child tax credit that would provide benefits to low-income Ontario families according to income levels and number of children. The credit would be refundable. We also propose that the equivalent-to-married credit in the current income tax, which provides a tax reduction to single parent families, be replaced with a supplement to the child tax credit payable to single parent families. The primary reason for this change is to convert the benefit into a refundable credit in order to provide assistance to single parent families not having taxable income.

RECOMMENDATION 18

The current system of tax-delivered assistance to families with children through the Ontario Tax Reduction and the sales tax credit should be rationalized into an Ontario child tax credit. The credit would be refundable and provide a declining benefit as family income rises.

RECOMMENDATION 19

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, the equivalent-to-married credit should be eliminated and replaced with a supplement to the child tax credit that would provide benefits to single parent families.

RECOMMENDATION 20

If Ontario establishes an income-tested child benefit program which provides benefits to low-income families regardless of the source of their income, Ontario should not implement the child tax credit proposed in recommendation 18. The assistance to families with children currently delivered through the tax system, through the Ontario Tax Reduction and the sales tax credit, should be eliminated and the additional revenue used to augment the benefits delivered under the child benefit program.

Support for Child Care

The ability of families to find accessible child care contributes to both the economic well-being of the family and the economic independence of women. Unfortunately, the availability of high-quality, low-cost child care is an ongoing challenge for many families. The Canadian National Child Care Study (1992) estimates that, in 1988, 483,900 Ontario children were enrolled in at least one paid child care arrangement, a figure that represents about 29 per cent of children 12 years of age and under in the province (Goelman et al. 1993, 86).

In 1992 the Ontario Ministry of Community and Social Services estimated that there were about 120,000 child care spaces in the province for children under the age of 12, but it is difficult to determine how many spaces are needed. One way to determine the need for child care is to estimate the labour force participation of women who have children under a certain age. This approach assumes that women are primarily responsible for child care, and that care is required if a mother is in the paid workforce. In 1986 almost one million Ontario children under six years lived in a family in which the mother was in the labour force.[7] Child care spaces are not, however, required for all these children since some families prefer to hire a nanny, and in some families the father remains at home with the preschool children. Although the numbers are imprecise, a general

[7] Adapted by Park (1991, 58) from Ram (1990).

feeling exists among parents that "the number of licensed (child care) spaces need to be increased in all areas of Ontario" (Ontario Ministry of Community and Social Services 1992b, 9).

In 1988 the estimated annual cost of child care in a child care centre was $7200 for an infant, $5400 for a pre-schooler, and $4200 for a school-age child (Ontario Ministry of Community and Social Services estimate, in Pence 1992, 396). The rates in private-home day care ranged from $11 to $24 per day, depending on the setting (Pence 1992, 397). Based on a 260-day child care year, the average annual fee for private-home child care would be between $2860 and $6240. It is widely believed that informal child care is less expensive than licensed child care, but costs are difficult to determine since receipts are not provided. In 1988 about 45,000 of the child care spaces in Ontario, or 38 per cent of all spaces, were subsidized. Eligibility for a full or partial child care subsidy was estimated to start at just over $12,000 for a single parent family with one child, and just over $20,000 for a two-parent family with two children (Pence 1992, 396).

Not only is the supply of child care in Ontario inadequate, but the cost to parents is significant. Park (1991, 58) found that in 1988 the cost of full day care for one child represented between 8 and 13 per cent of median family income in Ontario, and that the cost of full day care for two children represented 20 per cent of median family income. In 1988 median family income in Ontario was $48,854, well above the $20,000 cut-off for a child care subsidy.

Governments assist families with child care expenses through the child care expense deduction in the personal income tax. The deduction allows child care expenses, up to maximum amounts that vary according to the age of the child, to be deducted from taxable income. The 1992 federal budget raised the allowable deduction for child care expenses effective in 1993 from $4000 to $5000 for each child under seven years of age, and from $2000 to $3000 for each child between seven and 14. For a dependent child with a severe mental or physical disability, a family may claim up to $5000 regardless of age. Low-income families who are unable to deduct child care expenses are permitted to claim an additional amount per child under seven years of age ($213 in 1992) through the federal Child Tax Benefit. The Income Tax Act requires that, where there is more than one supporting adult, the person with the lowest income must claim the expense. In order to claim the deduction, the taxpayer must supply receipts, if the care-giver is an institution, or a social insurance number, if the care-giver is an individual. The federal government argues that child care expenses are those costs that must be incurred by parents to enable them to engage in employment, business, training, or research activity. Normally employment-related expenses are deductible only by taxpayers who are self-employed. The child care deduction stands as a unique item in the tax system since all other employment-related expense deductions for employees were removed with the abolition of the employment expense deduction in 1988.

We can understand the view that child care expenses are an expense incurred to earn income, as well as the strong support for the child care deduction, especially by parents who claim it. However, income tax data indicate that only 642,000 Canadian families claimed the child care expense deduction in 1990. In the same year, there were 953,000 families with pre-school children where both parents, or the single parent in one-parent families, worked outside the home. There were 2.2 million such families with children under the age of 16.

In our view, the child care deduction should be seen as an element of federal policy in support of early childhood development and child care. The unique status of the child care deduction suggests that it is implicitly viewed as a social policy commitment within the tax system. In addition, the child care deduction was clearly seen as a critical part of the federal government's national child care strategy in 1988–89, when it increased the deduction in order to increase its support for child care.

The fact that, as a deduction, it provides a larger subsidy to higher-income families with higher marginal tax rates, and no benefit to families with no tax payable, is a serious problem. A two-earner family with two children and two high incomes that are taxed at a marginal rate of 53 per cent will receive a tax benefit equivalent to $5300 for child care. A two-earner family with two children, where one spouse earns the lower income of $25,000 annually and is taxed at a marginal tax rate of 27 per cent, will receive a tax benefit equivalent to $2700 to pay for child care. The average value of the deduction for families claiming the child care expense deduction in Ontario in 1990 ranged from $140 in the under $10,000 income range to $2120 for those with incomes in excess of $150,000 (table 16.2). The fact is that low-income families derive little or no benefit from this program in support of child care.

TABLE 16.2
Analysis of Child Care Expense Deduction, Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	0.2	0	0
10,000 and under	8.4	3	140
10,001–20,000	25.3	31	516
20,001–30,000	29.5	45	634
30,001–40,000	19.0	52	1139
40,001–50,000	8.8	27	1257
50,001–60,000	4.5	14	1310
60,001–70,000	1.9	7	1480
70,001–80,000	0.8	2	1200
80,001–90,000	0.5	2	1624
90,001–100,000	0.3	1	2160
100,001–150,000	0.3	1	1525
Over 150,000	0.3	2	2120
All tax filers	100.0	187	781

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

The total federal and provincial tax subsidy in Ontario given through the child care deduction was $187 million in 1990 (table 16.2). Ontario's portion of this tax subsidy was approximately $63 million (in 1990). In our view, this money would be better spent outside the tax system on child care services that would be available to all families regardless of their socio-economic status. A direct spending program on child care would also be a more equitable way to support the needs of parents, whether women or men, for quality, accessible non-parental child care services.

RECOMMENDATION 21

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the child care expense deduction and use the revenue recovered in direct program spending for child care.

Disability and Taxes

According to the Health and Activities Limitation Survey (HALS), in 1986 about 1.3 million Ontarians, or 14 per cent of the population, had a disability (Statistics Canada 1990b, 1–2, 1–4).[8] The definition of disability used for the survey was that of the World Health Organization: "any restriction or lack (resulting from an impairment) of ability to perform an activity in the manner or with the range considered normal for a human being" (Statistics Canada 1990b, xxxvi). Of the Ontarians with disabilities, just under 8 per cent resided in institutions, while the majority resided in households (Statistics Canada 1990b, 1–6). About 37 per cent of Ontarians with disabilities were age 65 and over, although those age 65 and over made up more than 80 per cent of the people with disabilities residing in institutions (Statistics Canada 1990b, 1–4, 1–6).

Of Ontarians with a disability, aged 15 years and older and living in the community, about 6 per cent required assistance with personal care and 2 per cent required assistance with moving around at home (Statistics Canada 1990b, 5–8). Of those requiring assistance with personal care, 31 per cent were assisted by someone other than family, a friend, or a neighbour. Of those requiring assistance moving around at home, 26 per cent were assisted by someone other than family, a friend, or a neighbour (Statistics Canada 1990b, 5–8). In general, this kind of care would be provided by a paid attendant.

About 38 per cent of Ontarians with a disability living in the community used an assistive device or aid of some kind (Statistics Canada 1990b, 5–6). Aids include those required for impaired hearing, for impaired vision, and to assist in agility and mobility.

People with a disability do not participate in the labour force to the same degree as the general population. In 1986, 50 per cent of Ontarians with a disability aged 15 to 64 and living in the community were labour force participants (Statistics Canada 1990b, 3–4), compared with 69 per cent in the general population (Statistics Canada 1993f, 321). Of those in the labour force, 13 per cent of people with disabilities were unemployed (Statistics Canada 1990b, 3–4),

---

[8] All the information on people with a disability is based on results of the HALS and, as such, is based on self-reporting.

compared with 7 per cent of all Ontarians (Statistics Canada 1993f, 35, 215).

Ontarians with a disability have lower incomes than the general population. In 1986, 51 per cent of individuals with a disability, aged 15 and over and living in the community had an income of less than $10,000, and only 13 per cent had an income greater than $30,000 (Statistics Canada 1990b, 5–17). By comparison, 34 per cent of Ontarians had an income of less than $10,000 in 1986, and almost 24 per cent had an income over $30,000 (Statistics Canada 1987, 111). In 1986, almost 20 per cent of people with a disability, aged 15 and over received income related to the disability, most receiving Canada Pension Plan payments or workers' compensation. Just over 3 per cent of people with a disability aged 15 to 64 received social assistance payments in 1986.

People with mental and physical disabilities are among the most disadvantaged in Canada. This disadvantage stems from barriers they face to full participation in the social and economic life of the community, especially in employment. To overcome these barriers, both the individual and society generally must incur extraordinary costs for a wide range of products and services: wheelchairs and other assistive devices; special medical services, equipment, and medication; transportation; special housing; workplace adaptation; vocational rehabilitation; and attendant care.

The federal government has provided tax relief in recognition of disability-related costs since the 1930s. Starting with sales and customs duties relief on items for people with impaired mobility, tax relief provisions were extended over time to the personal income tax in the form of medical expense deductions and deductions associated with the disability expenses of individuals. Increasingly these forms of tax relief have become transferable in recognition of the fact that they may be incurred by a relative who supports a person with little or no taxable income. More recently, provisions have been introduced that allow businesses to claim expenses associated with accommodating people with disabilities; provide greater recognition for the expenses incurred by people with disabilities to earn income or to make adaptive renovations to their homes; and encourage people with disabilities to take advantage of educational opportunities.

Disability-related tax relief found its original justification in the principle of horizontal equity, the idea that people with the same income should pay the same tax. People with disabilities have higher non-discretionary expenses for daily living than persons without disabilities. These expenses create a consistently different ability to pay at the same level of total income. Putting the case slightly differently, if the goal in income taxation can be seen as taxing increments to economic power during the taxation year, it would be hard to argue that expenses required of people with disabilities simply to cope with day-to-day life should be counted as increments to their economic power.

While horizontal equity has been the central motive underlying disability-related tax relief in the past, the recent expansion of these provisions is also a reflection of the struggle for equality rights and the expansion of disability-related social policy. As disability groups have become more organized and vociferous in their demands for more support, governments have become more sensitive to the need to reduce barriers to participation in society. Disability-related tax assistance has been used to influence behaviour, to encourage employment, to promote community living as an alternative to institutional care, and to compensate people with disabilities for non-pecuniary hardships imposed by their disabilities.

For governments and for people with disabilities, the tax system has become an attractive vehicle for the delivery of disability-related benefits. The 1993 report of the House of Commons Standing Committee on Human Rights and the Status of Disabled Persons, *As True as Taxes: Disability and the Income Tax System*, reflecting an extreme but nevertheless telling position, argued that the tax system should become *the* delivery mechanism for benefits to low-income individuals with disabilities. Interest in tax-based disability support stems in large part from dissatisfaction with other parts of the disability income security system and frustration with progress in achieving badly needed reforms.[9] In her presentation to the commission, Diane Richler of the Canadian Association of Community Living argued that, because of the general trend towards cutbacks in direct social spending, people in social work look to the tax system as a surer method of equalization because the tax system can target support on an individual basis (Canadian Association of Community Living 1993).

[9] For a synthesis of the main criticisms of the disability income security system, see the Roeher Institute (1992).

The question for the commission was whether tax-based disability support was the best form of support for disability-related costs, or whether there were other mechanisms that would be fairer and more effective. We concluded that tax relief in this area as it is presently offered is far from the best approach. We are not convinced that the tax system is the appropriate foundation upon which to build more generous disability-related assistance for Canadians. As in so many other areas of social policy, the tax system has been handed responsibility for meeting program objectives that would be better achieved outside the tax system through more direct provision of benefits.

Disability Tax Credit

The single most important tax benefit for people with disabilities is the disability tax credit. The disability tax credit was introduced in 1988 but was preceded by a disability tax deduction. In 1992 the disability tax credit had a maximum value of $1114 as a combined federal and provincial tax reduction in Ontario. This is a significant benefit for people with at least that amount of tax payable. Prior to 1986 a person had to be blind or confined to bed or a wheelchair to be eligible for a disability deduction. In 1986 the eligibility criteria were liberalized to include all individuals who are "markedly restricted in activities of daily living." The Income Tax Act (1992, section 118.4) lists these activities as "perceiving, thinking and remembering; feeding and dressing oneself; speaking; hearing; eliminating (bowel and bladder functions); and walking." Those who are restricted in their ability to perform these functions are considered disabled and are eligible for a disability tax credit claim. Responsibility for assessing eligibility is assigned to the claimant's medical professional, who must complete a Disability Tax Credit Certificate (Form T2201) to accompany the tax filer's return. Health and Welfare Canada acts as the administrative mechanism for legitimating claims made to Revenue Canada.

The disability tax credit is designed to compensate for the non-quantifiable costs associated with disabilities that are the result of "severe and prolonged" mental or physical impairment and that are likely to last at least 12 months. Quantifiable and medically related disability costs can be claimed as medical expenses under the medical expenses credit. In addition, a deduction of up to $5000 is available for attendant care expenses associated with earning business or employment income. The disability tax credit cannot be claimed by people claiming the cost of full-time care in a nursing home as a medical expense, but can be claimed by people claiming the part-time attendant care deduction.

Disability groups including the Coalition of Provincial Organizations of the Handicapped (COPOH) like the disability tax credit because it provides a substantial tax benefit without the need to quantify or have receipts for the expenses incurred. However, they have two major criticisms of the credit: its limited definition of disability, and its non-refundability. They argue that, despite the 1986 liberalization of the disability tax credit, some disabilities are included while others are not. In addition, the requirement for doctor certification reinforces the medical model of disability, which limits eligibility to people with medically certifiable impairments. The alternative, which is advocated by groups representing people with disabilities, is self-declaration with a non-medical verification procedure to assure appropriate eligibility. This definition would undoubtedly expand significantly the number of disability tax credit claimants and the associated cost.

The number of disability tax credit claimants has expanded dramatically over the past several years. In 1985 there were 85,000 people in Canada who claimed the disability tax allowance. The 1986 change more than doubled the number of claimants in just one year. From 1985 to 1990 the number of claimants in Canada increased by 420 per cent to 355,840. In Ontario the corresponding number in 1990 was 149,000. Statistics Canada's 1991 Health and Activity Limitation Survey estimated that the range of potential recipients in Canada was 360,000 to 490,000. The difference between the number of claims and the estimated potential claimants might be attributable in part to the fact that the credit provides no benefit to people with insufficient income to be taxable. However, expanding the definition of disability for eligibility would do little to solve this problem.

Advocates for people with disabilities believe that non-refundability of the disability tax credit is its most important limitation. The average tax benefit in Ontario in 1990 was $751 per claimant. This amount varied only slightly by income group. The fact that the disability tax credit is a tax relief measure and not a direct transfer means that the lowest-income group received the lowest benefit, on average $317 (table 16.3). Some individuals receive nothing despite having significant disability-related expenses. However, if a person has a spouse or supporting relative with a taxable income high enough to use all or part of the unused portion, the family unit can still benefit because the disability tax credit is transferable. In 1990, about 30 per cent of disability tax credit claims were transferred to other taxpayers (Fair Tax Commission calculation based on Revenue Canada microdata file).

Despite the fact that the disability tax credit is transferable, advocates favour converting it into a refundable tax credit to extend the benefits now available to people who have a tax liability to those who do not have a tax liability. Transferability significantly reduces the losses to low-income people with disabilities. But there remains an inequity between disabled persons with supporting relatives and those without. Transferability is also perceived to reinforce the dependency of people with disabilities. A refundable credit has the advantage of being paid directly to the relevant person.

There are several problems with converting the disability tax credit to a refundable credit. Cost is likely the least serious issue because the transferability option already extends the credit substantially beyond the actual target group. If the disability credit were converted to a refundable credit, it would result in a net benefit to people with disabilities who receive social assistance benefits only if the amount of the credit is disregarded in determining social assistance benefits entitlements. Otherwise, conversion to a refundable credit would simply shift a portion of the cost of social assistance for people with disabilities from the provincial to the federal government. In addition, under the current Tax Collection Agreements, a federal initiative to make the credit refundable would have the effect of increasing provincial revenues from income taxation of people with disabilities, by the amount of the $38 million provincial share of the cost of the current non-refundable credit.

In principle, we support the extension of the support provided now by the disability tax credit to non–tax-paying individuals with disabilities. The credit is clearly a social benefit that bears no relationship to the actual spending of individuals on disability-related needs or to the degree of their disabilities. It is a reflection of the desire of government to provide a general benefit to all people with severe disabilities and should be designed to do so. It does not, however, follow that the best way to do this is to make the disability tax credit refundable.

TABLE 16.3
Analysis of Disability Amount
Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	1.1	0	1
10,000 and under	15.3	7	317
10,001–20,000	33.5	39	793
20,001–30,000	23.8	30	859
30,001–40,000	12.0	16	887
40,001–50,000	6.0	8	868
50,001–60,000	3.9	5	878
60,001–70,000	1.7	2	906
70,001–80,000	0.5	1	858
80,001–90,000	0.4	1	862
90,001–100,000	0.7	1	838
100,001–150,000	0.7	1	1046
Over 150,000	0.6	1	858
All tax filers	100.0	112	751

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

Originally the disability amount was provided in the form of a deduction. As a deduction it was intended to allow people with disability-related costs to deduct these costs before calculating their taxable income. This was and is the conventional way of assuring horizontal equity between people with and without these expenses. When the deduction was converted to a credit, it became much more clearly a social benefit unrelated to specific expenses. The fact that there are refundable credits that provide benefits to very low-income people frequently leads people to conclude that non-refundable credits should be converted to refundable credits as a matter of fairness.

Making the disability tax credit refundable would solve the problem of some low-income people not receiving any benefit. Once the decision is made to provide the benefit to all people with disabilities, regardless of whether or not they have a liability for tax, the delivery question then becomes: Is there an inherent reason why it would be better to deliver these benefits through the tax system than to do so directly? In our view, the latter conclusion is the appropriate one. Because of the difficulty in defining disability and because it is impossible to recognize systematically the degree of disability, the tax system is an extremely blunt mechanism for the delivery of benefits that are unrelated to tax liability.

We believe the disability tax credit should be converted to a flat rate benefit delivered outside the tax system. Government should provide, as a matter of social commitment, a constant dollar benefit, regardless of income, to all eligible people with disabilities. The superiority of a flat rate approach to the provision of this benefit is reinforced by the fact that it would be an open and highly visible program administered by the appropriate government department responsible for support for people with disabilities, rather than federal or provincial departments of finance that have little experience with such matters. The attractiveness of a flat rate non–tax-related benefit for disability is also enhanced by the fact that it can be made taxable to recover some portion of the benefit from high-income people. We favour converting the disability tax credit to a flat rate benefit delivered outside the tax system in principle; for Ontario we specifically recommend that under a new tax collection agreement it convert its disability tax credit to a provincial disability flat rate social benefit.

RECOMMENDATION 22

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the disability tax credit and replace it with a flat rate, taxable benefit payable to all persons with disabilities.

In making this recommendation about the structure of the benefit, we are not making a judgment about its adequacy. Indeed, there was considerable sentiment among us that the current level of support for people with disabilities is inadequate. However, as in other cases, we believe that a recommendation to spend more in this area (whether through the tax system or directly) is not within our mandate.

Medical Expenses Tax Credit and Attendant Care Deduction

The medical expenses tax credit is designed to be a measure of support for the specific and identifiable costs of sickness or disability. An individual may claim allowable expenses above a threshold of 3 per cent of income or $1614, whichever is less. The value of the credit is 17 per cent of the claim from the federal income tax, plus an Ontario amount equivalent to 58 per cent of the federal tax saving. For people with disabilities, the threshold is designed to ensure that compensation is provided only to those with extraordinary expenses over and above those covered automatically by the disability tax credit. For example, it is assumed that the disability tax credit will cover approximately the first $1100 in disability related expenses. For an individual with a gross income of $15,000, no other deductions, and $1000 in medical expenses, the credit will result in a reduction of federal and provincial tax payable of approximately $148. With $2000 in medical expenses, the credit will provide a tax saving of approximately $416. The main criticisms of the medical expenses tax credit by people with disabilities are its threshold, its list of allowable medical costs, and its non-refundability.

The problem with the threshold for the medical expenses tax credit is that it provides proportionately larger benefits for people who are sick and suffer temporary disability and who incur extraordinary one-time costs than for those with more severe and permanent disabilities and ongoing costs. Expenses are creditable only above a certain percentage of income. Someone with expenses spread over 10 years loses 10 times the threshold amount from the total claim. Someone who claims the same amount all in one year has the threshold amount subtracted only once. In addition, people with disabilities are frustrated that self-employed persons with disabilities seem to be able to claim the same items they claim under the medical expenses tax credit as business expense deductions with no threshold. Since the employment expense deduction for everyone was eliminated in 1988, employed persons with disabilities have lost an avenue for claiming similar expenses at the same rate as the self-employed (with the exception of the attendant care deduction). Lowering or removing the threshold would significantly improve compensation for such individuals.

Disability-related medical expenses most often claimed by people with disabilities under the medical expenses tax credit include drugs, assistive devices, medical supplies, health services not covered by OHIP, modifications to residences to make them more accessible, travel to and from treatments, personal services, home care, rehabilitative services, and nursing care (Ontario Ministry of Citizenship 1990, 19). A list of goods and services eligible for credit is published and updated each year by the Department of Finance as new allowable items are identified. Critics argue that the list always excludes important items. For example, an air conditioner cannot be claimed as an expense by a person who requires one for disability-related reasons because it is not specifically designed for people with disabilities (Sherman 1989, 56). It is estimated that approximately 45 per cent of the disability-related expenses of those with severe disabilities cannot be claimed as medical expenses eligible for credit (Canada Department of Finance 1991b, 48). Although many of the goods and services not covered, such as special transportation, are provided from other sources, there are many obvious gaps in the system. For example, although expenses associated with the servicing and maintenance of equipment can be claimed for credit, no benefits accrue to individuals who pay no income tax. For some equipment, the purchase price is relatively small compared with the operating and servicing costs.

Attendant care can be claimed under the medical expenses tax credit. As an alternative, an employed person can deduct part-time attendant care costs up to a maximum of $5000 from income. As a deduction, this provision is more valuable for those earning higher incomes and paying taxes at higher marginal rates. In addition, unlike the medical expenses tax credit, the deduction for attendant care expenses has no threshold. This treatment of attendant care expenses has been criticized because of its bias against the generally less costly and more desirable option of independent living at home. Disabled individuals who live in nursing homes or other institutions can claim the entire cost of their care as a medical expense. Individuals who live at home and participate in day programs or have attendant care are limited to a $5000 deduction. The tax treatment of attendant care expenses is exceedingly complex. This complexity alone suggests the need for reform to make the system easier to understand. As it currently stands, many people with disabilities require professional tax advice and planning to assure they benefit from all the tax options for which they are eligible.

Finally, disability groups argue that, as with the disability tax credit, the non-refundability of the medical expenses tax credit is a serious weakness. As is the case with the disability tax credit, the fact that the medical expenses tax credit is transferable to a supporting relative significantly increases the opportunities for low-income people with no tax payable themselves to receive some benefit. While we share the view that low-income people should receive some benefit from government to offset their specific and identifiable costs of sickness and disability, we are not convinced that making the medical expenses tax credit refundable is the most effective way of doing so. In effect, making the credit refundable means creating a separate tax benefit for quantifiable disability-related medical costs. The argument against making the medical expenses tax credit refundable is similar to the argument against making the disability tax credit refundable. A more direct form of partial or even full reimbursement for costs incurred would be preferable. A more direct form of compensation would also allow the appropriate authority more flexibility to lower thresholds and to expand eligible expenses as matters of social policy.

RECOMMENDATION 23

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the credit for disability-related medical expenses and the deduction for attendant care. In their place, Ontario should establish a program outside the tax system to subsidize the cost of attendant care or medical expenses for persons with a disability.

Seniors and Taxes

In 1991 almost 12 per cent of the Ontario population was 65 or older (Statistics Canada 1992c, 12). The average income of elderly families and unattached individuals was $32,018 in 1991, about 66 per cent of the average income of all families and unattached individuals in the province in that year (Statistics Canada 1992d, 107, 114). The average income of families and unattached individuals where the head of the household was 65 to 69 was about 18 per cent higher than that of families in which the head was 70 or older. In 1991, 37 per cent of elderly Ontario families and unattached individuals had an income of between $10,000 and $20,000, compared with 16 per cent of all families and unattached individuals (Statistics Canada 1992d, 107, 114). In all income groups from $30,000 and above, there were proportionately fewer elderly families and unattached individuals compared with the general population of the province.

In addition to the seniors' portion of the Ontario property and sales tax credit discussed earlier in this chapter, the personal income tax system supplements the incomes of seniors through two separate provisions that give tax relief for seniors: the non-refundable age credit and the non-refundable pension income credit. These tax measures reduce the average tax paid by seniors significantly below that paid by non-seniors at the same level of income. As a result, seniors at all income levels pay a lower proportion of their income in taxes than people under 65 years of age. Ontario shares in the cost of the tax expenditures.

Age Credit

Every taxpayer aged 65 years and over is eligible to claim the age credit. The federal credit was 17 per cent of $3482 in 1992. The provincial portion (54.5 per cent of 17 per cent in 1992) is a further 9.9 per cent. The total value for someone who pays tax was approximately $938 in 1992 ($615 in federal tax relief, and $323 in Ontario tax relief). Any unused portion of the credit is transferable to the taxpayer's spouse. The age credit cost the Ontario government approximately $227 million in forgone taxes in 1990, and the federal government a further $450 million in Ontario alone for a federal and provincial total of $677 million (table 16.4).

This special treatment of seniors in the tax system has been justified in several ways. First, it is a way of recognizing the lifelong contribution of seniors to Canadian society. It is argued that this contribution merits a social benefit to all seniors regardless of income. This was originally the rationale for the federal Old Age Security program, which pays a flat rate benefit of approximately $4600 a year

(1993) to every Canadian aged 65 or over who meets a residency requirement.[10] Second, it is based on the recognition that seniors generally experience a drop in income upon retirement and on average have significantly lower incomes than other Canadians. It is argued that because seniors have less ability to pay tax in general, tax relief is justified. Third, it is argued that because a high proportion of seniors have low pension incomes, they merit special assistance, in this case in the form of tax relief. About 80 per cent of people who claimed the age credit in Ontario in 1990 had incomes below $30,000.

Public policy in recent years has moved away from universal social programs. For example, although Old Age Security is still described as a "universal" benefit, in 1989 the federal government imposed a claw-back of Old Age Security payments, which now requires higher-income recipients to pay back at tax time part or all of the benefit they receive. In addition, restrictions were introduced to limit payments of Old Age Security to immigrants. Full benefits are now payable only to those who have resided in Canada for 40 years after the age of 18.

In this context the age credit stands out as potentially the only fiscal measure left in Canada which gives a public benefit to all seniors. However, as a universal benefit for seniors the age credit is inferior to a direct spending program such as Old Age Security as it was originally designed. Because the credit is non-refundable, it is of little or no value to very low-income seniors, many of whom are single elderly women, who have no tax payable and no spouse to whom to transfer any unused portion of the credit. In addition, because it is non-taxable (its net value is calculated after tax), it provides the same benefit to recipients over a broad income range. Old Age Security is taxable and, therefore, before the claw-back gave its largest benefit to low-income seniors and a declining net or after-tax benefit to higher-income seniors with higher marginal tax rates.

---

[10] There are important differences. Tax relief gives no benefit to those who have no tax payable, and Old Age Security is a taxable benefit. In addition, there is a special claw-back on Old Age Security benefits paid to high-income seniors.

TABLE 16.4
Analysis of Age Amount
Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	0.7	0	1
10,000 and under	25.0	67	271
10,001–20,000	33.4	263	794
20,001–30,000	19.1	162	856
30,001–40,000	9.1	78	861
40,001–50,000	4.8	41	862
50,001–60,000	2.7	23	862
60,001–70,000	1.3	11	863
70,001–80,000	0.9	8	861
80,001–90,000	0.6	5	860
90,001–100,000	0.5	4	860
100,001–150,000	1.0	8	859
Over 150,000	0.8	7	861
All tax filers	100.0	677	684

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

On balance, we believe the most equitable way to distribute the support currently provided to seniors through the age credit is in the form of a refundable tax credit. This revised credit would provide assistance to low-income seniors who are not able to receive any benefit (or receive only a small benefit) from the current credit.

RECOMMENDATION 24

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the age tax credit and replace it with a seniors tax credit. This credit should be refundable and provide a declining benefit as family income rises.

TABLE 16.5
Analysis of Eligible Pension Income Amount
Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	0.1	0	0
10,000 and under	6.9	4	83
10,001–20,000	32.0	54	229
20,001–30,000	26.3	49	251
30,001–40,000	14.4	27	254
40,001–50,000	8.0	15	253
50,001–60,000	4.4	8	256
60,001–70,000	2.5	5	254
70,001–80,000	1.5	3	252
80,001–90,000	1.0	2	248
90,001–100,000	0.8	1	251
100,001–150,000	1.3	2	247
Over 150,000	1.0	2	251
All tax filers	100.0	172	233

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

Pension Income Credit

Seniors in receipt of private pension or annuity income may claim a credit of 17 per cent of the first $1000 of income received from that pension in computing their Basic Federal Tax. At the current provincial tax rate of 58 per cent of Basic Federal Tax, this generates a further benefit of 9.9 per cent of the first $1000 against provincial tax. Eligible pension income includes annuity payments under a superannuation or pension plan, a registered retirement savings plan, a deferred profit-sharing plan, and payments under a registered retirement income fund. Eligible pension amounts do not include payments under Old Age Security, the Guaranteed Income Supplement, or payments under the Canada Pension Plan.

The tax benefit provided by the pension income credit is equal to approximately $270 in tax relief for seniors at all income levels if they have incomes high enough to pay taxes. The average tax benefit in

1990 was $233 per claimant (table 16.5). However, the average benefit for tax filers with incomes below $10,000 was only $83. Over 65 per cent of claimants of the pension income credit had incomes below $30,000. Any unused portion of the credit is transferable to a tax-paying spouse. In 1990 the total federal and provincial tax expenditure in Ontario for the credit was $172 million ($58 million of which was Ontario's contribution).

Prior to 1988 the tax relief provision for pension income in the personal income tax was in the form of a deduction that gave tax exempt status to the first $1000 of pension income. This was originally intended to be an incentive to participate in a private pension plan and to maintain a measure of purchasing power of private pension income which is generally not indexed to increases in the cost of living. However, as a deduction it provided a larger dollar benefit to taxpayers with higher incomes and higher marginal tax rates. As part of its 1988 tax reform, the federal government converted the pension income deduction to a credit. The pension income credit now results in an equal dollar amount to all taxpayers with qualifying pension income and sufficient tax.

The credit delivers up to $270 in tax savings to seniors with income from private pensions, while seniors who receive income only from the Canada Pension Plan and Old Age Security receive no benefit. In effect, the pension income credit provides a supplemental tax benefit to elderly Canadians who are on average better off than those who rely exclusively on public pension income. In addition, there is an inherent bias against women in this provision because women are far less likely to have a private pension or annuity income than men. On average, Ontario women in retirement receive 50.7 per cent of their income from government programs such as OAS, GIS, and CPP and only 14.0 per cent from private pensions. Ontario men in retirement, on average, receive 39.5 per cent of their income from government transfers and 25.1 per cent from private pensions. This reflects the fact that historically women did not participate in the labour force to the same extent as men, and, when they did, they were employed in jobs that did not include pension benefits as part of the compensation package. We see no justification for providing an additional tax subsidy to seniors who have private pension income that is not available to seniors without such income.

RECOMMENDATION 25

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the pension income credit. The revenue recovered by eliminating this credit should be used to increase the value of the seniors tax credit.

Retirement Savings

Tax assistance for private retirement savings is the biggest single tax expenditure in the personal income tax system and, arguably, the most important social program delivered through the tax system. Taxpayers are allowed to deduct from income their contributions – up to limits – to individual Registered Retirement Savings Plans (RRSPs) or to Registered Pension Plans (RPPs). In addition, it allows for the tax-free accrual of interest in these funds. Tax is imposed on withdrawals from pension funds. The combined national total tax expenditure for the deductions and non-taxation of interest accruals on RRSPs and RPPs was estimated to be $15.4 billion in 1989 (Canada Department of Finance 1992b, 13). The total provincial tax expenditure in Ontario was $2.7 billion (Block and Maslove n.d.). Only a small part of the revenue forgone was recovered through taxation of withdrawals from these plans. At the federal level, $3.5 billion in tax was collected from the taxation of RRSP and RPP withdrawals in 1989; Ontario's share of the tax receipts on withdrawal was $720 million. The net provincial tax expenditure for retirement income savings in Ontario, after the taxes on withdrawals are taken into account, was $1.98 billion in 1989.

The RRSP and RPP tax deductions are intended to help taxpayers save for retirement. However, it has been argued that the tax treatment of retirement savings is simply a way for people to spread their incomes over a longer period of time for tax purposes, and thus to make their tax liability better reflect their incomes over the period.

The Carter Commission, in its 1966 report, pointed out that "by allowing taxpayers to deduct their contributions to pension plans from other income, and by taxing them only on what they take out of such plans, thus deferring the imposition of tax on both the contributions and the current income earned on the assets of such plans, an income tax system is converted into a modified form of expenditure tax" (Carter Report 1966, vol. 3, 411–12). Nevertheless, the principal public policy rationale for providing special tax treatment for retirement savings has always been to encourage Canadians to save for their retirement (Ingerman and Rowley 1993).

These provisions have also become important in stimulating savings for investment. Because restrictions are placed on the share of foreign investment allowed in retirement savings plans – only 18 per cent of RRSP funds may be in foreign holdings – they are a critical source of investment dollars for Canadian economic growth. In spite of these considerations, in our view tax assistance for private retirement savings must be assessed principally on the basis of its role in Canada's retirement income policy. These tax expenditures represent a major loss of tax revenue, and they are equivalent to almost 42 per cent of total government direct spending on retirement income through such programs as Old Age Security and the Canada Pension Plan (Ingerman and Rowley 1993).

Federal personal income tax reforms that took effect in 1991 were designed to establish a common limit for tax assistance to all forms of private retirement savings, whether accumulated through RRSPs or through various types of private pension plans. Among those changes was an increase in the limits on contributions to RRSPs to match the size of pension that can be generated by an individual in an employer-sponsored plan. While various forms of private retirement savings now receive comparable tax assistance, the fundamental question of whether such assistance is appropriately delivered through the tax system remains.

A number of policy issues are raised by the existing system. If the objective of tax assistance for private retirement savings is to help taxpayers save for retirement, then all forms of retirement savings subsidized through the tax system should be on the same footing. Although the 1991 reforms established a common limit of tax assistance to all forms of private retirement savings, whether through RRSPs or registered pension plans, there is no requirement that funds saved through RRSPs be used for retirement purposes. A taxpayer may withdraw RRSP funds at any time for any purpose, although when withdrawn, funds must be included in taxable income. A taxpayer whose tax-assisted retirement savings are channelled through a registered pension plan may use the fund only to provide a pension at retirement. Pension legislation requires that funds from a registered pension plan transferred to an RRSP – for example, when an employee moves from one employer to another – must be locked into the RRSP and may only be used to provide a lifetime benefit for the holder at retirement.

It seems to us that if RRSPs are considered equivalent to pensions for tax purposes, there can be no justification for allowing RRSP holders to use their tax-assisted funds for purposes other than providing a pension at retirement. As long as tax assistance is given to RRSP contributions to encourage taxpayers to save for retirement, regulatory authorities would be justified in requiring that funds invested in an RRSP be locked in and may only be used to provide a lifetime benefit for the holder at retirement.

There are also serious problems with the existing system in terms of coverage. Only 50 per cent of men and 39 per cent of women in paid employment belong to private pension plans (Statistics Canada 1991b). With respect to RRSPs, only 27 per cent of men and 19 per cent of women who filed tax returns claimed an RRSP deduction in 1988 (FTC estimates based on Revenue Canada 1990 unpublished microdata). Given the likely overlap resulting from the same individual belonging to a pension plan and contributing to an RRSP, it would appear that tax subsidies for contributions to these plans do not benefit a large proportion of the population.

In addition, the system of tax assistance is linked to income in such a way that the higher the taxpayer's income, the bigger the tax subsidy. First, the limits on tax-assisted retirement saving are tied directly to earned income up to a maximum amount of tax-free saving. Up to this maximum, the higher the taxpayer's income, the greater the amount of tax assistance for retirement saving the individual is entitled to receive. Second, because the assistance is given in the form of a deduction from income, the tax benefit flowing from a given dollar amount of retirement saving increases as the marginal rate of tax paid by the taxpayer increases. As a result, higher-income taxpayers receive proportionately more assistance for a given amount of retirement saving than taxpayers whose marginal tax rate is below the maximum. While the average tax benefit of the RRSP deduction of contributions was $1079 per claimant in 1990, it was

TABLE 16.6
Analysis of RRSP Contributions
Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	0.0	0	0
10,000 and under	2.4	3	80
10,001–20,000	11.0	61	352
20,001–30,000	20.9	167	502
30,001–40,000	23.1	366	998
40,001–50,000	16.9	309	1146
50,001–60,000	9.7	201	1306
60,001–70,000	5.6	161	1811
70,001–80,000	2.8	89	1993
80,001–90,000	1.8	71	2435
90,001–100,000	1.2	50	2563
100,001–150,000	2.4	108	2882
Over 150,000	2.2	131	3663
All tax filers	100.0	1717	1079

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

$3663 for those with incomes above $150,000 and less than $1000 for those with incomes less than $40,000 (table 16.6). With the significant increase in the maximum RRSP contribution since 1989, this disparity has almost certainly grown. Not surprisingly, a very high proportion of high-income tax filers take advantage of the benefit, compared with taxpayers at lower income levels. For the RPP deduction the average tax benefit was $713; the average benefit for the bracket with the highest number of claimants – $30,000 to $40,000 – was only $608; and the average for taxpayers in the $100,000-plus bracket was in excess of $2000 (table 16.7).

Tax assistance for private retirement saving also delivers benefits to individuals with much higher incomes than other forms of publicly supported retirement income. Old Age Security benefits are reduced for people with incomes above approximately $53,000 at the rate of 15 cents in lost OAS benefit for each dollar of additional

TABLE 16.7
Analysis of RPP Contributions
Tax Returns for Ontario, 1990

Tax filer income for tax purposes ($)	Distribution of claimants (%)	Direct tax impact – aggregate ($ millions)	Average tax impact per claimant ($)
Nil or negative	0.1	0	0
10,000 and under	1.6	1	25
10,001–20,000	7.6	12	127
20,001–30,000	22.0	68	244
30,001–40,000	26.4	203	608
40,001–50,000	17.6	189	847
50,001–60,000	12.2	181	1176
60,001–70,000	6.1	115	1487
70,001–80,000	2.6	50	1536
80,001–90,000	1.4	26	1463
90,001–100,000	0.9	19	1685
100,001–150,000	1.2	30	2002
Over 150,000	0.4	9	1739
All tax filers	100.0	902	713

Source: Fair Tax Commission calculation based on Revenue Canada micro-data file.

income. Canada Pension Plan benefits cover only 25 per cent of the Yearly Maximum Pensionable Earnings (YMPE), which is equivalent to the average wage. In 1993 the YMPE is $33,400. In contrast, by 1996, when new pension rules are fully phased in, the earnings corresponding to the maximum contribution to RRSPs or private pension plans will be about 2.5 times the average wage. Tax assistance for retirement savings through RRSPs and pension plans is available at much higher incomes than any other form of public assistance for retirement income.

The working group on Women and Taxation addressed the question of the differential impact of tax assistance to private retirement savings between women and men. It found that women are less likely to belong to a pension plan and have less disposable income from which to save for retirement (Women and Taxation Working Group 1992, 18). As a result, the use of the tax system to deliver subsidies for retirement savings through RRSPs and private pension plans means that the economic inequality faced by women translates directly into lower subsidies for retirement savings for women than for men, even though women are more likely to need assistance.

This imbalance between public pension programs and subsidies for private retirement savings has grown dramatically in recent years. While public pension programs available to all Canadians are being cut back, tax assistance for private retirement savings has been increased. Higher contribution limits for pension plans and RRSPs are being phased in and will result in even greater revenue loss from these programs over the next few years.

Assuming that the objective of public policy for retirement incomes is to ensure that all Canadians have adequate incomes in retirement, we believe that some adjustment should be made to achieve a fairer balance between public support for private retirement savings delivered through the tax system and other forms of public support for retirement. We can see no justification for subsidizing individuals who are members of registered pension plans or who contribute to RRSP to accumulate pensions equivalent to 2.5 times the average wage, when other forms of public assistance for retirement income are set at much lower levels.

RECOMMENDATION 26

The maximum retirement benefit eligible for tax assistance through the deduction for contributions to registered pension plans and Registered Retirement Savings Plans in the personal income tax and the deduction of contributions in the corporate income tax is currently 2.5 times the average industrial wage. Ontario should seek the agreement of the federal government to reduce this limit to 1.5. This lower limit should be phased in by freezing the pension maximum and corresponding contribution limits at current levels until the maximum pension and corresponding limits are equivalent to 1.5 times the average industrial wage. Thereafter, contribution limits should be indexed to maintain the ratio.

This recommendation is consistent with that made by the parliamentary committee on pension reform (Canada House of Commons 1983). The committee pointed out that a tax-assisted pension plan of one and one-half times the average wage is over six times the maximum pension now payable under the Canada Pension Plan and would be in addition to OAS benefits.

The parliamentary committee also recommended replacing the tax deduction for qualified contributions with a credit. In our view, tax assistance to private retirement savings should not provide greater support to higher-income earners than to lower earners.

RECOMMENDATION 27

Ontario should seek the agreement of the federal government to convert the deductions for contributions to registered pension plans and RRSPs in the personal income tax and corporate income tax to tax credits. Withdrawals from plans should continue to be taxed as ordinary income.

Part Seven
Enhancing Progressivity in the Tax System

17 Taxation of Dividends and Capital Gains

We have presented the general case for increased overall progressivity in the tax system. Now we turn to the means by which this can be achieved, focusing on two specific tax bases. Later (part 12), we recommend changes in the tax mix that, in part, are also designed to achieve a more progressive Ontario tax system. Of the two specific taxes investigated in this part, the wealth tax, discussed in chapter 19, is not currently utilized in Canada. The other, the personal income tax, can be made more progressive by adjusting its rate structure (chapter 18) and by broadening its base to include certain kinds of income not now fairly taxed. Indeed, because these sources of income are currently taxed more lightly than others, these base-broadening measures can promote both horizontal and vertical equity. In this chapter we assess two such base-broadening measures, involving income from dividends and capital gains. This chapter concludes with a brief discussion of the tax treatment of owner-occupied housing, a matter which was raised at several of our public hearings, and which is appropriately considered in the same context.

Sources of Income by Income Group

Table 17.1 presents information on the different types of income earned by different income groups in Ontario for the taxation year 1989. The top half of the table shows the percentage of all income and of each source of income received by each income group.

The bottom half of the table indicates the composition of income for all tax filers in aggregate and within each income group.

Two patterns are clearly apparent in the data on dividends and capital gains. First, from the top half of the table, the distribution of different sources of income by income group indicates that, of the total amount of dividends and capital gains received by Ontario tax filers in 1989, most were received by high-income tax filers with taxable incomes of $100,000 or more: 21.9 per cent of the taxable amount of Canadian dividends and 25.2 per cent of taxable capital gains were earned by taxpayers with incomes of $100,000 to $250,000; and 28.1 per cent of dividends and 41.8 per cent of capital gains were received by taxpayers with incomes greater than $250,000. Second, as shown in the bottom half of the table, statistics on the composition of income within each income group indicate that dividends and capital gains accounted for a much larger share of total income for high-income tax filers with taxable incomes over $100,000 in 1989 than they did for all tax filers in aggregate. Dividends accounted for 2.2 per cent of all taxable income in Ontario in 1989 and capital gains accounted for 3.1 per cent, but tax filers in the $100,000 to $250,000 income group received 6.8 per cent of total income in the form of Canadian dividends and 10.7 per cent as capital gains, and tax filers with taxable incomes above $250,000 received 8.5 per cent from dividends and 17.4 per cent from capital gains.

Similar patterns emerge from a study of high income tax filers prepared for the commission (Murphy, Wolfson, and Finnie, n.d.). Part of this study focused on the top 1 per cent and the top 0.1 per cent of Ontario tax filers in 1990 (approximately 66,500 and 6600 individuals, respectively). The average reported income for the top 1 per cent group was over $283,000, while the average for the highest 0.1 per cent group was almost $1 million. In 1990, the highest-income 1 per cent of Ontario tax filers received, on average, about 9 per cent of their incomes from each of dividends and capital gains, compared with averages of about 6 per cent from each source for the top 5 per cent of filers and with less than 1 per cent from each source from the rest of the tax-filing population (the bottom 95 per cent). For the top 0.1 per cent group the shares were about 12 per cent from dividends and 9 per cent from capital gains.

TABLE 17.1
Sources of Taxable Income by Income Group (Individuals), Ontario, 1989

	Income group ($ thousands)						
	10 and under	10–30	30–60	60–100	100–250	Over 250	All tax filers
Distribution of tax filers (%)	27.1	40.7	26.1	4.4	1.4	0.3	100.0
Distribution of income by income group (%)							
Employment income	3.7	28.3	45.7	12.1	5.0	5.4	100.0
Taxable transfers (e.g., UI)	20.0	55.6	19.5	3.3	1.2	0.3	100.0
Pensions and annuities	7.4	47.6	32.1	8.5	3.2	1.1	100.0
Taxable dividends	0.5	9.6	21.9	17.9	21.9	28.1	100.0
Taxable capital gains	0.6	3.7	12.0	16.8	25.2	41.8	100.0
Other investment income	6.2	33.6	29.9	11.9	9.3	9.0	100.0
Net self-employment income	4.5	20.0	19.2	13.1	28.7	14.4	100.0
Miscellaneous	10.9	30.3	25.1	10.5	9.2	14.0	100.0
Total	4.6	29.3	39.7	11.8	7.2	7.4	100.0
Composition of income by income source (%)							
Employment income	56.9	69.4	82.7	73.3	49.2	52.5	71.9
Taxable transfers (e.g., UI)	15.0	6.6	1.7	1.0	0.6	0.1	3.5
Pensions and annuities	10.1	10.2	5.1	4.5	2.8	1.0	6.3
Taxable dividends	0.3	0.7	1.2	3.4	6.8	8.5	2.2
Taxable capital gains	0.4	0.4	0.9	4.3	10.7	17.4	3.1
Other investment income	9.1	7.8	5.1	6.8	8.7	8.2	6.8
Net self-employment income	4.8	3.3	2.4	5.4	19.4	9.5	4.9
Miscellaneous	3.4	1.5	0.9	1.3	1.8	2.8	1.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Fair Tax Commission calculations based on Revenue Canada micro-data file.

Note: Numbers may not add to 100 per cent due to rounding.

Deductions related to capital gains accounted for 47 per cent of total deductions claimed by the top 1 per cent group (46 per cent for the top 0.1 per cent group), compared with 37 per cent for the highest-income 5 per cent group and about 6 per cent on average for all others. Similarly, the dividend tax credit accounted for 39 per cent of all non-refundable credits claimed by the highest 1 per cent (47 per cent for the 0.1 per cent group), compared with only 25 per cent of credits for the top 5 per cent and less than 2 per cent on average for all others. These results indicate that not only are these sources of income from capital distributed disproportionately towards higher-income individuals, but that they are concentrated heavily among the top few percentile groups. As a result, the benefits of preferential tax treatment accrue mainly to taxpayers with the very highest incomes. Measures to reduce or eliminate these preferences can therefore be expected to enhance the progressivity of the income tax and the tax system as a whole, even if the schedule of rates remains unchanged.

In addition, largely as a result of the preferential treatment accorded these sources of income, horizontal equity is also compromised. The study of high-income Ontarians indicates that there was a significant dispersion of average effective income tax rates among taxpayers in the highest one-fifth of the income scale over the period 1982–86. While about one-third of this group had effective tax rates between 30 and 40 per cent, almost one-fifth paid less than 20 per cent in tax. The average effective tax rate for this group was 26 per cent, quite different from the "government takes half my income" complaint that is often heard.

Dividends

Dividends received from taxable Canadian corporations are subject to special treatment under the personal income tax. Although this dividend income is taxed at regular income tax rates, the "taxable amount" of these dividends is calculated by adding 25 per cent to the cash value of dividends actually received. A federal dividend tax credit is provided in an amount equal to two-thirds of this 25 per cent "gross-up." Assuming that provincial income taxes are levied at 50 per cent of Basic Federal Tax, this produces a combined federal and provincial dividend tax credit equal to the amount of the "gross-up."

This arrangement reflects a view of the corporate income tax as a withholding tax, paid by each corporation on behalf of its shareholders and therefore properly taken into account in the form of a credit for shareholders against their personal income taxes. In theory, the gross-up and credit mechanism is designed to "integrate" the corporate and personal income taxes by requiring shareholders to pay personal income tax on the gross corporate income (before corporate income tax) they receive in the form of dividends (hence the gross-up), and to provide a credit equal to the amount of corporate income tax already paid on the dividends they receive (the dividend tax credit). In this way, the tax system prevents a tax-induced bias against incorporating business enterprises by ensuring that income earned through a corporation is not subject to tax twice – once at the corporate level and again at the personal level.

Notwithstanding these reasons, the dividend tax credit is defective as a device to integrate the corporate and personal income taxes. First, although the theory of integration suggests that the credit should be available to all shareholders, regardless of their residence or the residence of the corporation paying the dividends, the dividend tax credit is available only to *Canadian* shareholders of taxable *Canadian* corporations. Consequently, foreign shareholders of Canadian corporations and Canadian shareholders of foreign corporations do not have access to this provision. Second, while the logic of the withholding concept implies that income taxes paid at the corporate level should be refunded to tax-exempt shareholders such as charitable organizations and pension plans, the dividend tax credit is not available to these institutions. Third, while the integration rationale dictates that the gross-up and credit should correspond to the tax already paid at the corporate level, the existing gross-up and credit apply at fixed rates, regardless of whether the corporation has paid income tax or the amount of tax paid. As a result, since the current gross-up and credit arrangement assumes that corporate income taxes are paid at a rate of about 20 per cent,[1] the system is overly generous where corporate taxes are less than the assumed rate and insufficient for dividends paid by companies with income taxes greater than this assumed amount. Because combined federal and provincial corporate tax rates in Ontario are 22.34 per cent for the

---

[1] In fact, with federal and provincial surtaxes and a basic personal income tax rate of 58 per cent in Ontario, the corporate income tax rate that achieves perfect integration ranges from 21.58 per cent to 26.29 per cent, depending on the shareholder's marginal tax rate.

first $200,000 of taxable income earned by Canadian-owned small businesses, 36.34 per cent for manufacturing and processing companies,[2] and 44.34 per cent for other kinds of corporate income, the current gross-up and credit scheme generally fails to achieve full integration, except where corporate taxes are paid at less than these statutory rates on account of various corporate tax incentives.

Because of these defects – especially for large companies not subject to the small business tax rate – it is arguable that the dividend tax credit functions as an incentive to encourage Canadian ownership of Canadian corporations more than it does as an effective method of integration (Couzin 1992, 7:11). Indeed, this incentive is often mentioned as a reason why the dividend tax credit is not available to foreign shareholders of Canadian corporations. Viewed as an investment incentive, therefore, the dividend tax credit should be evaluated the same way as any other tax expenditure, by asking whether the incentive is an effective way to achieve the desired policy objective and whether it is consistent with other goals of the tax system – in particular, fairness.

The argument in favour of the dividend tax credit as an incentive to encourage equity investment in Canadian companies and lower the cost of capital to Canadian firms overlooks the increasing international integration of capital markets that makes it possible for Canadian businesses (especially large companies) to obtain equity capital throughout the world. In fact, if the cost of equity capital is determined mainly by the international marketplace, it follows that the ultimate effect of the dividend tax credit is to increase Canadian ownership of Canadian corporations; that foreign investment in these corporations will decline correspondingly; and that total equity investment in Canadian corporations will increase by only a small amount compared with this shift.

Although incentives for Canadian ownership may or may not be regarded as desirable for social or economic reasons, the way in which this incentive is distributed among taxpayers through the dividend tax credit contradicts the basic tax fairness principle of a progressive distribution of taxes. As our earlier discussion demonstrates, high-income taxpayers are the main beneficiaries of the dividend tax

---

[2] This rate will fall to 35.34 per cent in 1994 owing to a scheduled increase in the federal deduction for corporate income from manufacturing and processing.

credit, receiving a much larger share of their total income in the form of dividends than other taxpayers, and receiving most of all dividend income received in Ontario. For this reason, we question the fairness of the dividend tax credit as an incentive to increase Canadian ownership of Canadian companies.

Despite these concerns about the dividend tax credit both as a mechanism to integrate the corporate and personal income taxes and as an incentive to encourage equity investment in Canadian corporations, measures to restructure the current gross-up and credit mechanism cannot realistically be undertaken by a single province acting alone. Even if Ontario were to withdraw from the current Tax Collection Agreements, a provincially based system could not be administered, given that corporate income is often earned in several provinces (and allocated among them on the basis of a formula) and that dividends are frequently paid by corporations resident in one or more provinces to shareholders resident in other provinces. As a result, we have concluded that these issues can only be pursued effectively at the federal level.

RECOMMENDATION 28

Ontario should discuss with the federal government the effectiveness and fairness of the dividend tax credit with a view to eliminating or restructuring the credit, subject to appropriate measures to ensure that small business income is subject to the same amount of tax whether it is earned directly through self-employment or a partnership, or indirectly through a Canadian-controlled private corporation.

Capital Gains

Capital gains are also subject to special treatment under the personal income tax. Gains are recognized for tax purposes on realization (or deemed realization, for example, at death) rather than as they accrue; one-quarter of gains are excluded for tax purposes; and taxpayers are granted lifetime exemptions of $100,000 or, if the gain is from the sale of a farm or assets of a small business, $500,000.

Under a comprehensive system of income taxation, increases in asset values should in principle be subject to tax each year, regardless of whether these capital gains are actually realized by selling the assets in question (Simons 1938, 148–69, and Carter Report 1966, 50–51). In practice, however, the concern that taxpayers might have to sell these assets to pay the tax has caused most countries to tax capital gains only when the assets are sold and the gains are actually converted into cash. Of OECD member countries surveyed in a recent publication, none taxed capital gains on an annual accrual basis, only five taxed capital gains when assets are transferred by gift, and only two (Canada and Spain) taxed capital gains at death (OECD 1988, 140).[3] Although any forced "premature" realization in order to pay the assessed taxes could be offset by means of an arrangement to assess the tax but defer its payment (plus interest) until the cash is available (Krever and Brooks 1990, 143–47), no such mechanism is in use in any country that taxes capital gains as income.

Because tax may be deferred until capital gains are realized, it can be argued that this type of capital income is treated more favourably than other kinds of income on which tax must be paid each year. Moreover, capital gains may result in a further tax advantage in that taxpayers may be able to minimize tax by choosing to realize these gains when other income is low (in order to benefit from lower marginal tax rates) or when capital losses are available to offset taxable capital gains.

An accrual system for capital gains would require the valuation of capital assets on an annual basis. For assets that are non-standard or are not traded regularly in markets, accurate and fair valuation would be a problem. Whatever the merits and feasibility of an accrual system, it would be impractical for Ontario to attempt to move in this direction unilaterally, even if the Tax Collection Agreements did not exist. A change could only be implemented by the federal government and all the provinces acting in concert. Therefore, we determined not to investigate further the feasibility of shifting to the accrual system. The current system, however, does create effects that are relevant for the remaining discussion of capital gains taxation. Specifically, taxation on realization creates a "lock-in" effect that can discourage asset sales and reallocation of assets to more productive

---

[3] In Canada, capital gains tax may be deferred until subsequent transfer or sale through a tax-free "rollover," where property is transferred to a spouse or spousal trust, or the transfer involves the transfer of farm property to a child.

uses. Declaring gains that may have accrued over many years only on realization "bunches" together what would otherwise have been reported in a more or less even flow over the preceding years. With progressive tax rate schedules, the "bunched" gains may be taxed at a higher rate than would otherwise have been the case. This creates an incentive to hang on to the asset to avoid taxation; in short, the investment becomes "locked-in." Though this problem is presumably less significant under the flatter rate schedule in place since the federal income tax reform of 1987, it remains a consideration.

The second capital gains issue we identified is the 25 per cent exclusion: only 75 per cent of total gains from taxable sources are reported as income for tax purposes.[4] In 1989 this exclusion resulted in a loss of revenue to Ontario of $267 million through the personal income tax system and an additional $300 million through the corporate income tax system. Table 17.2 provides an indication of the tax rates applicable to capital gains income as a result of the exclusion compared with other forms of income.

Several justifications have been advanced for the 25 per cent exclusion. First, it is often argued that the exclusion is a "rough justice" compensation for inflation. The tax system taxes nominal capital gains, only a portion of which are real gains; the remainder simply maintains the real value of the capital asset in the face of inflation. In a fair tax system, only real gains should be taxed. Therefore, the 25 per cent exclusion can be regarded as a method to isolate only the real gains, if only approximately. Second, the exclusion is sometimes defended as an offset for the lock-in problem. Third, for corporate shares that appreciate in value as a result of tax-paid earnings that are retained at the corporate level, the exclusion can be viewed as an arrangement – like the dividend tax credit – that is designed to integrate the corporate and personal income taxes and prevent double taxation of income earned through a corporation. Finally, the exclusion is sometimes treated as an incentive to increase investment.

---

[4] Correspondingly, only three-quarters of capital losses are deductible in computing income tax. In general, these losses are deductible only against capital gains in the same year or other years (except where they result from the disposition of either shares or debt of a small business corporation), but they can be used to offset ordinary income in the year of the taxpayer's death.

TABLE 17.2
Combined Federal and Provincial Tax Rates and Effective Rates for Capital Gains, Ontario, 1993 (%)

	Taxable income (by rate bracket)[a]					
	Under $29,590	$29,590–$46,716	$46,716–$58,320	$58,320–$59,180	$59,180–$62,866	Over $62,866
Basic federal tax	17.0	26.0	26.0	26.0	29.0	29.0
Federal surtax[b]	0.51	0.78	0.78	2.08	2.32	2.32
Basic Ontario tax[c]	9.86	15.08	15.08	15.08	16.82	16.82
Ontario surtax[d]	—	—	2.56	2.56	2.56	4.21
Regular combined rate	27.37	41.86	44.42	45.72	50.70	52.35
Effective capital gains rate	20.53	31.40	33.32	34.29	38.03	39.26

Source: Tax rates cited in Coopers & Lybrand Canada, *Tax Facts and Figures*, 1993.

a. Taxable income is calculated after deductions (e.g., RRSP), but prior to subtraction of non-refundable tax credits (e.g., personal amount).
b. 3% on all basic federal tax plus additional 5% on basic federal tax in excess of $12,500.
c. 58% of basic federal tax.
d. 20% (on provincial tax between $5500 and $8000) and 30% (on provincial tax in excess of $8000) rates are effective only after 1 July 1993. Previously the rates were 14% and 20%, so effective annual rates for 1993 are 17% and 25%.

If the exclusion is a rough justice adjustment for inflation, it would appear to be too rough to constitute justice. The 25 per cent exclusion is fixed; it is not dependent on how long an individual holds an asset or on the rate of inflation over the period in which the asset is held. Indeed, in recent years we have seen the inclusion rate rise in stages from 50 per cent to 75 per cent in a manner that bears little if any relation to inflation rates. In addition, since allowable interest deductions are based on nominal rather than real interest costs, a partial inflation allowance is already built into the system. Clearly, if an inflation adjustment is thought to be necessary, an index adjustment is preferable. This, in fact, is what several countries now do, including Australia and the United Kingdom.

The exclusion is also too blunt to serve as an antidote for the lock-in problem. The extent of the lock-in effect depends on how long the asset has been held, and the relevant difference between the taxes payable upon realization and those payable if the gain were taxed on an accrual basis. In any event, in Canada the lock-in problem is substantially reduced by the requirement (subject to various exceptions) that capital gains tax is payable when property is transferred by gift or at death.

Similarly, as an integration mechanism, the exclusion is poorly designed. First, on this justification there would be no reason for the exclusion to apply to assets other than corporate shares. Second, like the dividend tax credit, the capital gains exclusion applies regardless of whether or how much income tax was actually paid by the corporation, and is of questionable value for large corporations that are able to obtain equity capital throughout the world. Consequently, while it is important to prevent double taxation of income earned through a small business and to avoid tax-induced distortions in the manner in which corporate income is distributed to shareholders, the current exclusion is a poor method of achieving either objective.

Finally, as an investment incentive, the capital gains exclusion is poorly targeted. Presumably one would want to encourage productive investment in Canada, though, as noted, the predominant result may be the displacement of foreign direct investment with Canadian investment. But, leaving that aside for the moment, the exclusion applies to all capital gains, not only those earned on Canadian investments. Moreover, the incentive effect is provided only when a successful investment is liquidated, not when the investment is actually made.

Although we oppose the continuation of the 25 per cent exclusion for capital gains, we have concluded, for two reasons, that it is impossible for Ontario alone to tax capital gains at the regular personal and corporate income tax rates. First, Ontario residents could easily avoid this measure by transferring appreciated property into a corporation resident in another province (since this is allowed on a tax-deferred basis), selling the property in the other province, and paying themselves a tax-preferred capital dividend. Second, to the extent that the exclusion functions like the dividend tax credit to reduce the combined burden on income earned at the corporate level, initiatives by a single province acting alone have to be ruled out. Since corporate income is often earned in several provinces, and shares can be held and traded in any of the provinces, such a system would be administratively impossible.

RECOMMENDATION 29

Ontario should seek the agreement of the federal government to end the exclusion of 25 per cent of capital gains from taxable income. Similarly, all capital gains should be included in corporate income for corporate income tax purposes.

The third capital gains issue is the lifetime exemption. The first $100,000 of lifetime capital gains on most investments are exempt from taxation.[5] The exemption is $500,000 for small businesses and family farms. In 1989 the cost of this provision in forgone revenue for Ontario was $529 million. (In addition, all capital gains realized from the sale of principal residences are exempt.)

Unlike the 25 per cent exclusion, which is at least partially justified in tax design terms, the lifetime exemptions were introduced and continue to be justified purely as tax expenditures. The reason for the exemption is to provide an incentive for investment and risk taking in general, with special assistance for farms and small businesses. It is also intended to compensate for the difficulties farmers and small business owners encounter in obtaining access to credit.

In our view, the exemption is too poorly targeted in terms of both focus and timing to achieve its stated purposes effectively, and therefore its continuation cannot be justified given the measure of tax fairness sacrificed. If governments wish to provide incentives for investment and risk taking to enhance economic growth, more directly focused measures would be preferable. An investment subsidy provided through the capital gains exemption does not direct investment to activities or sectors that one might identify in an economic development strategy. Rather, it offers the same benefits for capital gains from a wide array of investments, including those made outside the country, and from gains realized from holding assets as distinct from real investment.

---

[5] The federal budget of 1992 made real estate gains ineligible for this exemption.

The timing of the benefit is also questionable. Although knowledge that realized capital gains will ultimately be exempt does provide some incentive, a much more effective incentive would be one that subsidizes investors at the time the investment is being made. Further, risk taking would be encouraged more effectively by some mechanism to address investment losses rather than through the existing mechanism, which rewards winners after the fact. Moreover, tax breaks at the "back-end" of the investment cycle do not address the problem of access to capital or credit; they only benefit those who have, at least to some extent, solved that problem.

The exemption for farms is often further defended on the grounds that it operates as a form of pension fund and that it supports the survival of family farms in Canada. The pension element of farm capital would be better and more fairly addressed by creating closer parallels between this form of investment and more conventional pension funds. For example, on the sale of a farm, the proceeds could be deposited in a Registered Retirement Savings Plan or a Registered Retirement Income Fund. They would then be taxed as they are withdrawn and consumed in the same way that other pensions and retirement funds are taxed. The maintenance of family farms is addressed by other provisions, including a "rollover" provision that permits the transfer of a farm to the owner's children by gift or at death without tax.[6]

In summary, we find the arguments for the lifetime capital gains exemption not strong enough to justify the tax fairness sacrificed, and on that basis we conclude that it should be abolished. Action by the federal government that would affect the federal and provincial income tax would be the preferred way to do so. However, since the exemption (unlike the exclusion) operates only at the personal level and is not linked with the dividend tax credit, Ontario could reform its income tax in this area even in the absence of federal action. This could be accomplished under an amended tax collection agreement that allowed provinces to levy tax on taxable income and allowed the

---

[6] The ability to transfer a farm under such a tax-deferred "rollover" is contingent on the child being a resident of Canada, and that the property was used as a farm before the transaction. Ironically, there is no stipulation that the child receiving the property continue to operate it as a farm.

current capital gains exemption to be added back to "adjusted taxable income" for provincial taxation.

RECOMMENDATION 30

Ontario should seek the agreement of the federal government to abolish both the $100,000 general lifetime exemption for capital gains and the special $500,000 lifetime exemptions for farming and small business assets. If the federal government does not agree to make the changes at the federal level, Ontario should make the changes in the Ontario income tax.

Principal Residences

In several of the submissions made to the commission, the proposal to permit tax deductions for mortgage interest (and possibly property taxes as well) was advanced. These deductions are permitted in the United States and we were urged to follow that example. Our response to this idea begins with a description of the current treatment accorded to owner-occupied housing.

Strict adherence to a comprehensive definition of income as an ability-to-pay measure would treat housing quite differently from the present situation. There are two aspects to the treatment of principal residences that raise fairness questions. First, owner-occupiers derive implicit income from their principal residences that, in theory, should be included in comprehensive income and then taxed. One way to think about the case is in terms of a choice facing an individual investor. He or she could invest in a bond or other income-earning instrument, pay tax on the earnings, and then pay rent out of after-tax income. Alternatively, he or she could invest in a principal residence, receive the income from the investment in the form of housing services, and under the current income tax, pay no tax on this income. In this sense the current tax system is horizontally unfair between two individuals with the same money income but making different choices. Second, as we noted earlier, capital gains from principal residences are exempt from taxation without limit.

Under a comprehensive income definition, both the imputed income in the form of housing services and the capital gains would be taxable, with allowances made for the costs of "earning" this income, including interest payments on mortgages. Whatever the logical merits of this argument, we recognize that income in this form is perceived quite differently from all other forms. Canadians' attachment to their homes is such that, in terms of popular perceptions, a move to tax this income would be widely regarded as creating unfairness rather than moving towards fairness. Owner-occupied housing is, in addition, regarded as important to maintaining and strengthening the social fabric of our communities, and any moves to treat it less favourably would be strongly resisted. In addition, taxing imputed income again raises the potential problem of taxpayers not having the cash to pay the tax. These issues aside, the transitional problems would be enormous, given that prices in housing markets have probably long since adjusted to the non-taxation of housing income. Therefore, we do not recommend any change in tax treatment.

To follow the US example and to permit tax deductions for mortgage interest, and possibly for property taxes as well, would be reasonable, indeed fairness would require they be permitted, if the income from owner-occupied housing were taxed. In this situation, they would rightly be regarded as expenses incurred in the earning of income. To allow the deduction of these expenses when no income is deemed to be earned, however, is clearly without merit.

18 The Income Tax Rate

The personal income tax rate structure is the most visible instrument used to achieve the desired relationship between income and the amount of tax paid. Many comparisons of tax systems across jurisdictions start (and sometimes finish) with a simple comparison of statutory rate structures.[1] Decision makers, such as investors, often base their decisions on published rate structures. Although the ultimate effects and impact of a tax result from the interaction of the rate and the base, the rate structure appears to be important for perceptual as well as substantive reasons.

Definitions

Three measures are generally used in discussions of tax rates and rate schedules. The first, and probably the one most often used in non-technical discussions, is the **statutory rate** schedule. This measure is simply a statement of the tax legislation, specifying the rates that apply to the various income brackets and defining those brackets. While often quoted, the statutory rate measure is less useful for most policy purposes than either the marginal tax rate or the average effective tax rate.

The **marginal effective tax rate** is the rate of taxation that applies to the last (or next) increment in income. The marginal effective tax

[1] Some of these simple studies, along with other more sophisticated analyses, are reviewed in Ernst & Young (1993a).

rate faced by a taxpayer may vary according to the source of the incremental income (wages, capital gains, dividends, transfer payments) because the exemptions, deductions, credits, or applicable statutory rates may be different. This measure is generally regarded as the most relevant when considering the impact of tax changes on taxpayers' behaviour. For example, it is the marginal effective tax rate that affects a taxpayer's decision to work more hours (or fewer), to save more (or less), or to invest in one asset rather than another.

One way to study the marginal tax rate is in terms of its effect on an individual's wage rate. A higher marginal rate corresponds to an effective decrease in the individual's net wage rate, and the worker may accordingly seek to work more (to maintain after-tax income levels) or less (because spending time in non-work activities is less costly in terms of forgone income). The theoretical literature indicates that under different circumstances either effect could dominate. As a practical matter, most wage and salary earners do not have the flexibility to adjust their working hours down, although over time this could occur. For example, negotiators of collective agreements may opt for differing trade-offs between higher wages and shorter work weeks, partly for reasons of taxation. Individuals with the ability to determine their working hours unilaterally, and the labour force participation of some categories of individuals, may be more sensitive to marginal tax rates.

The marginal tax rate may have a similar impact on saving and investment behaviour. For example, given a nominal rate of interest, an increase in the marginal tax rate reduces the net rate of return to an investor. Savings behaviour may change as a result. Theoretically, savings may either increase because an individual will be required to save more to generate a given dollar return, or decrease because future consumption becomes more expensive relative to current consumption. Studies of investor behaviour generally conclude that, on balance, taxing interest probably decreases savings. If this conclusion is correct, nominal rates of return are slightly higher than they would be if there were no tax on interest. The composition of savings may also be affected if some saving vehicles are sheltered or taxed at lower rates.

The third rate measure is the **average effective tax rate**. This rate is the total tax paid divided by total income. It is the measure commonly used when comparing the taxes paid by various groups of taxpayers as, for example, in a comparative incidence study.[2]

Under each of these three measures a tax can be classified as progressive, proportional, or regressive. If the rate of tax increases with income, the tax is said to be **progressive**. If the rate remains constant as income changes, the tax is **proportional**. Finally, if the rate decreases as income rises, the tax is **regressive**.

While these terms are generally descriptive of the pattern of a tax, taxes are often not uniformly progressive or regressive across the entire income spectrum. A tax may be progressive over some range of incomes, proportional over another range, and regressive over yet another portion of the income spectrum. This variability is of interest, from a policy perspective, because achieving progressivity or eliminating regressivity may be a greater concern at some income levels than at others.

As we saw in chapter 4, writers who have advocated a generally progressive tax system (and progressive personal income taxes in particular) have done so on the basis of several arguments. First, they argue that a fair system of general taxation is based on the ability-to-pay principle that calls for equal sacrifice from all taxpayers relative to their income. If we accept the view that the marginal utility or satisfaction that a taxpayer derives from income declines as income rises, this argument for fair taxation implies a progressive rate schedule (Boadway and Kitchen 1984, 89).

A separate argument calls for progressive taxation as a means of achieving a redistribution of income. We do not need to review the philosophical arguments about the desirability of income redistribution,[3] but only to note that this argument leads to essentially the same tax policy prescriptions for progressive rate schedules.

A third, or stabilization, argument made in favour of progressive rate schedules is qualitatively different from the first two. In times of inflation, with progressive rates, increases in after-tax income are less than increases in total income because some taxpayers move up to higher tax brackets. The effect is to reduce consumer expenditures

[2] The study prepared for the Fair Tax Commission by Block and Shillington (n.d.) is an example of a comparative incidence study.

[3] See the studies prepared by for the Fair Tax Commission by Cassin, Green, Head, Osberg, and Panitch in Maslove (1993).

below what they otherwise would have been, thereby restraining inflationary pressures. By the same token, in recession, as incomes fall, some taxpayers will move to lower tax brackets, and, as a result, their disposable income will not fall as quickly as they otherwise would. These changes are part of a progressive rate tax system and do not require any discretionary action by government.

Arguments against progressivity are, to some extent, responses to these positive endorsements. First, some writers argue that equating higher levels of income with declining satisfaction from income is nothing more than an assumption. The opposite might be argued just as easily. Second, some economists point out that a progressive personal income tax is not a strong stabilizer, and that, with the indexing of tax brackets (which began in 1974, but which reverted to partial indexing in 1986), this argument for progressivity has lost much of its validity.

Opponents of progressive taxation argue that the efficiency costs of such taxes are high. They point to the potential effects of the marginal tax rate on taxpayers' economic decision making. A progressive marginal effective rate schedule will create a variety of economic disincentives for taxpayers facing the higher rates. Moreover, certain activities aimed at avoiding taxes are directly related to marginal tax rates. In effect, if marginal tax rates were lower, the incentive to engage in tax avoidance activity would be weakened.

A final argument against progressive rates is linked to the annual accounting period of the tax system. In an annual-based system, progressive tax rates could impose a heavier burden on a taxpayer with a fluctuating income over a number of years than on one with an equal but stable income flow over the same period.

There is fairly strong evidence that "high" marginal tax rates have undesirable effects (Day and Winer n.d.), though what is high is open to question. In the final analysis, a decision on the appropriate degree of progressivity is largely a value judgment.

On several occasions during our public hearings we heard arguments for a "flat" tax system. Generally, the flat tax idea is taken to mean that after some basic income exemption, all income would be taxed at a single rate, and other deductions, exemptions, and credits would be eliminated or severely limited. It would be a simple tax system and, because of the larger base, the rate required to raise any level of revenue would be lower than the highest rates in a progressive schedule.

We are not convinced by these arguments. While a flat tax system would be simpler than the current income tax system (or one similarly structured), the real gains would not be significant enough to justify the move. A flat rate tax with a basic exemption would be arithmetically progressive in terms of average effective tax rates, but it would be impossible to achieve a degree of progressivity consistent with a fair income tax based on ability-to-pay principles. This loss is too great a price to pay for achieving greater simplicity.

Accordingly, we adopt the position that the personal income tax should continue to be based on a progressive statutory rate structure, and, indeed, that its progressivity should be strengthened to some extent.

PIT Rate Structure

The current income tax rate structure is described in the appendix to chapter 8. As that discussion demonstrates, the current rate structure is considerably more complex than it appears. Is this complexity a problem? On the one hand, it may not be particularly serious. Generally, it does not complicate the task facing tax filers because the great majority of filers calculate their tax liabilities using tables provided by Revenue Canada, and, as well, the department is moving towards calculating refundable credits on behalf of tax filers claiming them. Moreover, this structure of rates allows the tax system to differentiate among classes of taxpayers, distinctions that probably provide more opportunities for governments to pursue policy objectives than taxing all income the same way. On the other hand, excessive complexity is not desirable; an understandable tax system enables taxpayers to see clearly the tax implications of various courses of action they may undertake. For this reason, the complex rate structure may pose problems, particularly for those at the two extremes of the income spectrum who are most likely to face the surtaxes and "special" rates.

We had three objectives in developing our recommendations on the rate structure for the personal income tax. First, individuals with low incomes should not be called upon to pay Ontario income tax (or, ideally, federal income tax). At present, despite complex provisions to eliminate these individuals' tax liabilities, many people in Ontario who live below generally accepted measures of low income do pay personal income tax. The major attempt to alleviate this burden is the Ontario Tax Reduction program (see chapter 16).

Second, we recommend that the degree of progressivity in the income tax structure be increased. The federal reforms of 1987–88 greatly flattened the rate structure, moving from 10 to three marginal rate brackets. As a result, individuals with considerable income differences pay tax at the same rate, and the top rate bracket is reached at the relatively modest taxable income of $59,180 (1993). The Ontario rates mirror the federal rates, because a province participating in the current Tax Collection Agreements levies its tax as a constant percentage of federal tax.

Several provinces, including Ontario, have tried to reintroduce more progressivity through surtaxes. However, because of the conditions of the agreements, these surtaxes must be imposed as special levies on provincial taxes exceeding a certain level. The Ontario surtaxes are an attempt to restore more progressivity within the confines of the agreements. This is a poor method of enhancing progressivity because it applies only at the highest end of the income spectrum, rather than throughout, and because it is only indirectly related to actual taxable income. We have already recommended in chapter 13 that the Tax Collection Agreements be amended to allow provinces to set their own rate schedules.

Third, we suggest that the top marginal rate should not become excessively high. Obviously what is of concern here is the combined federal and provincial rates, because that is the marginal rate a taxpayer actually faces. While we are concerned that the top rate not be excessive, there is no clear guidance in the literature or elsewhere as to where this threshold lies. A popularly cited upper limit is 50 per cent, but there is really no special significance to this number other than the possible psychological impact of a taxpayer paying more than half of his or her incremental earnings in income tax. Historically in Canada, and in other countries, the top marginal rates have often been much higher. For example, in 1973 combined federal and provincial marginal tax rates were over 61 per cent for incomes above $60,000 (Canadian Tax Foundation 1992, 7:7).

The limit to the top marginal tax rate can, in theory, be determined through two approaches. One could ask, as a matter of fairness, when the rate becomes excessive: When is it unfair for the state to tax away more than a certain percentage of an individual's marginal income? Alternatively, one could view the limit as a constraint, where moving beyond the constraint proves counterproductive because of adverse impacts on behaviour. Beyond some level, the effects of high tax rates may become strong enough to influence taxpayers' investment and work behaviour adversely. Further, in an open economy, investment in the "high tax" jurisdiction may decline in favour of "low tax" areas, and ultimately, high-income individuals may relocate. While the fairness approach is based purely on value judgment, there is some evidence to support the constraint approach, particularly in the location decisions for both investment (Ernst & Young 1993a) and individuals (Day and Winer 1993). However, as we discussed in chapter 7, these influences cannot be interpreted simply as matters of taxation or reduced to a single number.

Finally, we also note that tension exists between our second and our third objectives. If one is concerned that the top marginal rate not become too high, the amount of progressivity that can be introduced into the rate schedule is limited.

Given these objectives and constraints, we recommend that if Ontario gains control over its personal income tax, the income brackets and rate schedule should be designed to reflect certain principles.

RECOMMENDATION 31

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should adopt a personal income tax rate schedule with the following features:

- **a basic personal credit determined by multiplying the lowest Ontario personal income tax rate by the basic personal amount in the federal personal income tax;**
- **a rate schedule that is graduated over the middle-income range;**
- **a top marginal rate which would result in a combined federal/provincial top marginal rate of no more than 60 per cent and which would apply to annual taxable income in excess of $250,000; and**
- **no more than 10 tax brackets.**

We tested some options for alternative Ontario income tax rate structures that achieve these objectives. In addition to achieving the objectives and balances we have described, we considered a number of other problems as well. First, we kept in mind the revenue implications of these alternatives, noting in particular that any major changes in revenue might require adjustment elsewhere. Second, we realized it is difficult to relate individual income tax payers to measures of low income that are family or household based. The semi-official low-income cut-offs, for example, are related to family size. There is no simple way to ensure that an individual in a family below this level is relieved of income tax, while an individual with the same income, but in a family above that level, is assessed tax at an appropriate rate. This conflict is unavoidable if, on the one hand, the commitment to the individual as the unit of taxation is maintained, and, on the other hand, poverty measures and social assistance programs are designed on a family unit basis.

These proposed changes, along with other recommended changes in the income tax (elimination of the spousal credit, age credit, and pension income credit), are discussed in chapter 33. These changes, combined with alterations to other taxes (primarily the property tax) recommended elsewhere in this report, are evaluated together in order to simulate their net impact on income groups and family types, as well as their economic impacts (see chapter 35).

19 Taxation of Wealth

Canada is one of the few member countries in the Organisation for Economic Co-operation and Development (OECD) that does not levy a tax on wealth, either on an annual basis or when it is transferred through gifts or at death. The United States and Japan levy wealth taxes, as do all the countries in the European Community. Despite its prevalence in other countries, the taxation of wealth in Canada generates a great deal of controversy.

In assessing the role for a wealth tax in a fair tax system, we considered its revenue potential, estimates of the distribution of various forms of wealth tax among individuals, and the impact of wealth taxes on the economy. We also compared the administrative feasibility of a wealth tax levied only at the provincial level with that of one levied at the national level or by all provinces.

Because of publicity generated by the Wealth Tax Working Group's report, and stories in the media about the provincial government's "plans" to impose wealth taxes, many people appeared before the commission to express their views. While some urged the commission to consider seriously wealth taxes as a means to improve progressivity in the tax system, others were strongly opposed to any form of wealth tax. We also discovered that many people held misconceptions about the structure and operation of wealth taxes, and about who the taxpayers of such a tax are likely to be.

Historical Experience

Wealth transfer taxes were levied by the federal government from 1941 to 1972 and by the Ontario government from 1894 to 1979. Revenues raised by Ontario's succession duty during the 1970s declined steadily from 1.4 per cent of provincial revenues in 1971–72 to roughly 0.5 per cent in 1978–79 (the last full year of its existence). For this commission, the origins and development of federal and provincial wealth transfer taxes are less important than the reasons for their abolition federally in 1972 and provincially in 1979.

There appear to be three reasons for the federal abolition. First, since federal-provincial agreements provided that the federal government would reduce federal estate taxes in provinces with their own succession duties (British Columbia, Ontario, and Quebec) and remit 75 per cent of estate tax revenues to the other provinces, the federal government obtained little revenue from the tax while bearing the political and administrative costs of its collection. In fact, when Alberta and Saskatchewan began to rebate their shares of federal estate taxes in the late 1960s, the federal government was put in the position of collecting taxes, of which a significant share were returned to the original taxpayers. As a result of these federal-provincial arrangements, the federal government's commitment to the wealth transfer tax was weakened.

The other two reasons for abolition of the federal Gift and Estate Tax stem from the 1966 Report of the Royal Commission on Taxation (Carter Report) and the federal tax reforms that followed its release. On the one hand, the Carter Report recommended that gifts and inheritances should be taxed as income to the recipient (a recommendation that was not adopted) and that the federal Gift and Estate Tax should therefore be abolished. This undercut the rationale for a separate wealth transfer tax distinct from the taxation of income. On the other hand, the Carter Report recommended the taxation of capital gains and the taxation of "deemed" gains when property that has increased in value is transferred by gift or at death (recommendations that were adopted in part when the federal government introduced partial taxation of capital gains in 1971). This recommendation provoked political opposition to the imposition of two taxes (wealth transfer and capital gains) at the same time, and political pressure to offset introduction of the new tax on capital gains with the abolition of the federal Gift and Estate Tax. When the federal government introduced legislation in 1971 to abolish the federal Gift and Estate Tax, provincial rebate schemes and taxation of capital gains at death were both mentioned as reasons for the decision (Carter 1973, 238).

For most provinces, the federal government's decision to abolish its Gift and Estate Tax was both unexpected and unwelcome. Of the three provinces that collected their own succession duties at the time, only Quebec favoured exclusive occupancy of this tax field. British Columbia and Ontario expressed concern that federal withdrawal would invite tax competition among the provinces, leading to the eventual demise of wealth transfer taxes in Canada. Likewise, of the other seven provinces, only Alberta continued to oppose wealth transfer taxes, whereas the other six provinces sought to regain lost revenues by enacting their own succession duties, which the federal government agreed to administer until the end of 1974. This initial response was short-lived, however. Prince Edward Island never collected its tax, and by the mid 1970s every province but Ontario and Quebec had repealed their succession duties.

After the abolition of the federal Gift and Estate Tax, Ontario introduced its own Gift Tax in 1972 to protect its succession duty, and later introduced amendments designed to prevent avoidance of these taxes through transfers to Alberta corporations. From the outset, though, the provincial government made it clear that it intended to abolish its wealth transfer taxes as the capital gains tax matured. In 1977 an amendment to the Succession Duty Act allowed federal and provincial capital gains taxes arising at death as a full credit against provincial succession duties.[1] When Treasurer Frank Miller announced the repeal of Ontario's wealth transfer taxes in his 1979 budget, he reiterated the province's "long-run" objective to eliminate these taxes as "revenues from capital gains increased ... and so avoid what many consider to be double taxation." Although Quebec continued to levy a succession duty after all other provinces withdrew from the field and introduced new legislation in 1978, this tax was itself abolished in 1985.

For our purposes, there are two important lessons to be drawn from the history of wealth transfer taxation in Canada. First, the federal government's decision to abolish its Gift and Estate Tax in 1971

---

[1] The Succession Duty Act, RSO 1970, c. 449, s. 7*a*, added by SO 1977, c. 8, s. 2 (effective 20 April 1977).

indicates that the political willingness to tax wealth or wealth transfers depends on both the existence of a specific rationale for such a tax (distinct from capital gains taxes) and the net benefits for the taxing jurisdiction in terms of revenues raised versus collection and compliance costs incurred. Second, the disappearance of all provincial succession duties a little more than a decade after the abolition of the federal Gift and Estate Tax suggests that wealth transfer taxes (and perhaps other kinds of wealth taxes) are difficult to maintain at a provincial level, especially if other provinces are unwilling to impose similar taxes. The statements of successive Ontario treasurers throughout the 1970s also indicate that the decline and eventual abolition of Ontario's succession duty was motivated by a concern about the combined burden of the succession duty and capital gains taxes as well as by the technical impracticality of taxing wealth transfers at a provincial level or by the prospect of the relocation of wealth to other provinces.

Comparative Experience

Twelve of 24 developed countries considered in a recent OECD survey levy an annual net wealth tax, and 21 tax wealth when it is transferred by gift or at death. Only Australia, Canada, and New Zealand levy neither kind of wealth tax, although these countries taxed wealth transfers in the past and abolished these taxes only within the last two decades (New Zealand abolished its estate tax in December 1992). Annual net wealth taxes are popular among Scandinavian and continental European countries, but they have never existed in developed English-speaking countries, except Ireland where the tax was abolished three years after it was enacted. All the countries with an annual net wealth tax also tax wealth transfers.

Tables 19.1 and 19.2 report data on the share of total tax revenues raised by OECD member countries (all levels of government) from annual net wealth and wealth transfer taxes in 1970, 1980, and 1990.

TABLE 19.1
Annual Net Wealth Tax Revenues as a Percentage of Total Tax Revenues
OECD Member Countries

Country	1970	1980	1990
		%	
Australia	—	—	—
Austria	0.65	0.47	0.43
Belgium	—	—	—
Canada	—	—	—
Denmark	0.56	0.56	0.24
Finland	0.49	0.21	0.08
France	—	—	0.22
Germany	1.06	0.34	0.31
Greece	—	—	—
Iceland	0.80	0.61	1.29
Ireland	—	0.03	—
Italy	—	—	—
Japan	—	—	—
Luxembourg	0.43	0.18	0.33
Netherlands	0.84	0.74	0.53
New Zealand	—	—	—
Norway	0.83	0.68	1.17
Portugal	—	—	—
Spain	—	0.49	0.62
Sweden	0.70	0.27	0.41
Switzerland	3.31	2.64	2.32
Turkey	—	—	—
United Kingdom	—	—	—
United States	—	—	—
Average % of countries with tax (unweighted)	0.97	0.65	0.66

Source: Organisation for Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries, 1965-1991* (Paris: OECD, 1992).

TABLE 19.2
Wealth Transfer Tax Revenues as a Percentage of Total Tax Revenues
OECD Member Countries

Country	1970	1980	1990
		%	
Australia	2.67	0.44	—
Austria	0.22	0.17	0.14
Belgium	1.01	0.81	0.69
Canada	**1.00**	**0.07**	—
Denmark	0.35	0.43	0.56
Finland	0.26	0.25	0.44
France	0.72	0.57	0.95
Germany	0.24	0.18	0.33
Greece	1.28	1.20	1.26
Iceland	—	0.13	0.21
Ireland	1.25	0.35	0.40
Italy	0.64	0.21	0.14
Japan	0.94	0.71	1.41
Luxembourg	0.39	0.34	0.31
Netherlands	0.58	0.48	0.50
New Zealand	1.88	0.51	0.29
Norway	0.24	0.09	0.15
Portugal	1.44	0.24	0.50
Spain	0.85	0.41	0.43
Sweden	0.36	0.21	0.19
Switzerland	1.03	0.75	0.89
Turkey	0.23	0.22	0.12
United Kingdom	1.98	0.55	0.65
United States	1.61	1.09	0.96
Average % of countries with tax (unweighted)	0.92	0.43	0.52

Source: Organisation for Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992).

Two points are worth noting from these statistics. First, neither kind of wealth tax is likely to be a major source of revenue, provincially or federally. Nonetheless, although the revenues raised by these taxes tend to be small relative to total tax revenue, they are not insubstantial in absolute amounts. Germany's annual net wealth tax collected roughly Cdn $2.2 billion in 1990, while wealth transfer taxes in Japan and the United States each raised almost Cdn $20 billion in the same year.[2]

The second point worth mentioning is the apparent decline in the role of wealth taxes over the last two decades, suggesting that Canada's experience may reflect worldwide trends associated with the increasing mobility of people and capital. It is also interesting to note, however, that the share of total tax revenues raised through wealth taxes ceased to decline and actually increased slightly during the past decade. This shift may indicate an increased international interest in wealth taxation.

The Case for and against Taxing Wealth

Although the main arguments in favour of introducing wealth taxes have to do with the overall fairness of the tax system, fairness considerations are also advanced to oppose wealth taxes. Nor are fairness issues the only questions to be considered in deciding whether or not to tax wealth.

Fairness Arguments for Taxing Wealth

The most important arguments in favour of taxing wealth involve issues of fairness. Specifically, wealth taxes have a role to play in enhancing the progressivity of the tax system, ensuring that taxes are levied according to ability to pay and as part of the distributive function of the tax system.

In our view, a key requirement of tax fairness is that the distribution of the overall tax burden should be progressive. Over the past two decades Ontario has eliminated wealth taxes and has come to rely on sales taxes to raise revenue, and especially on personal income taxes both for revenue and as the primary way to achieve progressivity in the overall provincial tax system. In this context, taxing wealth is an important way to offset the effect of regressive taxes in the overall tax mix and to ensure the progressivity of the overall tax system. In addition, since most OECD member countries levy one or both types of wealth tax, wealth taxation may be one of the few areas

---

[2] Canadian equivalents are based on exchange rates existing as of 31 January 1993.

where Ontario can enhance progressivity without departing from general international practice.

Earlier chapters have documented various departures between the current personal income tax and the comprehensive income base proposed by the Carter Report and others. Among other deficiencies, we have noted that the existing personal income tax contains a number of provisions granting favourable treatment to certain kinds of capital income, particularly capital gains (see chapter 17). Even if these deficiencies are addressed as we recommend, wealth taxes may address other limitations in the personal income tax as an adequate measure of people's ability to pay tax.

First, since wealth taxes apply to the stock of capital from which capital income is derived, the taxation of wealth can be viewed as an alternative method of taxing capital income. Two arguments can be made in favour of wealth taxation on this basis. First, wealth taxes are often regarded as an equitable way to increase the tax burden on capital income on the grounds that, unlike earned income, which depends on the taxpayer's continued efforts and ceases with illness or retirement, income from capital has a considerable degree of permanence and is obtained without having to sacrifice current leisure (Institute for Fiscal Studies 1978, 350). Second, wealth taxes may ensure that at least some tax is collected from taxpayers who might otherwise avoid or evade personal income taxes and pay little or no tax on their capital income.

A second limitation of the current personal income tax involves the transfer of wealth through gifts or at death. According to the broadest definitions of income, gifts and inheritances should in principle be taxed as income to the recipients. Although this approach was recommended by the Carter Report, the federal government has never considered these receipts to be taxable income. Nor are gifts and inheritances taxed as income in any OECD member country, although they are generally subject to separate taxes on wealth transfers.[3] Wealth taxation represents one way to account for this component of people's ability to pay tax. Indeed, it is often argued that gifts and inheritances should be taxed more heavily than other kinds of

---

[3] The United States proposed to tax gifts and inheritances as income under its first income tax, enacted in 1896, but for reasons other than this provision, this legislation was struck down by the US Supreme Court.

receipts (especially earned income) on the grounds that these wealth transfers represent windfalls to the recipient that are acquired largely without personal effort (Eisenstein 1956, 256).

Finally, even with a fully comprehensive income tax, it can be argued that wealth taxes have a role to play in a tax system based on people's ability to pay. First, by taxing assets that yield tangible economic benefits without producing monetary income (as in owner-occupied housing), wealth taxes can ensure that the non-monetary benefits derived from these assets are subject to tax. Second, to the extent that the ownership of wealth provides "opportunity, security, social power, influence and independence," it has been argued that "however well a system of taxation of income or of consumption may be devised, equity requires that wealth itself should be included in the base for progressive taxation" (Institute for Fiscal Studies 1978, 40).

In addition to the more traditional equity arguments for wealth taxes, a further reason to tax wealth involves the contribution that wealth taxes can make towards moderating extreme inequalities in the distribution of wealth and opportunity. By taxing wealth as it is transferred by gift or bequest, taxes can regulate one of the main causes of wealth inequality and help to equalize opportunities among successive generations. Alternatively, by taxing wealth holdings above a certain threshold and/or at graduated rates, an annual net wealth tax can influence the distribution of wealth in the same way that progressive income taxes affect the distribution of disposable income. In turn, since the distribution of wealth has an important influence on the distribution of income, wealth taxes have an indirect role to play in moderating inequalities in the latter.

These reasons for taxing wealth are often noted in tax policy discussions and were emphasized by the Ontario Committee on Taxation in 1967 (vol. 3, 136) as a reason for Ontario to retain the succession duty that was levied at that time.[4]

---

[4] Scholarly discussions concerning the distributive purpose of wealth taxation can be found in Bird (1972), Wagner (1977), Maloney (1988), Bale (1989), and Duff (1993).

Fairness Arguments against Taxing Wealth

Contrary to the argument that wealth and/or wealth transfers create an ability to pay distinct from the taxable capacity associated with income, it is often suggested that assets that are not easily sold or that yield little or no monetary income actually confer little or no ability to pay tax. For this reason, wealth taxes are often criticized on the grounds that they discriminate against non-marketable and low-yield assets, such as principal residences and family farms, and impose an unfair burden on taxpayers with substantial assets or inheritances but limited incomes, possibly forcing these taxpayers to sell assets to pay the tax.

Although we are sympathetic to the potential hardship that wealth taxes may cause taxpayers in specific contexts, we are not convinced that liquidity concerns should preclude the taxation of wealth altogether. On the contrary, to the extent that wealth holdings or wealth transfers represent measures of ability to pay distinct from income as currently defined, it is entirely appropriate that this taxable capacity should be taken into account in order to ensure an equitable distribution of personal tax. Wealth taxes may require some taxpayers to sell assets or borrow money to pay the tax, but it is by no means obvious that these results are unfair or economically inefficient. The ability to sell or mortgage an asset is as much a measure of taxable capacity as the receipt of income. Moreover, if assets are sold in order to pay the tax, it is likely they will be transferred to more highly valued uses. In any event, where undue hardship is seen to result, accommodations can be made in the form of specific exemptions or arrangements by which tax payments are deferred until assets are sold and converted into cash.

A second objection to wealth taxes argues that taxing wealth amounts to unfair double taxation, since the assets that would be subject to tax under either kind of wealth tax represent savings accumulated out of income on which tax has already been paid. There are several reasons why we do not find this argument persuasive.

First, one of the reasons for taxing wealth as part of the overall tax mix is to ensure that at least some tax is collected from taxpayers who might otherwise pay little or no personal income tax. Where wealth taxes fulfil this function, therefore, they do not result in double taxation. Second, even where wealth taxes apply to savings on which income tax has already been paid, it is questionable whether wealth taxes constitute double taxation. In the case of wealth transfer taxes, income taxes have been paid by donors, not recipients. Consequently, recipient-based gift and inheritance taxes cannot be regarded as double taxation. Further, to the extent that wealth and wealth transfers increase people's taxpaying ability irrespective of their income, wealth taxes do not involve double taxation because they are directed at the *additional* taxable capacity associated with wealth itself, as distinct from the income from which it may be derived. Finally, since wealth taxes, like consumption taxes, apply to an entirely different base from income taxes, it is as inappropriate to view wealth as unfair double taxation of income that is saved as it is to characterize consumption taxes as unfair double taxation of income that is consumed. In each case, these taxes reflect a decision to raise revenues from a mix of taxes involving a variety of tax bases, not to subject income to a second level of tax.

A third fairness argument against wealth taxes applies specifically to wealth transfer taxes and concerns the possibility that taxpayers might have to pay both capital gains tax and wealth transfer taxes when assets are transferred by gift or at death. Concern about the simultaneous impact of these two taxes was a key reason why the federal government abolished its Gift and Estate Tax in 1971 and one of the main reasons why the provincial government repealed Ontario's succession duty in 1979. It was also the reason why Ontario amended its succession duty in 1977 to allow capital gains taxes arising at death as a full credit against provincial succession duties. For some, this issue is one of double taxation; for others, the prospect of concurrent taxation is simply considered unfair on the grounds that the combined tax burden could be substantial. We find neither view persuasive as reasons not to levy a tax on wealth transfers.

It is important to distinguish between taxes on the transfer of wealth itself and capital gains tax on deemed dispositions, which is levied at the time property is transferred by gift or at death. While the former applies to the total net value of all assets transferred by gift or at death, the latter applies only to *increases* in the value of the assets transferred and is properly understood as a tax on income rather than wealth, applicable only to previous additions to economic power which have not already been subject to tax (as would occur under a system of accrual taxation). Consequently, it is mistaken to describe the simultaneous taxation of capital gains and wealth transfers as double taxation.

Neither do we view the prospect of concurrent taxation as unfair and thus unacceptable, although we recognize that taxation of wealth transfers and capital gains when property is transferred is rare among OECD member countries.[5] Since capital gains tax applies to income that has already accrued but has not been realized, it is in fact the special arrangements designed to limit the combined impact of both taxes that are unfair. By favouring transfers of property that have appreciated in value, for example, a credit against wealth transfer taxes for capital gains tax paid would discriminate against taxpayers who hold assets that do not appreciate in value or who sell assets shortly before their death, thereby encouraging taxpayers to hold appreciated assets until death (exacerbating the "lock-in" effect that the deemed disposition provisions are partly designed to relieve). Although liquidity considerations may justify some scheme for the deferral of tax payments, we are not persuaded that the simultaneous taxation of capital gains and wealth transfers is unfair.

A final set of fairness arguments against wealth taxes emphasizes the existence of other taxes on capital and argues that it would be unfair to introduce either an annual net wealth tax or a wealth transfer tax without in some way taking account of these existing capital taxes. In the case of an annual net wealth tax, attention is often drawn to residential property taxes and corporate capital taxes. In the case of wealth transfer taxes, mention is frequently made of the probate fees charged by the court system for processing a will at death.

As we explain in part eleven of this report, we do not accept the idea that the property tax should be considered as a form of wealth tax. As it stands, the current property tax is poorly correlated with wealth. Further, we believe that the proper role of the property tax is to serve as a benefits tax related to the provision of local services. Nor do we view the corporate capital tax as an appropriate substitute for a direct tax on personal wealth. Like the property tax, the corporate capital tax is a tax on the gross value of the assets, not the

---

[5] Of 24 OECD members surveyed in 1986, only Spain taxed wealth transfers and capital gains at death, while most countries with wealth transfer taxes exempted capital gains at death, or allowed capital gains taxes to be deferred by stipulating that recipients of property that has appreciated in value assume the donor's original cost basis. Several OECD member countries levy capital gains tax when property is transferred by way of gift (OECD 1988, 138–41).

net value that would be the normal base for a tax on wealth. Although the capital tax has some of the characteristics of a wealth tax, its purpose in the tax mix is generally seen as one of filling gaps in the corporate income tax system, particularly as they apply to financial services corporations. The federal government describes its large corporations tax (levied on a base similar to that of the Ontario capital tax) as a form of corporate minimum tax.

Probate fees are not a substitute for a wealth transfer tax. Probate fees apply neither to gifts nor to several types of property transferred at death, such as pensions, life insurance, and property that is jointly owned. Further, we believe that the proper role for probate fees is as a user fee to reflect the cost of processing wills. Consequently, the existence of probate fees should not rule out the introduction of a wealth transfer tax. Nonetheless, in the absence of an explicit wealth transfer tax, it does seem that probate fees are being used to raise revenue and achieve progressivity goals for which a proper wealth transfer tax would be better suited.[6] If Ontario or the federal government were to introduce a wealth transfer tax, the current structure of probate fees would have to be reconsidered.

Other Arguments

Although fairness is the most important criterion in deciding whether or not to tax wealth, the choice also depends on the amount of revenue that such a tax might raise and on economic and administrative considerations regarding the impact of the tax. These issues are considered more fully in the context of each kind of wealth tax. For now, it is possible to make the following remarks about wealth taxes in general.

It is difficult to assess the revenue potential of either kind of wealth tax for the simple reason that reliable data on current wealth

---

[6] Prior to 8 June 1992, Ontario probate fees were $5 per $1000, or 0.5 per cent of the estate assets probated. Effective 8 June 1992, the general rate was increased to 1.5 per cent, while the original 0.5 per cent rate was retained for the first $50,000 of assets subject to probate. In 1990–91, Ontario collected $27 million through probate fees, but this amount is expected to increase by $40 million as a result of the 1992 rate increase.

holdings are unavailable.[7] Nonetheless, based on wealth tax revenues raised in other countries and on research conducted for the commission (Davies and Duff n.d.), we estimate that either kind of wealth tax could annually raise between $500 million and $1 billion in Ontario, depending on the design of the tax and on whether it is levied nationally (with revenues shared among all provinces) or provincially. Whether these revenues would justify the introduction of a new tax depends on the economic and administrative costs, and on the value placed on the role of wealth taxes in enhancing the fairness of the tax system.

From an economic perspective, it is often argued that wealth taxes discourage risk taking, capital accumulation, and investments in low-yield assets, such as farms. Conversely, wealth taxes are sometimes defended as economically more desirable than progressive income taxes, on the grounds that they are more neutral than high rates of personal income tax and that they may encourage the movement of assets to more productive uses – stimulating owners of assets to seek higher rates of return to pay annual net wealth taxes, or prompting beneficiaries to sell or reorganize private enterprises to pay wealth transfer taxes (Pechman 1987, 234; Institute for Fiscal Studies 1978, 318). A further economic concern is that the introduction of a new wealth tax may prompt an exodus of people and capital from the jurisdiction that levies the tax, particularly if the tax applies only at a provincial level and all other provinces do not levy a similar tax. However, since location decisions are based on a variety of factors, it is the combination of wealth taxes with other taxes that is more likely to influence behaviour than the impact of wealth taxes on their own.

Administratively, wealth taxes are criticized as costly for governments to collect and for taxpayers to comply with, especially because neither kind of wealth tax currently exists in Canada. Although governments would benefit from a new source of information that might

---

[7] Statistics on the amount and distribution of wealth are generally based on tax returns (where wealth is taxed) or on household surveys. Statistics Canada conducted regular wealth surveys every seven years from 1970 to 1984, but did not repeat the survey in 1991 and has no plans to do so. Although a more recent Ernst & Young study provides estimates of wealth holdings in 1989 and projections up to the year 2000, this study is itself partly based on Statistics Canada's results from its 1984 survey.

be used to improve collection of other taxes (especially income taxes), these administrative costs are an important consideration in deciding whether to introduce a wealth tax, and must be weighed against the potential benefits in terms of revenues or improved tax fairness.

Conclusions

In principle, we believe that there is an important role for wealth taxation in the overall tax mix. Wealth taxes contribute to the fairness of the overall tax system in a variety of ways and can provide an important if secondary source of revenue. Further, since most OECD countries, including the United States, have at least one kind of wealth tax, wealth taxes can be added to the current tax mix without departing from current international practice. How practical it is to introduce a wealth tax, however, depends on the actual design of the tax and on whether it is enacted in Ontario or at the national level.

Wealth Tax Options

In general, wealth taxes take one of two forms: a periodic (typically annual) tax based on the net value of each taxpayer's taxable assets – an annual net wealth tax; or a tax based on the value of taxable wealth when it is transferred either by gift or at death – a wealth transfer tax. We examined both kinds to evaluate their costs and benefits and to assess their viability at the provincial level.

Annual Net Wealth Tax

As mentioned earlier, annual net wealth taxes have never existed in Canada. Nor are they found in developed English-speaking countries, although Ireland briefly levied one in the mid 1970s. This kind of wealth tax is, however, quite common among other OECD member countries. In some continental European countries, annual net wealth taxes are long-standing components of the overall tax mix. Typically, these taxes are levied on a relatively broad base, determined by calculating the total value of each household's worldwide assets and deducting the aggregate value of its worldwide liabilities. Non-residents are usually subject to tax on property located within the taxing jurisdiction. Exempt assets generally include pensions, household and personal effects, life insurance, modest personal savings, works of art, and scientific and historical collections. No OECD member country exempts owner-occupied homes from annual net wealth tax, although Ireland did so under its short-lived tax and other countries use favourable methods of valuation for owner-occupied housing. Special valuation rules are also often available to reduce the tax burden on agricultural property and private businesses.

Tax rates in OECD member countries range from 0.5 per cent to 3.0 per cent of taxable net wealth, with some countries levying tax at a single flat rate and others employing a graduated rate structure. Several countries impose ceilings on the amount of wealth tax payable, usually by limiting the combined amount of wealth and income tax payable to a specific percentage of taxable income. Thresholds below which no tax is payable range from as little as $10,000 to over $500,000.

Revenues raised by annual net wealth taxes as a percentage of total tax revenues were outlined earlier in this chapter. In 1990 these percentages ranged from 0.08 per cent in Finland to 2.32 per cent in Switzerland, and averaged 0.66 per cent in OECD countries. Expressed as a share of gross domestic product, annual net wealth tax revenues raised between 0.03 per cent (Finland) and 0.73 per cent (Switzerland), and averaged 0.26 per cent (table 19.3). Compared with data on wealth tax revenues as a share of total tax revenues, these figures likely provide a better measure of the revenue potential of annual net wealth taxes in different countries with differently sized public sectors.

Information on the administrative costs and economic impact of annual net wealth taxes is less precise. Because countries with annual net wealth taxes administer these taxes in conjunction with income and other taxes, it is impossible to assess specific collection and compliance costs. Nonetheless, the experience of several European countries suggests that these costs are similar to those for income taxes. Indeed, according to the OECD, member countries with annual net wealth taxes consistently considered these taxes easier to administer than taxes on income (OECD 1988, 163). Likewise, taxpayer compliance costs under the Swedish and German annual net wealth taxes are reportedly similar to or less than compliance costs for these countries' income taxes (Sandford et al. 1975, 67, 83).

TABLE 19.3
Annual Net Wealth Tax Revenues as a Percentage of Gross Domestic Product
OECD Member Countries

Country	1970	1980	1990
		%	
Australia	—	—	—
Austria	0.23	0.20	0.18
Belgium	—	—	—
Canada	—	—	—
Denmark	0.23	0.25	0.12
Finland	0.15	0.07	0.03
France	—	—	0.09
Germany	0.35	0.13	0.12
Greece	—	—	—
Iceland	0.25	0.19	0.42
Ireland	—	0.01	—
Italy	—	—	—
Japan	—	—	—
Luxembourg	0.13	0.08	0.17
Netherlands	0.32	0.34	0.24
New Zealand	—	—	—
Norway	0.32	0.32	0.54
Portugal	—	—	—
Spain	—	0.12	0.21
Sweden	0.28	0.13	0.23
Switzerland	0.79	0.81	0.73
Turkey	—	—	—
United Kingdom	—	—	—
United States	—	—	—
Average % of countries with tax (unweighted)	0.31	0.22	0.26

Source: Organisation for Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992).

With respect to economic impact, it is difficult to distinguish the effect of annual net wealth taxes from the rest of the tax systems of which they are a part, particularly since the wealth taxes in most OECD countries have existed for many years. In Ireland and France, however, where annual net wealth taxes were introduced in the

1970s and 1980s, adverse economic consequences were cited as reasons for the abolition of these taxes shortly after they were introduced. Then again, these decisions to abolish annual net wealth taxes appear to have been influenced as much by political changes as they were by their presumed economic impact. Indeed, the French tax was re-enacted in 1986.

Having reviewed the experience with annual net wealth taxes in other jurisdictions, we looked at two questions. First, given our support for wealth taxation in principle, does an annual net wealth tax make sense in practice, taking into account the revenue it is likely to raise and the administrative and economic costs that might be associated with it? Second, even if an annual net wealth tax makes sense both in principle and in practice, is it feasible for Ontario to introduce such a tax without corresponding initiatives on the part of other provinces or the federal government?

It is doubtful whether the benefits of an annual net wealth tax in terms of tax fairness and revenues raised would justify the administrative and economic costs of introducing such a tax. Although an annual net wealth tax may contribute to fairness in many of the ways outlined earlier in this chapter, its revenue potential is highly uncertain. Revenue estimates prepared for the commission indicate that Ontario could have raised up to $2.2 billion in 1989 from a 1.0 per cent tax on household net wealth exceeding $2 million, but this estimate assumes a fully comprehensive base (no exemptions), assessment of all assets at current market values, and absolutely no evasion or avoidance (Davies and Duff n.d.). In practice, annual net wealth tax revenues are certain to be much less than this amount.

Comparisons with annual net wealth tax revenues raised in OECD member countries are also imprecise. Based on the percentage of gross domestic product raised through annual net wealth taxes in OECD member countries, a Canada-wide tax could raise as little as $217 million (0.03 per cent of GDP, as in Finland) or as much as $5.3 billion (0.73 per cent of GDP, as in Switzerland), but is more likely to collect around $1.9 billion (0.26 per cent of GDP, the unweighted average for OECD member countries with annual net wealth taxes).[8] Since Ontario households hold roughly 45 per cent of Canadian

---

[8] These calculations are based on recent projections that Canada's gross domestic product will reach $724.6 billion in 1993 (Conference Board of Canada 1993).

household net wealth (Ernst & Young 1990, 4), Ontario's share of such a tax would likely be about $850 million.

The uncertain revenue potential of an annual net wealth tax is only one of several concerns with this kind of wealth tax. More important are the administrative and economic costs associated with an annual tax on wealth. The tax could involve substantial start-up costs, both for governments, which would have to establish new rules and collection arrangements, and for taxpayers, who would have to comply with a tax that is largely unknown among developed English-speaking countries. In addition, unless the threshold is sufficiently high to exclude most households, collection and compliance costs are likely to be substantial owing to the large number of returns that would have to be filed each year. This burden might be minimized by requiring information to be filed with annual income tax returns, but it would still be necessary for taxpayers to complete an additional form and for collection authorities to assess and enforce the tax. Finally, the costs of having to value assets and liabilities each year could be enormous, and special rules or exemptions to minimize these difficulties would undermine the fairness of the tax by favouring some taxpayers over others.

The potential economic effect of an annual net wealth tax provides further doubt as to whether the benefits of the tax would justify its costs. A number of potentially adverse effects are often mentioned. First, since annual net wealth taxes apply to income that is saved rather than consumed, such a tax may discourage saving and the capital accumulation necessary to economic growth and prosperity. Second, to the extent that annual net wealth taxes exclude or undervalue specific kinds of assets, they may disrupt otherwise efficient allocations of economic resources by encouraging potential taxpayers to invest in tax-preferred items. Finally, to the extent that annual net wealth taxes apply to taxpayers irrespective of their incomes,[9] these taxes may force owners of certain kinds of property to sell or mortgage these assets in order to pay the tax. Such insensitivity of annual net wealth taxes to taxpayer income might discriminate against own-

[9] Of the twelve OECD member countries with annual net wealth taxes in 1986, at least six (Denmark, Finland, the Netherlands, Norway, Spain, and Sweden) contained limits on percentage of taxable income payable in income tax and net wealth tax (OECD 1988, 40).

ers of farms, where rates of return tend to be low relative to the total value of the capital employed; new businesses, which often require several years to become profitable; and established businesses enduring a period of economic downturn or adjustment. As a result, annual net wealth taxes may discourage risk taking and the growth of new businesses, and accelerate the disappearance of agricultural land – particularly around urban areas where the value of land for development may be much greater than for agriculture.

There are a number of obstacles to an annual net wealth tax in Ontario. A provincial tax would be vulnerable to evasion and avoidance, and would be expensive to collect and comply with if not administered along with the personal income tax. Since taxpayers could attempt to evade the tax by placing Ontario property in a trust or holding company located in another jurisdiction and not reporting this property, Ontario would have to obtain information on property owned by Ontario residents in other jurisdictions in order to enforce the tax effectively. Although information on ownership of income-producing property might be found in federal income tax returns, and information on other property holdings might be shared by taxing authorities in other jurisdictions, it is uncertain whether jurisdictions that do not levy annual net wealth taxes would be willing to provide this information.

Even if Ontario were able to obtain information on property located in other jurisdictions, Ontario residents might still be able to avoid a provincial annual net wealth tax by transferring the legal ownership of their property into trusts located outside Ontario. Although the value of a beneficial interest could be attributed to a resident of Ontario, this would be difficult in the case of "discretionary trusts" where individual beneficiaries have no fixed claim to a distribution from the trust. Nor could Ontario tax the trust directly, since a province cannot tax residents of another province and cannot declare non-resident trusts to be resident in the province. However, Ontario could adopt rules attributing the value of these trusts back to living residents who set up the trust, and attributing the value of trusts established at death to specific classes of beneficiaries (for example, all children) resident in Ontario.

It is also doubtful whether collection of an annual net wealth tax could be administered effectively at a provincial level. European experience indicates that these taxes are typically collected in conjunction with income taxes, and that taxpayers submit net wealth information along with their income tax returns. Since Ontario income tax is currently collected by the federal government under the Tax Collection Agreements, the feasibility of a provincial annual net wealth tax may depend on federal willingness to collect the tax on Ontario's behalf or on Ontario's willingness to enact its own personal income tax. Agreement with the federal government seems unlikely, and, given the additional administrative and compliance costs, it is questionable whether Ontario should introduce a separate personal income tax simply to facilitate collection of an annual net wealth tax.

A provincial tax would be much more vulnerable than a national tax to adverse economic consequences resulting from investment and location decisions, since the costs of relocation within a country are much less than the costs of relocating to another country. Although studies reviewed by the commission suggest that the impact of taxes on business and personal location decisions is generally less important than other non-tax considerations, the potential tax savings from avoiding even a 1 per cent annual net wealth tax may be significant. For example, in a non-inflationary environment with a 3 per cent annual rate of return, a 1 per cent annual net wealth tax is equivalent to an annual income tax of 34 per cent or to a wealth tax of roughly 27 per cent every 30 years. If such a tax were to exist in Ontario and no other province, at least some effect on investment and location decisions is likely.

On balance, we are of the view that an annual net wealth tax is neither practical nor feasible at the provincial level. Although such a tax would enhance the fairness of the tax system as a whole, its revenue potential is too uncertain, its administrative costs too great, and its economic implications too troubling to warrant its introduction. This conclusion applies to both levels of government, but is particularly applicable to any province that might contemplate introducing an annual net wealth tax on its own.

Wealth Transfer Tax

Unlike annual net wealth taxes, wealth transfer taxes have a long history in Canada and Ontario, as outlined earlier in this chapter. In general, these taxes take one of two basic forms. An **estate-type** tax is based on the net value of all property owned by a person at death; an **inheritance-type** tax is charged to recipients according to the net value of the transfers they receive either from each individual donor or from all donors over a given period of time (accessions tax). Typically, these taxes are supplemented by a gift tax, which is often integrated with the wealth transfer tax at death by adding the value of lifetime gifts to the value of the property transferred at death and providing credit for gift taxes already paid. Among OECD member countries, most levy inheritance-type taxes, though estate-type taxes are more common among common law countries such as the United Kingdom and the United States. In Canada, the federal wealth transfer tax that was abolished in 1972 took the form of an integrated gift and estate tax, while Ontario combined estate- and inheritance-type features in its succession duty, added gifts made within five years of the donor's death to the base of the tax at death, and levied a separate gift tax on transfers made more than five years before death.

Wealth transfer taxes usually apply to transfers of property situated within the taxing jurisdiction (usually real property and unincorporated businesses) and to transfers made by resident donors (living and deceased) regardless of where the property is situated. Some countries, most notably Germany and Japan, also tax resident beneficiaries on property that is situated outside the country and received from non-resident donors. Ontario's succession duty applied to property located in Ontario (*situs*) and to transfers from resident donors to resident beneficiaries (*transmissions*), while most other provinces levied tax on transfers of property situated within the province and on transfers received by resident beneficiaries, regardless of the residence of the donor or the location of the property.

Regardless of the specific form or jurisdictional scope that these wealth transfer taxes take, they generally apply to most kinds of assets, though favourable treatment is often provided for household and personal effects, works of art and national treasures (provided they are made accessible to public viewing), pension rights, life insurance proceeds, agricultural property, and family businesses (OECD 1988, 114–17). Ontario's succession duty, for example, allowed a $75,000 deduction in determining the taxable value of farms and small businesses and fully exempted transfers of farm assets and shares of a small business corporation to family members who continued to operate the farm or business for a period of 10 years after the transfer. In addition, all wealth transfer taxes exempt transfers below certain threshold amounts. These exemptions range from a few hundred dollars in some countries with inheritance-type taxes to $600,000 under the US Gift and Estate Tax (which also contains a separate gift tax threshold of $10,000 per recipient per year).[10] Ontario's succession duty included a basic threshold of $250,000 per estate from 1975 to 1977 and $300,000 thereafter. Ontario's gift tax allowed donors to transfer up to $50,000 per year ($10,000 per recipient) without incurring any tax. Above these thresholds, wealth transfer taxes are generally imposed at graduated rates, with top marginal rates typically higher than the highest rates for income tax. In the United States, for example, rates range from 18 per cent on the first $10,000 of taxable value to 50 per cent on taxable amounts exceeding $2.5 million, whereas income taxes are levied at rates ranging from 15 per cent to 36 per cent.

Wealth transfer taxes are usually based on the individual, though Denmark and the Netherlands regard spouses as a single tax unit for purposes of gift and inheritance taxes (OECD 1988, 109). However, all countries with wealth transfer taxes provide special relief for transfers to spouses or dependent children. In countries with estate-type taxes, such as the United Kingdom and the United States, this relief takes the form of an exemption or deduction for the total value of all transfers to spouses provided they are domiciled in the United Kingdom or are citizens of the United States, and non-taxation of transfers for the purpose of maintenance, medical care, and education. In countries with inheritance-type taxes, maintenance costs are also excluded, and further relief is generally provided through exemptions, higher thresholds, or different rate schedules, with lower rates on transfers from spouses, parents, or other "blood relatives." In Germany, for example, rates range from 3 per cent to 35 per cent on transfers from parents or spouses, from 6 per cent to 50 per cent on transfers from grandparents, from 11 per cent to 65 per cent on transfers from aunts, uncles, and siblings, and from 20 per cent to 70 per cent on transfers from other persons. Similarly, exemptions are DM 250,000 for transfers from spouses, DM 90,000 for transfers from parents, DM 50,000 for transfers from grandparents, DM 10,000 for transfers from aunts, uncles, and siblings, and DM 3000 for transfers from other persons.

---

[10] Inheritance tax thresholds are generally much lower than estate tax thresholds, since inheritance-type taxes are based on shares received by each beneficiary rather than the total value of the estate.

Variable rates were also employed under the Ontario succession duty, which exempted spousal transfers after 1973 and taxed "preferred" beneficiaries (children, children-in-law, grandchildren, and parents) at rates ranging from 11 per cent to 28 per cent on the aggregate value of the estate and from 7 per cent to 30 per cent on the amount that they themselves received. "Collateral" beneficiaries (siblings, nieces and nephews, and great-grandchildren) were taxed at rates ranging from 24 per cent to 34 per cent on the aggregate value of the estate and from 9 per cent to 26 per cent on amounts received, and "strangers" at rates of between 35 per cent and 70 per cent on the aggregate value of the estate (without a separate levy on amounts actually received). In addition, the Ontario succession duty allowed a special exemption for dependent children, equal to $3000 for each full year the child was under age 26 where there was a surviving spouse (otherwise $6000 for each full year), and, in the case of infirm dependent children, an additional $6000 for each full year between age 26 or the child's current age and the age of 71.[11]

Revenues raised by wealth transfer taxes as a percentage of total tax revenues were reported earlier in this chapter. In 1990 these percentages ranged from 0.12 per cent in Turkey to 1.41 per cent in Japan, and averaged 0.52 per cent in OECD countries with wealth transfer taxes. Expressed as a share of gross domestic product, wealth transfer taxes raised between 0.03 per cent (Turkey) and 0.46 per cent (Greece) and averaged 0.20 per cent; in the United States from 1970 to 1990, wealth transfer taxes have raised revenues in the range of 0.29 per cent of GDP to 0.47 per cent of GDP (table 19.4). As with the annual net wealth tax estimates presented earlier, these figures are more stable over time than data on wealth transfer tax revenues as a share of total tax revenues and provide a better measure of the revenue potential of wealth transfer taxes in different countries with differently sized public sectors.

Statistical information on the collection and compliance costs associated with wealth transfer taxes is limited. Only the United Kingdom publishes current figures on the costs of collecting its wealth transfer tax. As table 19.5 indicates, these figures suggest that wealth transfer tax collection costs are small relative to revenue yields and comparable to the costs of collecting income taxes.

---

[11] The Succession Duty Act, 1970, c. 449, ss. 7(2), 7(11).

TABLE 19.4
Wealth Transfer Tax Revenues as a Percentage of Gross Domestic Product
OECD Member Countries

Country	1970	1980	1990
		%	
Australia	0.65	0.12	—
Austria	0.08	0.07	0.06
Belgium	0.36	0.36	0.31
Canada	**0.31**	**0.02**	—
Denmark	0.14	0.20	0.27
Finland	0.08	0.08	0.17
France	0.25	0.24	0.42
Germany	0.08	0.07	0.13
Greece	0.32	0.35	0.46
Iceland	—	0.04	0.07
Ireland	0.39	0.12	0.15
Italy	0.17	0.06	0.06
Japan	0.18	0.18	0.44
Luxembourg	0.12	0.16	0.15
Netherlands	0.22	0.22	0.23
New Zealand	0.52	0.17	0.11
Norway	0.09	0.04	0.07
Portugal	0.33	0.07	0.17
Spain	0.14	0.10	0.15
Sweden	0.14	0.10	0.11
Switzerland	0.24	0.23	0.28
Turkey	0.04	0.05	0.03
United Kingdom	0.73	0.19	0.24
United States	0.47	0.32	0.29
Average % of countries with tax (unweighted)	0.26	0.15	0.20

Source: Organisation for Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992).

TABLE 19.5
Collection Costs as a Percentage of Revenues from Selected Taxes
United Kingdom, 1986–91

	Fiscal year				
Tax	1986/87	1987/88	1988/89	1989/90	1990/91
Income tax	2.26	2.23	2.22	2.15	2.17
Corporation tax	0.56	0.57	0.50	0.50	0.58
Capital gains tax	1.87	1.84	1.15	1.85	2.10
Wealth transfer tax	2.42	2.22	2.17	2.04	2.24
All taxes	1.76	1.67	1.62	1.61	1.70

Source: KPMG Peat Marwick Thorne, "Wealth Transfer Taxation: Planning and Avoidance Techniques," research papers prepared for the Fair Tax Commission, 1992, United Kingdom Section, table 1.

Similar figures have been reported for Ontario, where the administrative costs of collecting provincial succession duty in the 1970s varied from 1.37 per cent of revenues raised in 1971 to roughly 3 per cent in 1978, the year before the tax was abolished (KPMG Peat Marwick Thorne 1992).

Wealth transfer tax compliance costs are much harder to estimate, in part because of difficulties in distinguishing measures that individuals must take to satisfy tax obligations from those that may be taken to plan around or avoid wealth transfer taxes. In the United States, it has been suggested that total expenditures on estate planning represent a sizeable share of the total yield from the federal gift and estate tax (Aaron and Munnell 1992, 138). It is impossible to verify this opinion.

Finally, although wealth transfer taxes are often favoured as more neutral than income taxes yielding the same amount of revenue, tax specialists mention a number of potentially adverse economic consequences as reasons not to tax wealth transfers. First, since wealth transfer taxes apply to income that is saved rather than consumed, it is often suggested that these taxes discourage the saving and capital accumulation necessary to economic growth and prosperity (Boskin 1977, 60–62). In addition, it is often argued that wealth transfer taxes discourage entrepreneurship by making it costly to transfer private enterprises to family members and by breaking up pools of private capital that may be used to start new businesses. Although there is little statistical evidence on these issues, at least one study indicates a strong correlation between entrepreneurship and access to capital through gift or inheritance (Blanchflower and Oswald 1991).

Second, to the extent that wealth transfer taxes cannot be paid out of income or liquid assets, non-liquid assets like private businesses or farms might have to be sold in order to pay the tax. Statistical evidence on this issue is mixed. Several studies have found no evidence that wealth transfer taxes are a major factor in the sale of farms or small businesses (Sandford et al. 1973, 134-46; Maloney 1991, 257), but an inquiry by the Ontario Advisory Committee on Succession Duties determined that federal and provincial wealth transfer taxes played a key role in at least some decisions to sell family farms or businesses of persons who died in 1970 and 1971. Of 217 estates with farm properties for which questionnaires were returned, 161 (74.2 per cent) were transferred to or held in trust for the recipient(s) and 56 (25.8 per cent) were sold; of those sold, 10 (4.6 per cent) were sold "primarily to raise monies to pay liabilities payable at death (including succession duties and/or estate tax)." Of 197 estates with family businesses for which questionnaires were returned, 157 (79.7 per cent) were transferred to or held in trust for the recipient(s) and 40 (20.3 per cent) were sold, of which 12 (6.1 per cent) were sold for this reason (Ontario Advisory Committee 1973, app. C, 2, 6)

A final concern about the potentially adverse economic impact associated with the introduction of a wealth transfer tax is the encouragement it might give for wealthy persons to move themselves and their property to other jurisdictions. This issue is crucial to an assessment of the feasibility of a wealth transfer tax in Ontario.

As with our evaluation of an annual net wealth tax, we addressed two questions based on our historical and comparative review of wealth transfer taxes in Canada and other countries. First, is it in fact practical to introduce a wealth transfer tax given the amount of revenue it could raise and the administrative and economic costs it might entail? Second, if a wealth transfer tax is regarded as a practical measure that should be implemented, is it feasible for Ontario to levy such a tax if wealth transfer taxes are not also collected by other provinces or the federal government? Although we have strong reservations about the feasibility of an Ontario-only wealth transfer tax, we are firmly convinced that a national wealth transfer tax would be a practical and beneficial addition to the current tax mix in Canada.

A wealth transfer tax has several characteristics in its favour, particularly compared with an annual net wealth tax. On the whole, a moderate tax on wealth transfers is more likely to affect progressivity and the distribution of economic resources in society than a low-rate annual net wealth tax. Indeed, Canadian and US taxation statistics indicate a progressive distribution of the wealth transfer tax burden in both countries, at least when measured against assessed net values of estates. According to figures reported 25 years ago by the Ontario Committee on Taxation, average effective tax rates under Ontario's succession duty increased steadily from 6.7 per cent on estates with net values of less than $25,000 to 18.1 per cent on estates valued at more than $1 million (Smith Committee 1967, vol. 3, 140). Based on reported figures, average effective tax rates were 7.0 per cent for estates with net values of $25,000 to $100,000, 9.2 per cent for estates with net values of $100,000 to $200,000, 12 per cent for estates with net values of $200,000 to $500,000, and 15 per cent for estates with net values of $500,000 to $1 million. In the United States, federal Gift and Estate Tax returns filed for people who died in 1986 indicate a steady increase in average effective tax rates from 0.6 per cent for estates with a net worth between $500,000 and $600,000 to 38.5 per cent on estates with net values of more than $10 million. Based on reported figures, average effective tax rates were 6.6 per cent for estates with net values of $600,000 to $1 million, 17.2 per cent for estates with net values of $1 million to $2.5 million, 28.7 per cent for estates with net values of $2.5 million to $5 million, and 35.8 per cent for estates with net values of $5 million to $10 million.[12]

Available evidence also indicates that wealth transfer taxes can make a meaningful contribution to government revenues. Ontario raised over $60 million from its gift tax and succession duty in 1975–76, even though wealth transfer taxes were levied only in Ontario and Quebec at the time, and estimates prepared for the commission suggest that Ontario could have raised almost $640 million in 1989 from a 30 per cent tax on the value of Ontario estates exceeding $1 million, even assuming a full exemption for transfers to surviving spouses (Davies and Duff n.d.). Although this estimate assumes a fully comprehensive base (no exemptions) and absolutely no evasion or avoidance, it does not reflect revenues from an accompanying gift

[12] Calculated from statistics reported in Johnson (1990, table 3).

tax which, based on current US experience, might add an additional 15 per cent to the revenues collected from a pure estate tax. Comparative estimates of actual wealth transfer tax revenues raised in OECD member countries as a percentage of gross domestic product suggest that revenues from a Canada-wide wealth transfer tax could be anywhere from $217 million (0.03 per cent of GDP, as in Turkey) to $3.3 billion (0.46 per cent of GDP, as in Greece), but are most likely to be in the range of $1.7 billion (0.24 per cent of GDP, as in the United Kingdom) to $2.1 billion (0.29 per cent of GDP, as in the United States).[13] Since Ontario households hold roughly 45 per cent of Canadian household net wealth (Ernst & Young 1990, 4), the share for Ontario revenues from such a tax is likely be in the range of $765 million to $945 million.

Further, although wealth transfer tax revenues are likely to be similar to those that might be obtained from an annual net wealth tax, the administrative costs of a wealth transfer tax would almost certainly be less. First, the number of taxpayers that would be subject to a wealth transfer tax in any year is only a fraction of the number that would have to pay an annual net wealth tax. There were almost 215,000 Ontario households with net wealth of more than $1 million in 1989 (Ernst & Young 1990, vol. 1, table 1.5.1), and a study conducted for the commission estimates that among residents of Ontario who died in 1989 there were roughly 2500 estates valued at more than $1 million (Davies and Duff n.d.). Second, unlike an annual net wealth tax, which would have to rely on costly annual valuations or valuation rules that facilitate the administration of the tax but undermine its fairness and efficiency, a wealth transfer tax could be based on valuations that are already required for purposes of capital gains tax on deemed dispositions (for property that has increased in value) or probate fees (for property subject to probate at death). More generally, since wealth transfer taxes have a long history in Canada, it might be expected that taxpayers and collection authorities would face fewer initial costs with this kind of wealth tax than with an annual net wealth tax, with which Canada has little or no experience.

---

[13] These calculations are based on recent projections that Canada's gross domestic product will reach $724.6 billion in 1993 (Conference Board of Canada 1993).

Finally, the economic impact of a wealth transfer tax is less worrisome than that of an annual net wealth tax, which may discourage all kinds of saving since these savings become taxable wealth. Wealth transfer taxes should affect only savings for the purpose of transferring wealth. In fact, it is generally agreed that adverse economic impacts of wealth transfer taxes are less severe than those resulting from higher marginal income tax rates designed to raise the same amount of revenue.

Whether it would be feasible for Ontario to levy a wealth transfer tax if it were the only province to do so is much less certain. Indeed, based on experiences in Canada and Australia, where subnational wealth transfer taxes were abandoned after the national government withdrew from this tax field, it might be reasonable to conclude that these taxes are sustainable only at the national level. On the other hand, the decision to abolish Ontario's gift tax and succession duty appears to have been motivated more by political concerns about the combined burden of capital gains tax and wealth transfer tax than by any difficulties taxing wealth transfers at the provincial level.

To begin with, it seems clear that a wealth transfer tax could be collected effectively at a provincial level. Although European experience suggests that the collection of any gift tax would likely be facilitated by a combined return for income and gift tax, administrative links between the collection of income taxes and wealth transfer taxes in other countries are generally limited (OECD 1988, 156). Consequently, it is doubtful whether the administrative viability of a provincial wealth transfer tax would depend on federal agreement to collect the tax or on the introduction of a separate personal income tax in Ontario. In addition, Ontario has considerable experience with wealth transfer taxes, and only a small number of transfers would be subject to tax each year. Throughout the 1970s, Ontario collected a succession duty and a gift tax, and collection costs averaged between 2 per cent and 3 per cent of revenues raised from these taxes.

On the other hand, Ontario could have difficulty obtaining the necessary information to actually enforce and collect a wealth tax. Although provincial tax authorities would be able to obtain information on transfers of property registered in Ontario, and on transfers of property subject to probate in Ontario, they would have more difficulty obtaining information about transfers of property located outside Ontario and about transfers of property that are neither registered in Ontario nor subject to probate (for example, certain kinds of joint property, or gifts that need not be registered). While Ontario might establish arrangements with other jurisdictions to share information on transfers of property to or from residents of the other jurisdiction, it is doubtful whether other provinces would enter into agreements to provide this sort of information if they themselves did not also tax wealth transfers. Ontario might, however, be able to obtain information on wealth transfers from federal income tax returns that record capital gains tax on deemed dispositions when property is transferred by gift or at death.

Even if Ontario were able to obtain all the information necessary to administer a provincial wealth transfer tax, it could face legal challenges arising from the constitutional limitation on provincial taxing powers to "direct taxation within the province" under section 92(2) of the Constitution Act, 1867. Although provinces are constitutionally allowed to tax transfers of property situated in the province, transfers to recipients resident in the province, and gifts from resident donors in cases where property is situated outside the province, it is often argued that provinces cannot levy estate taxes on transfers to non-resident beneficiaries from persons resident in the province since the tax cannot be paid by the donor (who is deceased) and is therefore an "indirect tax" (LaForest 1981, 106–109). As a result, taxpayers might be able to avoid Ontario tax on transfers to non-resident beneficiaries by first transferring ownership to a corporation resident in another jurisdiction and then transferring shares to a non-resident beneficiary. In addition, since Ontario cannot tax non-resident recipients, resident donors might attempt to avoid Ontario tax on transfers to resident beneficiaries by transferring Ontario property first to a non-resident corporation owned by the donor and then transferring the shares of this corporation to another non-resident corporation owned by the resident beneficiary or to a trust with beneficiaries resident in Ontario.

A provincial wealth transfer tax might attempt to address these avoidance possibilities in a number of ways. First, as Ontario did in the 1970s, it might enact specific rules to tax resident beneficiaries on increases in the value of shares in non-resident companies due to wealth transfers and to attribute increases in the value of non-resident trusts to specific classes of beneficiaries (for example, equally among children). Second, it might attempt to tax worldwide estates of persons resident in Ontario at their deaths on the same basis that capital gains are subject to tax at death: by deeming the tax to be imposed on the taxpayer immediately before death. Third, it might decide to tax all transfers of property outside the province, both by gift and at death, and whether to a natural person or a legal entity such as a corporation or trust. Each of these approaches would improve the viability of a wealth transfer tax at the provincial level, though all would add to the complexity of the tax. The third approach would likely be the most effective, but would have serious implications for the mobility of persons and capital within Canada.

Probably more significant than these administrative and constitutional obstacles, a provincial wealth transfer tax would be extremely vulnerable to location decisions that might substantially reduce revenues raised and affect the general level of economic activity in the province. To the extent that the tax applied to the estates of donors resident in Ontario at death, people could avoid the tax by moving to another province upon retirement. Alternatively, although tax might still be imposed on transfers of property situated in Ontario and on receipts by resident beneficiaries, the former could be avoided by transferring property to a corporation resident in another province while the latter could be avoided through the use of planning devices like trusts or evaded by failing to report property received from outside the province.

Although relocation and tax planning are by no means costless, they are much less costly within a country than they are between countries. Further, although the studies reviewed suggest that the impact of taxes on business and personal location decisions is generally less important than other non-tax considerations, the potential savings from avoiding a wealth transfer tax may be substantial. It is reasonable to expect that persons with estates of this nature would not willingly endure a tax that they need not pay in any other province, but would move themselves and their assets out of Ontario to avoid the tax.

TABLE 19.6
Estimated Distributive Impact and Revenue Potential (in Ontario) from a Comprehensive Flat Rate Estate Tax with Full Exemption for Transfers to Surviving Spouses

			Average tax paid by				
	Taxable estates		Taxpaying estates		All estates		
Estate size ($ millions)	#	% of all estates	$	Avg. % of estate	$	Avg. % of total value	Revenue raised ($ millions)
1.0–2.0	497	38.3	90,000	6.9	34,487	2.7	44.7
2.0–5.0	342	33.2	658,599	20.6	218,468	6.8	225.2
Over 5	85	44.5	4,339,137	28.1	1,931,029	12.5	368.8
All estates	924	1.6	691,339	20.9	10,840	3.6	638.8

Source: James B. Davies and David Duff, "Wealth Tax Proposals: Distributional Impact and Revenue Potential," in *Issues in the Taxation of Individuals*, ed. Allan M. Maslove, Fair Tax Commission Research Studies (Toronto: University of Toronto Press, forthcoming).

Note: Exemption, $1 million; rate, 30% above $1 million.

Nevertheless, the revenue potential in Ontario from a wealth transfer tax is substantial, and the distribution of such a tax would be highly progressive. A variety of simulation scenarios were prepared for the commission. To illustrate the potential impact of a tax on estates, one of these scenarios is presented in table 19.6. It models a tax with a 30 per cent rate applied to estates after allowing a $1 million general exemption and a complete exemption for transfers to surviving spouses. The revenue potential is estimated at almost $640 million annually. Over half the total would come from estates valued at more than $5 million. They would be assessed an average tax of more than $4 million, compared with an average value of these estates of about $15 million (Davies and Duff n.d.).

On the basis of our analysis and discussions, we have concluded that a national wealth tax in the form of a wealth transfer tax is the preferred option. This kind of wealth tax is most familiar, administratively manageable, present in most developed countries, and most compatible with our views of fairness. This tax could be levied by the federal government or by all provinces acting together. The tax base should be fully comprehensivepension funds, and life insurance), the tax should apply to gifts as well as transfers at death, the jurisdictional basis of the tax should be as broad as possible, spousal transfers should be fully exempt, transfers should be taxable only on the portion of the transfer above a generous exemption, and there should be no credit for capital gains taxes on deemed dispositions. If such a tax is introduced, and Ontario derives revenues from it, probate fees should be restructured so that they do not function as a progressive tax (as they do now), but as a user fee to reflect the true costs of processing wills.

RECOMMENDATION 32

Ontario should seek the agreement of the federal government and the other provinces to establish a national wealth transfer tax. This tax should be fully comprehensive and should apply to gifts as well as transfers at death. The tax should exempt spousal transfers. It should have a generous exemption level but should contain no credit for capital gains taxes on deemed dispositions.

RECOMMENDATION 33

If a wealth transfer tax is implemented which generates additional revenue for the Government of Ontario, Ontario's probate fee should be levied as a user fee at a flat rate, rather than as a percentage of the estate.

We also considered the role that special taxes on luxury goods might play as a partial substitute for wealth taxes, and as a method to enhance overall tax progressivity. Our discussion of luxury taxes is included in chapter 24.

Part Eight
The Tax System and Economic Activity in Ontario

20 Corporate Taxation in a Fair Tax System

Corporate tax issues were among the most contentious in our public hearings. For many of those who appeared at our hearings, declining revenue shares from corporate income and capital taxation stood as a symbol of increasing unfairness in our overall system of taxation. For others, our current levels of corporate taxation were cited as a major problem for Ontario as this province attempts to compete with jurisdictions with apparently lower corporate tax levels.

While corporate taxation raises literally hundreds of important technical questions, debate and discussion both in our hearings and among ourselves focused on a limited number of broad questions including:

- the role of corporate taxation in a fair tax system;
- the impact of corporate taxes on corporate decisions in particular and economic activity more generally, and the implications for Ontario's ability to sustain levels of corporate taxation higher than those applicable in jurisdictions with which Ontario competes for investment and economic activity;
- the use of the corporate tax system to deliver subsidies for certain kinds of economic activity and the impact of these subsidies on the revenue generated from corporate taxes; and
- the relationship between corporate taxation and the taxation of income from capital in the personal income tax system and its impact on the fairness of the personal income tax.

In this chapter, we deal with the first three issues – the role of corporate taxation in a fair tax system, the impact of corporate taxation on the economy, and the effectiveness of tax-delivered subsidies as instruments of economic policy. The last issue, special provisions for the taxation of capital gains and dividends, and their role in the integration of the personal and corporate income tax systems, are dealt with in chapter 17.

Our work in this area attempts both to clarify and build understanding of these complex issues. However, jurisdictions are just beginning to address the implications for their national public finances and economic policies of the growing integration of the world economy in the past 25 years and the resulting increased mobility of capital and economic activity. Therefore, our analysis does not point directly to firm conclusions; it can only inform judgments about what the appropriate course of action is for Ontario in the 1990s.

Role of Corporate Taxes in a Fair Tax System

Share of Corporate Income Taxes in Provincial Revenue

In recent years, revenue from corporate taxes has been declining as a proportion of government revenues throughout Canada and in most other nations. In Ontario, for example, corporate tax revenue has dropped from just over 19 per cent of provincial revenue in 1961–62 to just under 8 per cent in 1991–92. At the federal government level in Canada, corporate taxes fell as a proportion of revenue from 19.9 per cent in 1969–70 to 11.5 per cent in 1989–90.

Canada is not alone in experiencing a declining share of revenues from corporate income taxation. The decline in corporate income tax revenues in Canada has largely paralleled experience in the United States. A recent study for the OECD observed:

> The share of corporate income tax receipts in total government revenues over the past 25 years has been either relatively stable at fairly low levels or has declined steadily in the majority of OECD countries. Japan, Luxembourg and, to a lesser extent, the United Kingdom and Italy, are notable exceptions. (Carey et al. 1993, 7)

One of the reasons revenue from taxes on corporate profits has declined relative to other underlying tax bases is that profitability reported by corporations has declined. Recent studies have documented the role of profits in the relative slide in revenues.[1] For example, a study of the decline of federal corporate tax revenue concluded that:

> Falling profitability is the most important factor in explaining the declining importance of corporate taxes in the Canadian federal budget from 1960 to 1985. Other factors, such as legislative changes and inflationary effects, also had an impact, but they were of secondary importance. (Douglas 1990, 79)

The long-term decline of corporate income tax as a share of provincial government revenue raises important questions of public policy. Are corporate tax rates lower than they should be in a fair tax system? What contribution would higher corporate tax revenue make to a fair tax system? Is it realistic, given the mobility of capital in the international economy, for Ontario to increase its revenue from corporate taxation? What should Ontario's response be to these realities?

The decline of corporate tax revenue as a proportion of provincial revenue has given rise to concerns and to numerous suggestions to restore corporate taxation to its former share of government revenues. The discussion that follows explains the constraints Ontario faces in raising more revenue through corporate taxes, but suggests ways to increase fairness at the same time.

Incidence of Corporate Taxes

In assessing the role of corporate taxes in a fair tax system, perhaps the fundamental question concerns who actually bears the ultimate burden of such taxes. While the legal obligation to pay tax may rest with a corporate institution, the eventual burden of the tax will be borne by the people who own, work for, or buy goods and services from the corporation. To what extent are corporate taxes reflected in a reduced return on capital for shareholders, or are passed on in higher prices to consumers or in lower wages to workers? As the dis-

---

[1] For Canadian evidence see Perry (1986); for US evidence see Auerbach and Poterba (1987).

cussion of tax incidence in chapter 9 pointed out, the answer to that question depends on the workings of markets for investment capital, goods and services, and labour. The functioning of these markets in Ontario has in turn been influenced significantly by changes in the international economy. In particular, the growth in global interdependence of national economies has contributed to a significant increase in the mobility of capital. From 1983 to 1989, global flows of foreign direct investment grew at an average annual rate of 34 per cent (Canada 1991, 35). One study observed that "the unprecedented development of global capital markets reflects a world awash with stateless capital that flows rapidly to the locations that offer the highest financial return" (Brean 1992, 307). This mobility in turn has important implications for the way capital markets work and, consequently, for the way the burden of corporate taxes is divided among owners of capital, consumers, and workers.

Since capital is more mobile internationally, it is more responsive to tax rates than is labour or consumption. Higher corporate tax rates may not result in a lower return on investment to the shareholders of corporations, but in the additional tax being passed on in some combination to labour in the form of lower wages and to consumers in the form of higher prices. These conclusions were reflected in the discussion of tax incidence in chapter 9.

Ontario has always had an open economy linked to markets in other jurisdictions. As a result, the province is particularly vulnerable to the movement of capital in response to factors such as tax rates. If Ontario were to levy corporate taxes that were significantly higher than those in competing jurisdictions, the additional burden of the tax would not likely fall on the owners of capital (the shareholders), but on other inputs into production, such as labour, and on consumers. As a result, there is some question about whether corporate tax levels that are appreciably above those in other jurisdictions would actually result in an increased tax burden being borne by owners of capital.

Objectives in Setting Corporate Tax Rates

One of the purposes of the corporate income tax is to ensure that shareholders cannot defer tax on the profits from their investments by leaving these profits in the corporation and paying tax only when they are distributed as dividends or realized as capital gains.

Corporate income taxation also serves as a way to tax the capital income of non-resident owners of corporate shares. According to this rationale, to eliminate any advantage in the form of deferred taxes, the rate of tax on corporate income should be the same as the rate of tax paid by the individual on other personal income. The corporate and personal income tax systems could then be integrated by giving credit in the personal income tax system when profits are distributed by corporations and taxed in the hands of individuals. The credit would be equal to the amount of tax paid by the corporation on the profits distributed as dividends or realized as capital gains.

In a progressive income tax system, however, shareholders do not all pay the same rate of tax. As a result, it is not possible to link corporate tax rates to the individual tax rates faced by shareholders. An alternative approach is to establish the corporate income tax rate at the same level as the top marginal rate in the personal income tax system and then to provide a full credit for corporate income tax paid at the time the profits are distributed as dividends. For an individual taxed at the top marginal rate in the personal income tax system, income earned through investment in a corporation would be taxed when it is earned at the same rate as it would have been taxed if it had been distributed to the shareholders. For an individual whose marginal personal income tax rate is below the top rate in the personal income tax, however, the rate of tax at the corporate level would exceed the individual's rate of tax in the personal income tax system and the individual would effectively have overpaid at the corporate level. The overpayment would be refunded in the form of a tax credit at the time the profits were distributed.

There are two major problems with this rationale for establishing corporate tax rates. First, it presumes that the corporate and personal income tax systems are fully integrated. In chapter 17, we conclude that that the dividend tax credit system is more accurately described as an incentive for investment in the shares of Canadian corporations than as a system for integrating the general corporate and personal income tax systems. Second, the effect of this approach would be to tax the corporate income of non-residents at the highest personal tax rate in Canada. As a result, difficult questions of capital mobility and impact on investment make such an approach impractical.

Top marginal rates in the personal income tax system have not played a significant role in the determination of corporate tax rates in recent years. Indeed, while the top marginal rate in the personal income tax system has been a important factor in setting corporate tax rates in Canada in the past, there have been significant exceptions to this rule. Both the manufacturing and processing tax rate and the small business tax rate have been well below the level required to match the top personal tax rates. As a consequence of concerns such as these, the general corporate tax rate in Ontario has gradually declined in relation to the top marginal rate in the personal income tax.

Although a strict link between the personal and corporate income tax systems may not be practical for corporate taxation in general, such provisions are important for certain types of corporate income and certain types of corporate organization. In particular, some form of integration is necessary between the personal income tax system and the corporate tax system as it applies to Canadian-controlled private corporations. There are two reasons for such integration. First, it is necessary to ensure that the tax treatment of small business income is the same whether it is earned directly by an individual or indirectly through a corporation. Second, it may be appropriate to tax certain types of income earned by private corporations at the highest personal tax rate, for example, income earned by a corporation from passive investments (minority holdings of stocks, bonds, etc.) and income earned by a corporation that really represents income from employment. The purpose would be to ensure that such income earned in a corporation bears the same tax as income earned directly or to discourage the use of corporations to earn income where there is no business reason for a corporate form of organization. These specific issues are discussed more fully in chapter 21.

The Mobility of Profits and Production

The international integration of economic activity discussed in chapter 5 has profound implications for Ontario's ability to tax business profits. The mobility of financial capital means that a corporation can avoid high tax rates by shifting profits from high-tax to low-tax jurisdictions. In addition, relatively low transportation costs and increasing market access as a result of trade liberalization agreements encourage firms to consider moving operations to low-cost, often low-tax, jurisdictions, despite the cost of relocation. In light of these developments, we considered how the following constrains Ontario's corporate tax system:

- the impact of corporate tax levels on investment location decisions; and
- the impact of corporate tax levels on where corporations declare their profits.

Taxation and Business Location

The first question related to tax competitiveness is how tax levels on corporations in Ontario compare with those in other jurisdictions that compete for some of the same business investment. A paper written for the commission surveyed tax comparison studies that had been undertaken and concluded that on balance: "Ontario and Canadian taxes on corporation investments are somewhat but not dramatically higher than those of US jurisdictions" (Ernst & Young 1993a, 10).

In their 1992 budgets, both the federal and the Ontario governments reduced tax rates on manufacturing and processing and increased depreciation rates for tax purposes for that sector. As a result, it might be expected that the differential has been narrowed even further. A study by the Conference Board of Canada repeated earlier studies for four manufacturing sectors, but used 1992 tax rates. It concluded: "Canada's tax system is relatively less competitive than the United States; however, the difference in the overall tax burden on corporate organizations in the two countries is marginal and this gap is narrowing" (Iqbal 1993, 12).

Other studies using alternative approaches reach similar conclusions. For example, a study for the Economic Council of Canada which looked at the combined impact of personal income taxes and corporate taxes suggests that Canadian recipients of capital income pay similar taxes to those in the United States; the rate is slightly lower in Canada for manufacturing, but slightly higher in other sectors (Ernst & Young 1993a, 45–46).

The second question is what effect Ontario's corporate taxes have on decisions made by businesses about their location. A commission review of the role of taxes in influencing business location decisions concluded that:

> There are still major gaps in our knowledge of the impacts of taxes on business-location decisions. Little formal empirical work has been done on Canadian data, and many of the US studies are seriously flawed in

> the choice of tax measures or the econometric techniques applied. (Ernst & Young 1993b, 204–205)

Another recent survey, which questioned whether any progress had been made in the last 20 years in understanding the connection between taxation and investment, reached similar conclusions:

> In all classes of models ... there is great variation in the predicted effects of tax policy on business investment. Further, there is no solid evidence to indicate which models of investment best explain the data. The conclusion is that our knowledge of the effects of tax incentives on investment has not advanced in recent years, in large part perhaps because the models estimated are inappropriate for use with aggregate data. (Rushton 1992, 640)

Given the mixed results, it is not surprising that opinion is sharply divided on the effectiveness of incentives. Many sectors and groups continue to believe that incentives can be effective generators of investment. Sceptics, however, can point to the lack of solid evidence that lower taxes on corporations and their investments will necessarily lead to greater investment activity. Indeed, most commentators on the issue would agree that other economic factors will be the dominant consideration in most location decisions. It is really an issue of how many of the truly marginal decisions will be affected by tax considerations.

Competing jurisdictions have tended to keep their tax systems within quite narrow ranges of tax rates and incentives for investment. It is not clear that conclusions about the limited impact of tax levels on investment decisions would continue to apply outside such narrow ranges. For example, one view of the impact of taxation on plant location decisions suggests there is a two-stage decision process. The first stage involves development of a short list of two or three locations. Development of this short list may be quite subjective. The final decision is then based on a systematic analysis of the relevant characteristics of the short-listed jurisdictions. Under this decision-making process, perception of a jurisdiction as having high taxes can be harmful, even when final decisions are likely to focus on business factors such as labour costs and transportation. From this perspective, then, moving to a tax regime in which Ontario's corporate tax levels were clearly outside the range of those applied in other jurisdictions would involve serious risks with respect to both new investment and reinvestment of profits generated in the province.

Corporate Tax Planning and Avoidance

The Canadian and Ontario tax systems treat each corporation as a separate entity for corporate income tax purposes, even when the corporation is a member of a closely held corporate group. However, within a corporate group there is considerable leeway in determining how profits are distributed among member corporations and which corporations pay tax. When a corporate group operates in more than one tax jurisdiction, either provincially or internationally, it typically has a degree of flexibility in selecting the jurisdiction in which taxes are paid. As a result, there is a possibility that high-tax jurisdictions will see their revenue eroded.

It should be noted that what is being considered here relates exclusively to the implications for government revenue of corporate organizational and financial decisions rather than the decision by businesses on where to locate their operations. Regardless of how a corporation decides to distribute its taxable income among jurisdictions, there may be no impact on the level of business activity, employment, and other corporate activities in the province.

The opportunities to influence the jurisdiction in which income is reported are varied. Corporations can effectively transfer their profits to low-tax jurisdictions by manipulating the prices they charge affiliates for goods and services, as well as for such things as research and development and copyrights – known as transfer pricing. The transfer price can be defined as the price of any non–arm's-length transaction involving goods, technology, or services between affiliates of an individual multinational enterprise (Eden n.d.). A major study was prepared for the commission on the implications of transfer pricing and the approaches to the issues raised used by taxation and other regulators in Canada, the United States, and elsewhere (Eden n.d.). This study shows that multinational enterprises supply affiliates with a package of capital, technology, and managerial skills when they make a direct investment in a foreign affiliate. In return, the multinational enterprise receives a flow of dividends, interest payments, royalties, and licence fees. In addition, there is a flow of goods and services, as well as financial flows associated with financing arrangements, between the subsidiary and its parent and other affiliates. For tax purposes, all of these items must be priced to determine the taxable profits of each company in the group. Prices are also placed on these transactions for business reasons and for other purposes, such as the requirements of international trade agreements. Since transfer prices are charged within the firm, no independent arm's-length price is involved. For tax purposes, the prices set will help determine how income is allocated between jurisdictions. This process leads to the possibility of intra-firm prices being chosen to minimize tax liabilities by shifting income to lower tax jurisdictions. One could, at least in theory, deal with this possibility through the rigorous application of arm's-length pricing rules – that is, by requiring the price used in intra-firm transactions to be the same as it would be if the transaction were between unrelated parties. In practice, however, this approach has limitations owing to the difficulties of not only applying the rule in many of the complex business arrangements that occur, but also of satisfying the legal requirements necessary to obtain reassessments. As a result, the administrative approach can only place an upper bound on income transfers of these types.

In addition, there are other methods of transferring profits that are so bound up with business practices that arm's-length tests are even less feasible. A prime example relates to the capital financing structure of the corporate group. It may be possible to allocate external debt and intra-group debt, and thus the associated tax deductible interest, to selected corporations in the group in a way that reduces reported profits in the desired jurisdictions. The profits are then reported by those group members principally financed by equity. Since there is no equivalent of arm's-length pricing tests for debt-equity structure, any attempt to limit such income redirection must depend on specific rules. For example, Canada's Income Tax Act contains a provision that limits interest deductibility for a foreign subsidiary operating in Canada financed in excess of 75 per cent by debt, called the thin capitalization rule. However, this again provides only an upper bound on the extent of tax planning based on the type of financing undertaken. There is no similar rule for the financing of corporations in a corporate group with members in different provinces within Canada.

TABLE 20.1
Corporate Income Tax Rates in the United States and Ontario, 1992–94

Year ends on 31 Dec.	US rate including average state rate	Ontario M&P rate including federal rate	Ontario general rate including federal rate
		%	
1992	38.0	38.34	44.34
1993	38.3	36.34	44.34
1994	39.3	35.34	44.34

Sources: Canada, Department of Finance, *The Budget 1992* (Ottawa, 1992); Canadian Tax Foundation, *The National Finances, 1992* (Toronto, 1992); *The National Finances, 1993* (Toronto, 1993); International Bureau of Fiscal Documentation, *Bulletin for International Fiscal Documentation* (Amsterdam, 1993); Ontario, Ministry of Finance, *1993 Ontario Budget* (Toronto, 1993); Research Institute of America, *Highlights of Revenue Reconciliation Act of 1993* (Valhalla, NY, 1993).

Implications for Corporate Income Tax Rates in Ontario

In looking at the potential for income transfers to a jurisdiction outside Canada, the corporate income tax rate is a key determinant, although other provisions of Canadian and foreign corporate income tax systems may also influence potential tax savings from such transfers. For example, the foreign tax credit system in the parent company's home country, rates of withholding tax in Canada, and differences in the definitions of corporate income and allowable deductions from taxable income between the two countries can all affect the choice of jurisdiction in which to report corporate income. However, since the basic structure of the corporate tax is essentially the same among provinces in Canada, the tax rate differentials among provinces are the only factors that must be taken into account when considering transfers between provinces. Because of the way the Canadian corporate tax system is structured, tax avoidance through income transfers is of concern mainly where there are separate corporations acting as part of a group. For a single corporation with activities in several provinces, profits are attributed to each province based on the distribution among provinces of sales and wages. Intra-corporate transfer arrangements are irrelevant to the allocation of profits for these corporations.

Ontario's corporate income tax rates are generally comparable to those of other provinces, with the exception of Quebec (table 20.1). In 1993 the corporate income tax rate for manufacturing and processing profits, including both the federal and the provincial taxes, was 36.34 per cent in Ontario and 31.74 per cent in Quebec; the general rate was 44.34 per cent in Ontario and 37.74 per cent in Quebec. This disparity has led to some apparent income transfers through tax-planning mechanisms that cause corporate income to be reported in Quebec.[2]

A more telling comparison is one of effective corporate tax rates; that is, rates which actually apply after taking into consideration all the deductions available. A study for the commission estimated effective corporate tax rates for a variety of sectors in Ontario and the other provinces based on the corporate tax system in 1991 and 1992 (Chen and Mintz 1993). The study found that, in general, industries in Ontario face higher effective tax rates than those in other provinces, but that the effective corporate tax rates in Ontario are not much higher than those in Quebec, Manitoba, Saskatchewan, and British Columbia. The rates are lower in the Atlantic provinces because of special federal credits, as well as in Alberta, which has a relatively low corporate income tax rate, a very low small business rate, and no general capital tax.

Internationally, the principal point of comparison for Ontario's corporate tax rates is, of necessity, the United States, the predominant home country for foreign parents of Canadian subsidiaries. Prior to the federal tax reform in the two countries in the late 1980s, the Ontario and Canadian systems, with such features as the lower manufacturing and processing rate, were not at a disadvantage in terms of tax rates. This situation changed following tax reform; tax rates in the United States fell more than in Canada. Table 20.1 sets out the general rate and the manufacturing and processing rate in both Canada and the United States.

As a result of budgetary changes at the federal level and in Ontario in the last few years, manufacturing and processing profits are now taxed at a slightly lower rate in Canada than in the United States. For income not taxed at the manufacturing and processing rate, the rate

---

[2] Quebec has higher payroll and capital tax rates, but these are not directly relevant to the issue of income transfers.

in Ontario is higher than it is in the United States. However, the federal withholding tax on dividends paid to non-residents raises the effective tax rate on profits repatriated from Canadian subsidiaries to foreign parent corporations.

Although the evidence regarding the effect of corporate taxes on business location decisions is not conclusive, there is reason to believe that tax rates have some effect on where profits are declared. A study for the commission reviewing the impact of international integration on the mobility of capital concludes that:

> If Ontario's taxes on capital and income from capital were to deviate significantly from those in other jurisdictions, then Ontario's tax base could change to the degree that total tax revenue could be impacted substantially. For the 1990s, this places a new emphasis on comparisons between Ontario's tax system and the tax systems of other jurisdictions. Consequently, the trends of tax reforms in other countries, particularly US tax reforms, will be increasingly important for Ontario's economy and for the design of Ontario's tax system. (Conklin and Whalley n.d.)

We agree that the role of other tax regimes in influencing what policy choices are appropriate here is going to be even more important in the future. It is critical that the nature of the constraints be fully appreciated. Tax levels that are significantly higher than those in competing jurisdictions will almost certainly have the paradoxical effect of lowering overall revenues by driving out the tax bases that are targeted for taxation.

RECOMMENDATION 34

Ontario should maintain effective rates of tax on business at approximately their current levels relative to other jurisdictions, given the evidence with respect to:

- **effective tax rates in competing jurisdictions,**
- **the impact of effective tax rates on business location decisions, and**
- **the shifting of corporate taxes to employees, consumers, and investors.**

It is always more desirable in principle to levy taxes based on the ability to pay of the individual or business being taxed. The corporate income tax is based on ability to pay in that tax is owing only in years when profits are made. However, as discussed earlier in this chapter, the ability of corporations to shift profits to low-taxing jurisdictions constrains Ontario's ability to raise revenue solely from a tax on profits. As a result of this limit on profits-based taxation, Ontario and other jurisdictions with an open economy levy taxes on business based on other characteristics of the business, including the size of its payroll and the land it occupies. Factors such as land and people are not as easy to transfer to other jurisdictions and thus make a more stable tax base than profits.

RECOMMENDATION 35

It would be desirable in principle to change the composition of taxes on business by increasing taxes based on profitability and decreasing taxes that are not sensitive to profit. However, the fact that the corporate income tax base can move from country to country in response to statutory tax rate differentials means that it is unlikely that increased revenue could be raised through higher corporate income tax rates. The Ontario government should consider the potential for tax base mobility when setting corporate income tax rates.

Taxation of Income from Capital in a Multi-jurisdictional Context

One of the most significant implications of a world "awash with stateless capital" is the increasing difficulty faced by individual national jurisdictions in taxing income from capital.[3] It is generally acknowledged that factors such as increasing investment flows and deregulation are placing growing strains on the taxation of such

---

[3] Various studies have evaluated the conditions under which a taxing jurisdiction can successfully tax capital income originating within its boundaries and the pressures that make this difficult. For example, see Diamond and Mirrlees (1971); Razin and Sadka (1990); and Gordon (1992a).

income. There is a risk that more income from capital will be diverted to jurisdictions where tax rates are low. In turn, other jurisdictions will reduce tax rates to maintain at least some tax revenue from capital and to alleviate concerns that real business investment is being deterred.[4] The eventual outcome of such a process would be that capital income would no longer be taxable. Part of the research and debate on this issue is concerned with identifying under what conditions jurisdictions could continue to tax capital income with its source in the jurisdiction (Gordon 1992a).

This is an extremely important issue because, if it becomes impossible to tax income from capital except in limited circumstances or at very low rates, fairness objectives in taxation will be severely compromised. In particular, effective rates of tax on income earned from employment will exceed rates of tax on income from capital. Clearly, there is little public support or sympathy for such an outcome in Ontario and in most other jurisdictions. Fairness in taxation requires that income from capital be taxed on exactly the same basis as other forms of income. These developments have already served to limit Canadian corporate tax rates, in that Canada no longer attempts to link corporate tax rates and the top marginal rate in the personal income tax. While we would hardly suggest that there is a crisis in the taxation of income from capital in Ontario, it is clear that the forces at work to push taxes on income from capital to the lowest common denominator are real and must be taken seriously.

Our recommendations take these pressures into account. At the same time, however, we do not believe that either Ontario or Canada should accept passively the tax implications of capital mobility. Rather, the recommendations have been developed to improve the taxation of business income in the province in terms of fairness and efficiency, while fully recognizing the constraints imposed by competitiveness issues.

Maintaining tax fairness in the face of capital mobility requires explicit recognition of the difficulty faced by governments in taxing income from capital, and it demands cooperation among

[4] This effect can already be noted in the decision by several of the eastern Canadian provinces in recent budgets to cut corporate tax rates on manufacturing roughly in half. The new regimes are seen as being more competitive while causing little direct revenue loss.

governments in responding to the situation. First, it must be recognized that the pressures in this area are real, which is not always obvious since measures that work to reduce the taxation of capital income are almost never introduced with this as the explicit objective. The rationale is typically based on the argument that tax incentives increase investment and create jobs. From the perspective of a single jurisdiction, with little revenue at stake in the taxation of any single operation, there may appear to be little to lose from adopting such measures. While reference is often made to states in the United States with low tax rates or generous incentives, similar pressures are evident in Canada. Several provinces in recent years have reduced tax rates significantly on certain types of economic activity.[5] Alberta has established a tax reform commission with the express purpose of tailoring that province's tax system to attract investment. Referring to the objectives of the commission, Premier Klein stated: "Our objective is not to raise more revenue through more taxes, but to attract more investment to Alberta by making our tax regime more competitive than any other jurisdiction in Canada" (Alberta Treasury 1993, 6).

Second, while the pressures are real and powerful, there is evidence that most jurisdictions and their citizens wish to maintain the taxation of capital income and that they are willing in some cases to consider greater degrees of cooperation and harmonization with other jurisdictions to this end. For example, the Commission of the European Communities (CEC) established a committee to make recommendations that would increase the harmonization of taxation of capital income within the European Community. The committee made a number of proposals to allow greater integration of European capital markets and to prevent excessive tax competition in corporate taxation once the barriers were removed (CEC 1992). In line with this objective, the committee recommended that a range of corporate income taxes be established within which member countries would be required to set their tax rates. The range recommended involved a minimum corporate income tax rate of 30 per cent and a maximum rate of 40 per cent. The committee also

[5] During 1992, both Prince Edward Island and Newfoundland dropped their corporate tax rates on manufacturing and processing income to 7.5 per cent, respectively halving and more than halving their corporate tax rates on this income.

recommended that minimum standards be set for major elements in the tax base, although this would leave open the use of some incentives (CEC 1992, 13–14).

In the United States, considerable concern has been shown about the transfer of corporate income to avoid tax. Several states, worried about income transfers both within the country and internationally, have adopted systems that attempt to combine all the income within a corporate group before determining the income allocated to the state. California was the first state to adopt this approach, usually referred to as unitary taxation (Munnell 1992, 48–50). This unilateral approach has been controversial because, without inter-jurisdictional coordination, it can lead to double taxation of income where other jurisdictions take a different approach to corporate taxation and apply tax to the same income.

It is obvious that a single jurisdiction can have only limited success in this area. Corporations operating in multiple jurisdictions have too much flexibility to be dealt with effectively on a unilateral basis. At the same time, when a lower tax rate on capital income is adopted in one jurisdiction, there are considerable pressures on other governments to match the move. The cost of failing to be competitive in lost revenue, if not in lost economic activity, is too high not to expect governments to adopt competitive tax measures. The inevitable result of this process will be an erosion in the taxation of capital income, with serious implications for the fairness of the overall tax structure.

Greater cooperation among governments in Canada is required to ensure that fairness is not overwhelmed by tax competition. This cooperation will not be easy, as it will involve some loss of flexibility by provincial governments in setting their corporate tax policies. In the past, the Canadian system has provided a reasonable compromise, both in theory and in practice, between provincial autonomy in tax rules designed to foster development and harmonization of corporate income tax systems. Given the pressures involved, the time has arrived for a more unified approach. This would not lead to meaningful losses in economic development, but would protect tax bases from wasteful erosion from tax competition. If the provinces agree to more harmonization, the federal government should establish a greater degree of meaningful pre-budget consultation about the corporate tax system.

A number of avenues should be explored in this respect, and it is not our intention to recommend a particular approach. The issues are complex, and the views of all the provinces and the federal government must be considered.

One of the options that merits consideration is a system of consolidated taxation, where corporations would be taxed as members of a group. An allocation system similar to that used now for single corporate entities could then ensure that tax bases are distributed according to the realities of sales and employment. Other approaches could include agreeing on a range of tax rates, as has been proposed in the European Community.

RECOMMENDATION 36

Ontario should seek agreements with the federal and provincial governments to minimize interprovincial tax competition. Agreements should provide for such measures as:

- **consolidated taxation in which the tax-paying unit would include all the Canadian members of a corporate group; and**
- **minimum provincial corporate tax rates.**

At the international level, there should be a concerted effort to ensure that the taxation of income from capital is not allowed to deteriorate to the lowest common denominator. Evidence of concern about this issue can be found in attempts by European Community members to establish a set of guiding rules for corporate taxation, and in periodic proposals in the United States to implement special rules for the taxation of foreign subsidiaries operating there. However, unilateral action or actions by groups of countries cannot be a substitute for general international norms.

RECOMMENDATION 37

National and subnational jurisdictions face constraints in their ability to tax the income of multinational corporations. While respecting those con-

straints in establishing its own policy, Ontario should urge the federal government to play an active role in promoting initiatives, such as international tax agreements, to ensure that the income of multinational corporations is taxed fairly.

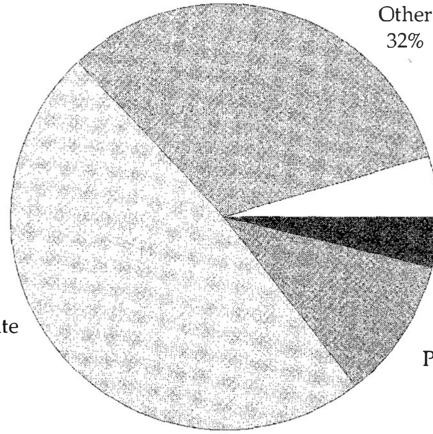
Corporate Tax Expenditures

Many features of the corporate income tax system are designed into the system to influence corporate behaviour in the interests of overall economic policy. The federal government provides a number of tax-based incentives to encourage firms to undertake certain activities or to make certain investments. In adopting essentially the same definition of corporate income and the same deductions for the Ontario corporate income tax that apply in the federal corporate income tax, Ontario virtually automatically adopts those incentives in its corporate tax as well. In addition, Ontario provides certain incentives in its corporate income tax that go beyond those in the federal system. While these provisions are designed to achieve economic development objectives, by allowing firms to reduce their taxable income they contribute significantly to the widely debated phenomenon of profitable corporations paying no income tax.

In 1989 tax subsidies to business were estimated to be about $1.2 billion (Block and Maslove n.d.). Most of these tax expenditures – subsidies delivered through the tax system in the form of reduced taxes or tax credits – are delivered through the corporate income tax system. Tax expenditures in the corporate income tax system in 1989 amounted to approximately $800 million, or two-thirds of the total, not counting the revenue forgone as a result of the reduced rate of tax for small business.

In this section, we first analyse the phenomenon of profitable corporations paying no income tax. The data demonstrate that, after allowing for provisions that are an integral part of a properly functioning corporate income tax, such as the deduction of prior-year losses and the deduction for dividends paid by one corporation to another, the phenomenon of profitable corporations paying no tax is largely the result of those corporations taking advantage of tax expenditures in the corporate tax system.

FIGURE 20.1
Major Reasons Why Profitable Non–tax-paying Corporations Paid No Ontario Income Tax in 1989 – Profits Distribution



Source: Ministry of Revenue PTAD database, as cited in Corporate Minimum Tax Working Group, *Report* (Toronto: Ontario Fair Tax Commission, 1992).

Note: Figures may not add to 100 per cent due to rounding.

We then address the cost and effectiveness of the tax expenditures themselves, and consider the idea of a corporate minimum tax as a substitute for – or as a complement to – direct action to limit corporate tax expenditures. We conclude that it would be more effective and more consistent with the original purposes of the tax expenditures to deal with their cost and effectiveness directly and eliminate those that cannot be justified.

Tax Expenditures and Profitable, Non–tax-paying Corporations

Popular criticism of the corporate tax system has often pointed to profitable corporations that pay little or no corporate tax. This situation is perceived to be primary evidence of problems with the current tax structure, particularly in three basic areas. First, it is seen as inappropriate that corporations with profitable operations in the province benefit from government services without contributing to payment for such services. Second, the ability of corporations to make profits and distribute income without any tax being applicable is seen as a significant fairness issue. This concern is amplified because the dividends received at the individual level are then taxed at preferential rates, as a result of the dividend tax credit. Finally, untaxed profit is seen as a potential tax base, which could yield substantial tax revenues and check the slide of corporate tax revenues as a share of provincial revenue.

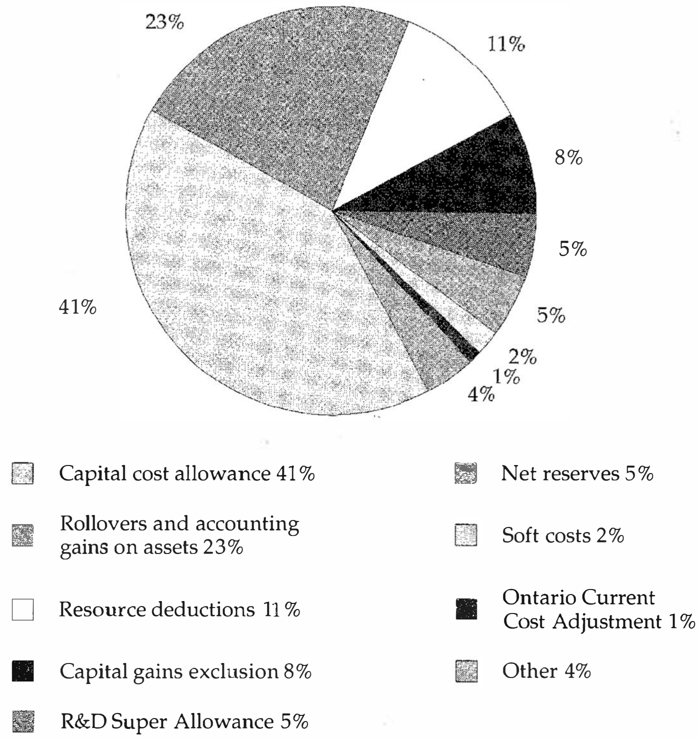
The report of the Corporate Minimum Tax Working Group remains the best existing information on the number of profitable, non–tax-paying Ontario corporations. According to provincial data presented in the report, of almost 177,000 corporate tax returns from 1989 (representing 93 per cent of Ontario corporate tax returns filed in that year) analysed by officials at the Ministry of Finance, about 116,000 corporations reported book profits, of which 23,300 paid no Ontario income tax. A further 6000 corporations paid Ontario income tax at an average rate of less than 5 per cent of Ontario book profits.[6] Of roughly $53 billion earned by these 116,000 profitable corporations, $18.5 billion (or 35 per cent of all profits) was earned by the 23,300 companies that paid no Ontario income tax, and roughly $5 billion (or 9 per cent of all profits) was earned by companies that paid Ontario income tax at an average rate of less than 5 per cent of Ontario book profits.

The report of the Corporate Minimum Tax Working Group went on to analyse the reasons why some corporations paid no corporate income tax. Of the 23,300 profitable corporations that paid no Ontario income tax in 1989, roughly 12,800 were non-taxable because of a since-abolished tax holiday Ontario offered to new small businesses in 1989; 1600 paid no corporate income tax in Ontario because inter-corporate dividends are not taxed in order to prevent double taxation of income earned in the corporate sector; 2200 used prior-year losses to offset corporate income tax otherwise payable; and a further 6700 (with total book profits of almost $6 billion, 55 per cent of which were allocated to Ontario for tax purposes) were non-taxable for other reasons. Figure 20.1 shows what proportion of total profits of profitable non–tax-paying corporations these reasons represent.

---

6 "Ontario book profits" are financial statement profits multiplied by the percentage of each corporation's taxable income that is allocated to Ontario for income tax purposes.

FIGURE 20.2
Other Reasons Why Non–tax-paying Profitable Corporations Paid No Ontario Income Tax in 1989 – Profits Distribution



Source: Ontario, Ministry of Revenue, data, as cited in Corporate Minimum Tax Working Group, *Report* (Toronto: Ontario Fair Tax Commission 1992).

Notes:
Capital cost allowance is the rate of depreciation of capital assets allowed for tax purposes. For certain classes of assets, this rate exceeds book depreciation used for general accounting purposes.
Rollovers and accounting gains on assets or "paper gains" on corporate rollovers are gains that are recognized for accounting purposes but are not recognized for tax purposes on tax-free inter-corporate reorganizations in which assets are transferred between members of the same corporate group without any economic gain or loss to the group.
Resource deductions include a deduction for exploration and development expenses and a deduction of 25 per cent of the amount by which resource

profits exceed exploration and development overhead expenses for oil, gas, and mining companies.

Capital gains exclusion represents the one-quarter of capital gains that are exempt from tax.

R&D Super Allowance provides a 25 per cent deduction for research and development expenditures incurred in Ontario over and above the 100 per cent write-off for R&D current and capital expenditures otherwise available.

Net reserves are amounts deducted from income to reflect various contingencies; for example, reserves for doubtful debts, for amounts not due until a later year, and for undelivered goods or unrendered services.

Soft costs (interest, accounting and legal fees, insurance, and property taxes). Prior to tax reform, soft costs were attributable to a period of construction or renovation of a building and could be fully deducted in the year the costs were incurred. Tax reform has limited the deductibility of these costs.

Ontario Current Cost Adjustment provides for pollution control equipment for use in Ontario.

"Other" includes pension adjustments, deferred charges, asset write-offs, plant closure and restructuring costs, price support, deferred tax adjustments, and miscellaneous other items.

Based on a sample of 144 profitable non–tax-paying companies, the working group concluded that there are a number of other reasons why profitable corporations may pay no corporate income tax. The report estimated that roughly $3.3 billion was untaxed for these reasons, and it is this amount that is of primary concern from the perspective of fairness.

When the federal government introduced its tax reforms in 1987, one of the objectives was to reduce the number of profitable corporations escaping tax altogether. These reforms also affect the picture in Ontario, because almost all of the federal changes were also adopted in this province. The data for 1989 do not fully reflect the effect of tax reform, as many changes were phased in over a number of years and other changes have their full impact only after assets in place before tax reform have been replaced (for example, reduced rates of tax depreciation apply only to assets purchased after reform). The possibility exists that the 1989 information on profitable, non–tax-paying firms may, therefore, significantly overstate the problem.[7]

[7] A commission study looking at effective tax rates (Sabourin et al. 1993) considered the extent to which corporate tax reform was likely to affect the results of the analysis that could be deduced from the limited information available for 1989

Nevertheless, the large pool of losses and carried-over deductions that existed at the time of reform, the incentives that still remain in place, and losses associated with the serious recession of the last few years all suggest that the phenomenon of profitable, non–tax-paying corporations is likely to continue at least for some time.

It is clear from these data that the phenomenon of profitable corporations paying no tax, after allowing for the impact of deductions for dividend income and prior-year losses, which are clearly justifiable in a fair corporate tax system, is actually a direct consequence of the fact that, through tax expenditures, significant subsidies are delivered to corporations through the tax system. When those subsidies are claimed by a profitable corporation and exceed the amount of tax that would otherwise be payable by the corporation based on its income, the result is a profitable corporation that appears to pay no income tax.

In general, there are two potential responses to this situation. One is to focus on the outcome of the tax and tax expenditure process and consider the application of a special tax that would be imposed on profitable corporations that have been able to use subsidies delivered through the tax system to reduce their tax liability to zero. This approach is discussed in more detail below. The other is to direct our attention to the underlying reasons for the phenomenon – the fact that subsidies to corporations are delivered through the tax system – and consider whether or not those subsidies are justifiable from a public policy perspective. We believe that this is the appropriate approach for Ontario to take. If a tax expenditure is considered to be the most effective way to achieve a given public policy objective, the fact that a corporation may pay no tax as a result of having taken advantage of the provision cannot be seen, in and of itself, as evidence of a problem with the tax structure. Although the specific public policy questions raised by individual subsidies go beyond the fair taxation mandate of the commission into the realm of economic policy, we have addressed broader issues related to the process by which tax expenditures are

---

coupled with macroeconomic information. The authors concluded that "it is very difficult in projecting the volume of corporate income tax revenues, let alone their distribution amongst corporations of various types, to disentangle changes in tax structure from changes in the macro economy. More definitive results will have to await more detailed and current data" (34).

devised, approved, administered, reviewed, and audited. In chapter 12, we recommended a comprehensive approach to tax expenditure budgeting and called for more complete and public disclosure by corporations of the benefits that they receive through the tax expenditure provisions of the corporate income tax.

We also address general issues related to the effectiveness of tax expenditures in the Ontario corporate income tax and consider additional criteria that should be applied in analysing the effectiveness of corporate tax expenditures in particular.

Measuring and Evaluating Tax Expenditures

The estimated values of the tax expenditure provisions of various Ontario taxes are summarized in table 20.2.

The measurement of tax expenditures is a contentious issue. Although it is relatively easy to determine the value of some tax expenditures that are narrowly directed – such as the Research and Development Super Allowance – others require a number of assumptions. For example, the figure shown for the capital cost allowance is the estimated value of the difference between the rate of depreciation of assets for accounting purposes and the rate of depreciation for tax purposes. It is possible that in some areas where technological advance is very rapid, depreciation may exceed what is allowed for tax purposes. As a result, the capital cost allowance may underestimate accounting depreciation, and the aggregate figure for the tax expenditure cost of the capital cost allowance may be an overestimate.

In our opinion, the tax system is an appropriate means for only a limited set of objectives. There are many other mechanisms that are better suited to most government policy objectives. Tax expenditures to support economic activity have the twin characteristics of not being highly visible to the general population and yet being very visible to their targeted beneficiaries. The combination of these two attributes makes them hard to modify as the economic objectives of government evolve. A more general difficulty in using the tax system as an instrument of economic policy is that there is no recognized set of criteria by which tax incentives are created and evaluated. Tax expenditures can also be potentially costly to the government if significant resources are reallocated to the targeted low-tax activity. Often direct spending programs achieve greater success because they can be targeted and evaluated more easily. In addition, uncoordinated tax measures designed to achieve a variety of policy objectives can debilitate the tax system, making it less efficient, less equitable, and more complex.

There is also evidence that tax incentives generally change corporate decisions only marginally. Most companies will not make major business or investment decisions on the basis of tax incentives, but a tax incentive can make the difference on marginal projects – especially when the incentive is seen to be secure and long-lasting. If there is doubt about the incentive being maintained, most companies will discount it significantly, if not altogether, in decision making.[8]

Because tax incentives tend to operate at the margin, they are most effective if they are sharply focused on making a particular type of activity significantly more attractive in Ontario than in comparable jurisdictions. Small tax advantages for Ontario in many areas will have less impact on corporate decision making than large differences in one or two key areas. We concluded that, in general, the assistance Ontario offers through the tax system for business activity is too small to be meaningful relative to the values of other factors that affect business decisions. Although these incentives fail to change corporate behaviour, they make the corporate tax system more complex – an effect that contributes to public perceptions about the unfairness of the corporate income tax. As a result, Ontario's tax-based subsidies for business activity are not worthwhile when compared with the revenue forgone and the complexity they add to the corporate tax system.

We are also concerned about the pressure on provinces to compete for business investment by increasing tax expenditures and lowering statutory tax rates. If Ontario were to significantly increase tax expenditures for business activity in an effort to make more than a marginal impact on business decisions, this could trigger interprovincial competition, bidding up of tax expenditures, and eroding corporate tax revenue. We conclude that Ontario should not try to modify or supplement tax-based subsidies to business in the federal tax system.

---

[8] From a study by the Canada Consulting Group for the National Advisory Board on Science and Technology, "Under-funding the Future: Canada's Cost of Capital Problem."

TABLE 20.2
Ontario's Tax-based Subsidies to Business Activity in 1989

Activity and subsidy	Estimated value ($ millions)	% of total
Capital investment:		
Capital cost allowance	460	39.8
Pollution control equipment:		
Ontario current cost adjustment	75	6.5
Small business:		
Reduced employer health tax rate	150	13.0
Flat capital tax	120	10.4
Small business development corporations tax credit	a	
Resource industry:		
Exploration and development expenses	175	15.1
New mines tax exemption	10	0.9
$500,000 mining profits tax exemption	a	
Processing allowance	40	3.5
Resource allowance	25	2.2
Research and development:		
R&D Super Allowance	50	4.3
Various sectors:		
Reduced corporate income tax rate for specified sectors including manufacturing and processing	50	4.3
Total	1155	100.0

Source: Sheila Block and Allan M. Maslove, "Ontario Tax Expenditures," in *Taxes as Instruments of Public Policy,* ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

a. Estimate (under $5 million).

RECOMMENDATION 38

Ontario should not attempt to use its corporate tax system as a mechanism for delivering incentives that are more generous than those offered in the federal system. Corporate tax deductions in Ontario which are either in addition to federal deductions or accelerated compared with federal deductions should be eliminated.

We also suggest specific criteria for tax expenditures related to economic development goals. These criteria should be applied for federal-level initiatives.

RECOMMENDATION 39

In addition to the criteria applicable to tax expenditures generally, tax expenditures designed to further general economic development goals should meet the same criteria that apply to economic development programs delivered outside the tax system:

a) Subsidies should be focused on desired activities or behaviours, not on sectors, types of companies, or size of businesses.
b) The activities or behaviours targeted must be defined and measured easily.
c) The incentives given should be large enough to result in changed corporate decisions.
d) The subsidy programs must be simple to understand and transparent for both companies and the administrative authorities.
e) To limit the potential for abuse, tax incentives in the form of non-refundable credits should not be tradable among firms but rather should be restricted to the recipient company.
f) All subsidy programs should be reviewed in depth with potential recipient firms for their likely impact on behaviour before they are introduced.

Supporting Training through the Tax System

We received a number of suggestions on using the tax system to encourage businesses to train their employees. This issue has received a great deal of attention in recent years, especially in the context of labour force adjustment.

In July 1993 Ontario passed legislation creating the Ontario Training and Adjustment Board (OTAB). The board is a government agency with responsibility for the design and management of provincially funded training and adjustment programs. It is cooperatively led by representatives of employers, unions, trainers, educators, and a range of social action groups. The method for funding training above what is currently being provided will be determined by the board. During the government's consultation on the OTAB project, however, various approaches to training were discussed, including:

- levering funds through sectoral agreements (that is, providing access to government assistance that is conditional on a suitable training investment); and
- introducing a training tax or levy.

During our public consultations, several representatives from the labour movement suggested that tax incentives were necessary to encourage firms to provide training. We considered the advantages of delivering support for training through a direct-spending program or through the tax system. In particular, we looked at a training tax credit for incremental levels of training. However, we conclude that such a credit would be inadvisable for a number of reasons:

- the tax credit for incremental training would discriminate against firms that already provide a high level of training;
- it would be more difficult for firms that supply training in-house, rather than purchase training services, to estimate their costs and to make this estimate verifiable;
- firms that have losses in a given year would not be able to use the credit; and
- the broad public sector would not be covered by a tax-based incentive.

The most costly aspect of training for most firms is the time workers spend off the job while they are enrolled in training, especially if the training is conducted off site. We support the general approach to training embodied in the Ontario Training and Adjustment Board legislation and urge the new board to seek an appropriate non-tax mechanism for supporting firms that undertake training and retraining.

Taxation of Manufacturing and Services

Ontario's Preferential Rate for Manufacturing and Processing Profits

The preferential corporate income tax treatment of manufacturing and processing profits, compared with profits in all other sectors, is a fairness and competitiveness concern given the growing role of the service sector in the Ontario economy. In 1993 Ontario's general corporate income tax rate was 15.5 per cent, while the rate applied to the profits of manufacturing and processing firms was 13.5 per cent. Thus, the service sector, encompassing such activities as transportation, communications, personal and business services, tourism, and wholesale and retail trade, is taxed at this higher rate.

Not only is the statutory corporate income tax rate on manufacturing and processing profits lower than the rate that applies to profits earned in the service sector, but the average effective tax rate is higher for service sector firms that do not qualify for the small business rate. (The average effective tax rate is the rate at which the tax actually applies to profits in a given year after taking into consideration all the deductions available.) Using 1989 data, we found that the average effective tax rate on manufacturing firms with assets of more than $5 million (firms which clearly do not qualify for the small business rate) was about 5 percentage points lower than the average effective tax rate on the same size firms in the service sector and about 2 per cent lower than the average effective tax rate on all non-manufacturing firms of the same size (Ontario Ministry of Finance calculation based on the 1989 corporate sample file database).

The picture changes somewhat when all firms are considered, including those that qualify for the small business rate. Using the same data, we found that the spread between the average effective tax rate for all firms in the manufacturing sector and those in the service sector was less than a percentage point. This smaller spread is a result of the fact that 39 per cent of firms in the service sector are eligible for the small business rate, compared with 11 per cent in the manufacturing sector. These results are echoed in a study for the commission estimating effective corporate tax rates (including both corporate income and capital taxes) based on the corporate tax system in 1991 and 1992 (Chen and Mintz 1993). The study found that the primary sector (mining, agriculture, fishing, logging, and trapping) and the service sector faced the lowest effective corporate tax rates, while construction and wholesale trade faced the highest.

The reasons for the special emphasis given to manufacturing are varied. Historically, a strong and expanding manufacturing sector was considered essential in enabling a developed country to deliver increasing standards of living to its citizens. Manufacturing activity was viewed as the best means of providing the opportunity for economic growth and new and higher-paying jobs. The sector has traditionally been a primary source of foreign exchange, although, in Canada's case, the resource sector has also played a prominent role. Manufacturing was also seen as being exposed to international competition to a greater degree than the service sector.

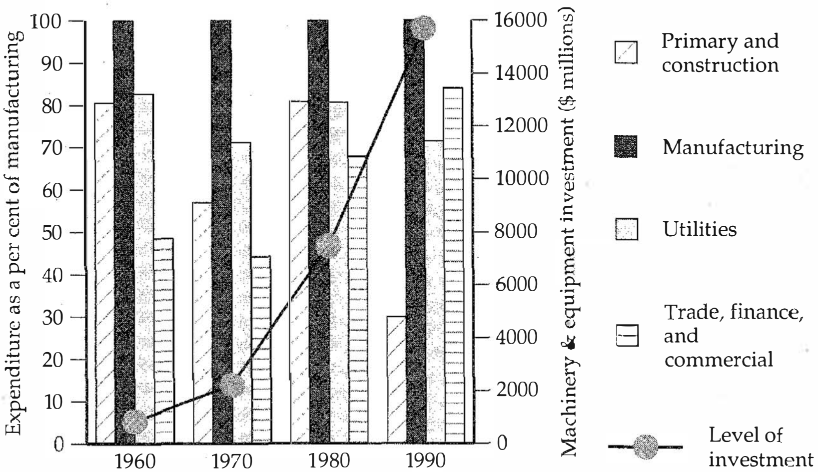
Concern regarding the vulnerability of the manufacturing sector has led to special rules for the tax treatment of manufacturing profits and to the tradition of responding to tax changes in other jurisdictions. While the system that has evolved seems to provide incentives for manufacturing, it can also be seen as one that contains a bias against services. One of the issues we considered in detail was the desirability of taxing the service sector, in effect, at a higher tax rate than manufacturing.

Emerging Role of the Service Sector

The service sector has long been seen as an important provider of employment. In recent years its increasing share of total output has also been recognized. The nature of the service sector has changed; for example, several of the most technologically advanced and fastest changing industrial sectors are in the service sector, communications and financial services being two examples.

Investment in machinery and equipment over a 30-year period provides dramatic proof of this trend. Figure 20.3 compares the level of investment in machinery and equipment in four broad industrial sectors at the beginning of the decades 1960 to 1990. The bar chart shows the level of machinery and equipment investment relative to that in manufacturing. The actual level of investment in manufacturing is shown by the line chart and the right-hand scale.

FIGURE 20.3
Machinery and Equipment Investments by Industry Sector, Canada, 1960–90



Source: Canada, Statistics Canada, *Private and Public Investment in Canada, Intentions,* Cat. 61-205, summarized in Department of Finance, Economic Reference Tables, August 1992.

The figure shows that manufacturing made the largest single investment in machinery and equipment in every year shown. However, there are major changes in the relative positions of the other sectors. In both 1960 and 1970, the service sectors (trade, finance, and commercial) made less than half the amount of investment of manufacturing and less than either the primary and construction sector or utilities. By 1980, machinery and equipment investment in the service sectors had reached almost 70 per cent of that in manufacturing, and was approaching the level in the other two sectors. By 1990, investment in the service sectors in machinery and equipment had exceeded 80 per cent of that in manufacturing and was higher than in the other two sectors. Clearly, the service sectors shown here are an important and growing component of the demand for machinery and equipment.

Another important development in the service sector is the increasing competition faced by many suppliers. This competition is often driven by deregulation or by increasing international trade.

Three important examples can be seen in Canada in the past few years. Retail and wholesale trade have been subject to intense international competition as a result of cross-border shopping. Transportation, in the form of trucking, rail, and air, has faced much more competition as a result of deregulation. Finally, financial services were greatly changed as barriers to competition between major segments in the industry were dismantled in the 1980s. In the face of such developments, it is misleading to characterize the service sector generally as one that is immune to international or interprovincial competition.

Finally, the line between manufacturing (or goods production) and services production is becoming blurred in many ways. More services are being used as intermediate inputs into manufactured products, and manufactured products themselves are, in effect, including additional services as part of the final product. One commentator summarized the changing patterns as follows:

> Services and production are becoming so widely substitutable that distinctions between the sectors seem more arbitrary than helpful. Executives and policy analysts often view activities like product design, market research, accounting, and data analysis as product costs if they are carried out within manufacturing concerns but as services if they are provided externally. Internal salespeople are classified under manufacturing employment, but external sales representatives and wholesalers are called service providers. (Quinn and Gagnon 1986, 101)

The 1992 annual review of industrial policy by the Organisation for Economic Co-operation and Development provides a useful overview and summary of the forces at work (OECD 1992a). It represents a review of industrial development in seven countries (including Canada) over a 15-year period in the 1970s and 1980s. The report considers the changing role of services in some detail, analysing growth and putting forward several observations and conclusions:

- Technologically sophisticated industries have provided the predominant source of growth over the last 15 years. Two of the four leading industries were in the service sector: financial and business services and communications services. The other leading industries were computers and communication and semiconductor equipment.

- "Trade, demand stimulus and other similar policies aimed at providing assistance to low technology industries may be of limited utility" (188).
- The diffusion of technology is as important to growth as the development of technology. The service sector plays an important role in technology diffusion both as a user and a promoter of the services.
- "The economies [being considered] have become more interconnected as manufacturing firms now request more inputs from service industries and vice-versa ... In short, this means that more service value is added to each unit of output, blurring the distinction between what is meant by services versus manufacturing output" (188).
- "Instead of emphasizing one sector over another (e.g., 'manufacturing matters') the focus of economic development policy should be on system-wide gains that maximize the efficiency of the integration of different industries" (188–89).
- "From the perspective of overall productivity growth as well as containment of inflation, increases in service sector productivity would appear to be at least as important as those in manufacturing, despite past emphasis on the latter ... [For many products more than half of the price is] attributable to trade and distribution margins. Given this, efficiency gains in wholesale and retail trade or transportation are likely to have a larger impact on reducing the cost of the final product than changes in the manufacturing process" (189).

These observations raise important issues about the corporate tax bias currently being directed against service sector income.

Reducing Complexity

As far as manufacturing and processing is concerned, the reduction in the Ontario tax rate follows the federal definitions and rules for this tax incentive. While the concept is straightforward, the process for determining the amount of income eligible for the tax rate reduction actually involves several steps. Each step is subject to detailed rules and regulations, which in turn have been tested in the courts (and subject to judicial interpretation).[9] Detailed rules to distinguish between eligible and ineligible income are necessary because the dividing line is blurred between manufacturing and processing activities and the other activities of a business.

Many commonplace examples can be cited where it is not obvious whether an activity should be considered manufacturing/processing or a service activity. Examples include photocopying in a retail store, food prepared in commissaries or by caterers, desk-top publishing, custom tailoring, and the production of software. The courts have addressed a variety of such cases (including those cases addressing similar definitions with respect to sales taxes or other provisions of the Income Tax Act), with the general result that the line between manufacturing and processing activity and other activities is indistinct. Indeed, the courts themselves have commented on the difficulty. One judgment noted with respect to the definition of processing that "not only has [the word] a broad meaning to begin with, but [it] has an ever-increasing range of meanings, and so is almost impossible to define" (*Federal Farms Ltd. v MNR* 1966, EC 66, DTC 5068, CTC 62).

Some activities are eligible in one set of circumstances, and ineligible in another, even though the economic substance of the situation is identical. One important example applies where activities are contracted out. Federal regulations specify a list of operations which are eligible for the low tax rate, including:

- engineering design of products and production facilities;
- receiving and storing of raw materials;
- inspecting and packaging of finished goods; and
- production support activities, including security, cleaning, heating, and factory maintenance.

If these activities are contracted out, not only are they no longer considered in determining the share of the activities of a business eligible for manufacturing and processing tax treatment, but the firm performing the service does not qualify either. In some cases, the

---

[9] Detailed discussions of the definitions, rules, Revenue Canada interpretations, and relevant court decisions can be found in the various tax services published for Canada. For example, see MacDonald and Cronkwright (1993, vol. 3, 33,000–34,499).

courts have considered activities to be eligible in determining the manufacturing and processing deduction, which would certainly not be considered manufacturing or processing activities if they were carried out on their own. For example, in one case the preparation and editing of feature articles, editorials, news stories, and advertisements were considered to be part of the manufacturing process of publishing a newspaper, and the associated labour costs were classified as manufacturing costs in the calculation of income eligible for the low rate (*St. Catharines Standard Limited v The Queen* 1978, FC–TD, 78 DTC 6168, CTC 258).

Sometimes factors such as ownership of the materials or goods being processed can determine whether an activity is manufacturing or a service. For example, engine overhauls, custom-tailored goods, tire retreading, and muffler replacement are activities that have not been considered to be manufacturing and processing when the activity is carried out for someone else (MacDonald and Cronkwright 1993, vol. 3, para 33). They would be eligible if the ownership of the property in question were in the hands of the person doing the overhaul or retreading.

Any definition segregating complex activities into eligible and ineligible categories will create problems and will usually result in some apparent inconsistencies. The situations and examples provided are not intended to suggest that the rules are inoperable; rather, they are intended to emphasize that the distinction between services and manufacturing is blurred. In addition, if one of the functions of the lower tax rate is to leave more retained earnings in the hands of corporations with the best prospects for growth and creating employment, then the incentive is not well targeted for this purpose.

In the case of the manufacturing and processing deduction for Ontario tax purposes, the most significant special eligibility issue is that the exemption also encompasses the primary sector (farming, fishing, logging, and mining). Given the limited prospects for economic growth and employment generation in some of these areas, it is difficult to justify discriminating against the service sector, where the potential benefit in terms of reinvestment and employment must be greater.

RECOMMENDATION 40

Ontario should eliminate the bias in the corporate income tax against income generated in service industries by removing the preferential rate for profits from manufacturing and processing.

Controlling Tax Expenditures through a Corporate Minimum Tax

The existence of non–tax-paying and low–tax-paying corporations in Ontario led many people to suggest that Ontario levy a corporate minimum tax in addition to the existing corporate taxes. The Corporate Minimum Tax Working Group assessed three design options for a corporate minimum tax. We analysed the information developed by the group as well as other information on the various options.

Dividend-based Options

Under the Canadian income tax system, a dividend tax credit is available for dividends received by individuals. Part of the purpose of this credit is to provide recognition for income taxes paid at the corporate level. If income taxes have not been paid by the corporation, however, this integration mechanism means that the income underlying the dividend is never taxed in the corporate sector and is taxed at a lower rate than other income when it is received at the individual level.

This credit obviously raises fairness concerns. As the working group report put it: "Non-taxation of dividends without regard to the amount of tax actually paid by the distributing company represents both a logical inconsistency in the operation of the current tax system and a potentially unacceptable reason why some profitable corporations pay little or no corporate income tax" (Corporate Minimum Tax Working Group 1992, 45). The paying out of income in the form of dividends without tax being assessed is also inappropriate where the lack of taxation results from tax deferrals designed to encourage investment. To the extent that funds arising from tax deferrals associated with incentives are reinvested, the full value of the incentive continues to be available.

To address this problem, a tax can be applied to dividend distributions, with the tax being recoverable if sufficient income tax has been paid. This system is in place in various forms in a number of countries, including the United Kingdom and Australia. The House of Commons Standing Committee on Finance and Economic Affairs recommended this approach as an alternative to certain federal tax reform proposals (Canada House of Commons 1987, recommendation 51).

Although we have some sympathy for this approach, we consider that the tax could not be administered on a provincial basis only. The working group report referred to several major problems associated with Ontario alone implementing such a tax, including administrative complexity, potential avoidance, and inconsistency with federal and international treatment of dividends (Corporate Minimum Tax Working Group 1992, 46). We agree with these observations and recognize that, because of the issues identified, this approach could not function at the provincial level.

Capital-based Options

Another form of corporate minimum tax is one that taxes the capital employed in the province. In this respect, such a tax would be similar to Ontario's existing capital tax and would apply to the taxable capital employed by corporations with capital of $1 million or more. (Taxable capital includes paid-up capital stock, retained earnings, surpluses, and debt less an allowance for investment in other corporations. For a brief description of Ontario's capital tax, see the appendix to chapter 8).

The working group's analysis shows that Ontario's capital tax currently "falls mainly on profitable companies which already pay some corporate income tax and on companies paying little or no tax on account of current or prior years' losses." It does not act effectively as a minimum tax on profitable corporations paying little or no income tax (Corporate Minimum Tax Working Group 1992, 52–53). The working group determined that a capital-based corporate minimum tax would have to take the form of a surtax on Ontario's existing capital tax or of a separate levy that would apply only to profitable corporations. Like the working group, we are concerned about a capital-based corporate minimum tax applying to unprofitable corporations rather than to those that have losses generated through tax preferences. We reject the capital-based design option because of the difficult task of designing a capital tax that is profit sensitive and reconciling such a tax with the existing capital tax.

Income-based Options

Under the income-based minimum tax, a revised tax base would be calculated which more closely approximates the economic or accounting income of the corporation. In other words, it does not allow some deductions that are provided as incentives under the regular income tax, and it may include income items that are excluded from the base for regular income tax. Conceptually, it amounts to the calculation of a replacement income tax that dispenses with many of the incentives incorporated in the regular corporate income tax.[10]

This approach appears to be a direct and obvious response to the issue. However, as several members of the Corporate Minimum Tax Working Group observed, it has a number of serious shortcomings. Not only does it tend to be complex, but the option introduces a limit or claw-back on incentives that governments have deliberately introduced to advance economic or social policy goals. In general, we conclude that the introduction of this type of minimum tax does little more than introduce a second income tax structure. Over time, this new tax is unlikely to be any more effective than the regular income tax in dealing with the complex issues of what should be included in the tax base for a corporate income tax. At the same time, such a structure would significantly complicate tax policy and tax compliance by introducing a parallel income tax system.

In the 1993 Ontario budget, the government proposed that a corporate minimum tax based on the incomes-based option be adopted (Ontario Ministry of Finance 1993a). Although we have considerable sympathy with the aim of this tax in attempting to deal with the problem of non–tax-paying and low–tax-paying profitable corporations, we are convinced that explicit recognition and a vigorous assessment of tax expenditures will deal with this blatant unfairness in the tax system better than the application of a further corporate tax.

---

[10] Several major variants of the income-based minimum tax are described in the working group report (Corporate Minimum Tax Working Group 1992 46–47). A more detailed technical analysis is also available in a discussion paper prepared by the federal Department of Finance (Canada Department of Finance 1985b).

21 Taxation of Small Business and Cooperatives

Almost every tax in Ontario that applies to business contains a provision that offers special treatment for small business. These special provisions take a number of different forms – special exemptions, reduced or flat rates of tax, and so forth – but usually the result is that the effective rate of tax is lower for small businesses than it is for businesses generally. These special provisions not only are ubiquitous in tax legislation, but are also among the most costly tax expenditures in the corporate sector in terms of revenue forgone as a result of their application.

This chapter is devoted to a review of the rationales for and cost effectiveness of the major special tax provisions that apply to small business in Ontario. Because most of the special provisions for small business are targeted to some definition of the word "small" without reference to any other rationale or objective, we begin with an extensive discussion of the arguments in favour of and against special assistance for small business in general. We provide an overview of the major special provisions for small business in Ontario and then focus in particular on the three provisions that are most costly in terms of revenue forgone: the reduced rate of tax on small business; the stepped flat rate in Ontario's capital tax; and the graduated rate schedule in the Employer Health Tax. We also review the special exemption in the personal income tax for capital gains on small business assets, and we comment on the implications of our recommendation to eliminate all exemptions from capital gains taxation, including the special lifetime exemption for small business assets. Finally, we review issues in the taxation of cooperatives, with a particular focus on provisions of the tax system that have the effect of discriminating against cooperatives.

One of the immediate problems in assessing the effectiveness of special tax provisions for small business is that there is no consistent definition of small business either in the tax statutes that provide for the special treatment or in the statistics often cited in support of such special treatment from an economic policy perspective. The term "small business," as used in this chapter, has a general meaning. The term "business" covers sole proprietorships, partnerships, and incorporated businesses. The term "small" is defined variously in terms of sales, employment, income, and capital employed. However, each actual tax provision for small business involves an explicit or implicit definition of what constitutes a small business for the purpose of that particular provision. There is no consistent definition of small business for tax purposes, and different definitions apply across different taxes and even within the same tax. Therefore, taxing statutes may identify specific provisions as being targeted to small business, but the actual beneficiaries range from only the very smallest commercial activities in some cases to large businesses in others. For example, the federal Goods and Services Tax legislation defines the small business provision as sales of $30,000 annually. Below this threshold, a person does not need to register and is, accordingly, exempt. In rough terms, this would correspond to the level of sales associated with a single individual running a small service operation. In comparison, the federal Large Corporations Tax exempts any business with assets of less than $10 million from the tax, a threshold that would be associated with a significant manufacturing or other business.

The Debate over Special Tax Treatment of Small Businesses

Small business tax provisions cannot, in general, be objectively linked to a single rationale. The provisions reflect subjective responses by government to a set of rationales for special measures. In addition, almost all the arguments put forward in support of the incentives are open to some degree of criticism. All these observations underline the difficulty of assessing these provisions.

Nevertheless, there appears to be widespread support for tax relief and incentives for the small business sector, reflecting some genuine economic concerns and specific needs. As various commentators have noted, the small business sector is an essential element in a healthy market economy, largely because it is a source of innovation for which risk is diversified because of the large number of firms. In addition, the small business sector plays an important role as an employer and in job creation in Ontario. According to a study by the Canadian Federation of Independent Business, firms with fewer than 50 employees accounted for just under one-third of business employees, on a full-time equivalent basis, in Ontario in 1988 (1991, 1). These same firms accounted for almost three-quarters of net job creation, again on a full-time equivalent basis, in Ontario's private sector between 1978 and 1988 (Canadian Federation of Independent Business 1991, 1). A study for the federal Department of Regional Industrial Expansion found that 80 per cent of net new employment in manufacturing during the 1970s was in firms employing fewer than 50 people (Canada Department of Finance 1984, 42). However, wherever such broad-based support and goodwill exist, there is always a danger that incentives will be badly targeted or overextended. It is from this perspective that we considered it important to ask basic questions about the level and type of special tax provisions directed to small business.

We also recognize that, since the early 1970s, small business has formed a highly effective lobby group in debates on tax reforms. The input of small business associations and their members has often been influential in the tax policy process. An observation that a measure "benefits small business" is almost always recognized as a positive comment. There has thus been a receptive environment surrounding tax measures supportive of small business.

The arguments supporting the existence of tax provisions beneficial to small business range from economic ones, often related to the difficulty of financing small business, through pragmatic ones (generally related to the cost of compliance and administration), to philosophical ones ("small is beautiful"). Our analysis of these provisions is focused on whether they, in seeking to support small business, undermine the fairness of the tax system. As well as examining these arguments, we look at the case that could be made for scaling back or eliminating incentives.

Improving Access to Capital

A general economic argument can be made that special tax treatment for small business is needed to counter market imperfections that have the effect of limiting the access of such businesses to capital financing.

From the observation that small businesses are generally more dependent on debt financing than large businesses, it is then argued that a "capital gap" exists for the sector. The gap is sometimes considered to be a shortage of equity funds for the sector, which may be the result of outside investors finding it difficult to assess potential returns. It may also result from more general problems, such as a bias in the tax system against risk taking. From different premises, it is argued in the alternative that the problem is a lack of outside debt financing, often ascribed to an unwillingness of banks, the major supplier of debt capital, to provide funds. The result of any type of underfinancing would be insufficient investment in the sector with an attendant loss of growth and employment.

There was a lively debate on this issue in the 1970s and early 1980s. In response, Ontario and other provincial governments, as well as the federal government, introduced tax measures supportive of both debt and equity investment in the sector. Acceptance of the arguments regarding the difficulty of financing small business has also led to major provisions for small business in the income tax system. The small business deduction, the small business development corporations system, the $500,000 lifetime capital gains exemption for small business property, and the stock option rule for employees of Canadian-controlled private corporations have all been supported on the basis of the "capital gap" argument.

Critics of this argument for small business tax incentives for debt and equity financing have argued that the existence of a capital gap has not been proved. They argue that the supply of debt financing reflects the operation of appropriate market rationing of a scarce commodity and that the relatively low use of outside equity reflects the strong desire of business people to retain full control of their small business by not involving outside equity investors. Critics of tax incentives for small business financing also argue that failures in the debt market could be more appropriately handled by direct intervention in this market. Both federal and provincial governments have operated such programs. Two such mechanisms at the federal level have been the Small Business Loans Act and the Federal Business Development Bank. During the extensive debate in the early 1980s on the issue of small business financing, one argument concerning these mechanisms, which would also apply to tax measures, was that they may be less necessary since Canadian financial markets have matured, with an increase in bank lending to small businesses and the arrival of new market participants such as venture capitalists.[1]

Investment Incentives

A classic argument for providing investment incentives is to increase the rate of capital formation, leading to more production (and employment) both directly and through the improved productivity provided by new machinery and equipment.

Although this argument is a general one, the central role of the small business sector in recent employment and economic growth has led to a considerable concentration of incentives. With job creation centred on small business during a period in which employment levels have been a persistent problem, it is not surprising that governments have found it attractive to provide investment incentives to support new activity in the sector.

Risk Taking

Small business is normally considered a high-risk sector. Business failures occur at a higher rate than they do with larger businesses. Outside investors such as venture capitalists usually take the view that such businesses will include a mixture of many failures and some spectacular successes. Therefore, special consideration is given to small business in a number of income tax provisions – among them, the ability to deduct allowable business investment losses on the shares or debt of small businesses against income in general (rather than just to offset these losses against other capital gains). The small business financing program, a provision in the federal and Ontario income tax that has been in place since 1992, represents another effort by governments to help small business obtain financing.

---

[1] See, for example, Hatch et al. (1983).

This program permits qualifying small businesses to borrow money at interest rates below those normally charged in the commercial market by treating the interest payments to the lender as dividends. The corporate lender then qualifies for the inter-corporate dividend deduction, and the individual lender for the dividend tax credit. Thus, lenders are able to charge small businesses lower interest rates while maintaining the same after-tax rate of return (Canada Department of Finance 1992a, 160). The program permits small business corporations and unincorporated businesses to issue small business financing instruments until the end of 1994 (Canada Department of Finance 1992b).

The lifetime capital gains exemption of $500,000 and the Ontario small business development corporation tax credit are both justified on the basis that they increase the after-tax rate of return on risky investments in small business relative to other investments.

A policy environment that supports risk taking is generally seen as a desirable feature of public policy in a market economy. An appropriate volume of risky investments can lead to higher average rates of return and, thus, better economic growth; but, more important than that, it can provide the innovations and new development that can lead to large bursts of economic growth. The tax system is an important part of the policy environment for risky investments. If a risky investment pays off, the tax system effectively shares in the rewards. If the risky investment fails, the tax system only shares in the loss to the extent that the loss can be written off against other income. Thus, because losses generally do not give rise to a tax refund, there is an imbalance in the system that results in a bias against high-risk investments in stand-alone businesses. If risk taking is desirable, then it is appropriate that the tax system be supportive of, or at least neutral in dealing with, risk in investments.

There are two general approaches to supporting risk taking through the tax system. The first responds to the fact noted above that if the government takes a share of profits through income tax but ignores losses, there is asymmetrical treatment of losses and gains and a resulting bias against risk taking. The second approach consists of providing preferential tax treatment for income from risky investments.

An income tax that allows full-loss offsets (immediate refundability of the loss times the tax rate) would help risk taking because it would tend to reduce the risk faced by investors without lowering average rates of return. This situation would occur because the government, in effect, would be partially insuring against losses. In practice, income tax systems, including the federal and Ontario ones, typically do not allow for full-loss offsets and thus can be seen as deterring risk taking. However, the income tax does provide for the carry back and carry forward of losses to reduce taxable income in years in which tax would otherwise be payable. The income tax thus does allow for partial loss offsetting in cases where the business is profitable over a series of years. Other taxes that do not contain any form of loss offsetting are even more detrimental to risk taking than the income tax. Capital taxes, for example, are payable whether or not the business is profitable. They are therefore payable by firms in a loss position, increasing the chance of business failure.

Although at the conceptual level one finds fairly general support for avoiding biases against risk taking, less agreement exists on the extent to which this problem should be considered a small business issue. If the failure to credit losses is discouraging risk taking, or if a need exists for preferential treatment of the returns on more risky investments, then it could be argued that improvement of the general tax rules would be a more appropriate solution.

Cash Availability Issues

Small businesses are particularly vulnerable to cash flow difficulties. While taxes are often associated with a flow of cash into a business, some taxes – the corporate capital tax, for example – apply regardless of the cash position of the business. It is sometimes argued that it is unfair and inappropriate to apply taxes to such a situation, since the business or investor may have to dispose of assets or borrow to make the payment.

Cash availability may, in certain situations, be an issue under the income tax as well. For example, in the transfer of a business between generations, where the retiring individuals may accept debt or instalment payments to ease the transition, no cash may be involved in the transaction. This consideration is used to argue for a deferral or forgiveness of tax. In such situations, it may be more appropriate to adopt instalment or flexible payment provisions than to accept mechanisms that lead to exemptions or lengthy deferrals. In general, the real problem of cash availability occurs when there is no underlying ability to pay the tax. Such a situation represents a more fundamental issue of tax fairness than the concept of cash availability.

Compensatory Relief

It has been argued that in certain cases, parts of the tax structure interact with the typical characteristics of small businesses to create a bias against this sector. For example, small businesses are, on average, more labour intensive than large ones. As a result, incentives for capital (such as accelerated depreciation in the income tax) or taxes on labour (such as payroll taxes) are implicitly biased against smaller businesses. The bias does not arise because of market imperfections or because the tax structure is explicitly structured to affect smaller businesses to a greater degree. Rather, it results from the interaction of the structural features of the tax and the economic characteristics of small business. Arguments are then advanced that compensating provisions should exist to offset the bias.

Compliance and Administration Costs

Clearly any tax that has a high ratio of compliance costs to tax paid is of questionable merit. From the taxpayer's viewpoint, the actual burden imposed by the tax includes the compliance cost plus the tax paid. However, only the tax paid finds its way into the public treasury to support government expenditure. Since compliance costs generally include a fixed element (for example, obtaining basic information about the tax) and economies of scale (record keeping), the compliance cost per dollar of tax paid is likely to be higher for small businesses than large ones.

In some cases, this imbalance seems to have been part of the motivation for the adoption of special tax provisions for small business. For example, the exemption and the special flat rate in the capital tax for small business, the graduated rate schedule in the Employer Health Tax, and the payment to vendors for collecting the retail sales tax all have been explained on this basis.

Any tax with a high ratio of administrative cost to taxes collected would also be questionable as a tax source. Only the net collections are available for government purposes, but the negative effect of the tax on the economy relates to the full amount of the tax – including the amount spent on administration. Like compliance costs, administration costs involve a fixed element and economies of scale, so they are higher per dollar of tax collected from smaller taxpayers. A size threshold may in fact exist, below which it would make little economic sense to impose the tax. The exemption and flat rate features of the capital tax for small business could be partially justified on this basis.

In general, it makes sense to look at the combined size of compliance and administration costs in assessing whether they present a reason for special provisions for small business. However, it must be recognized that thresholds or special rules will themselves lead to costs of compliance and administration. For example, government incurs costs to ensure that an exemption is claimed by eligible taxpayers. An exemption could cost more in revenues forgone than the actual cost of delivering the intended benefit.

Overall Levels of Taxation on Small Business

In addition to these specific arguments, a more basic argument is often raised about the combined effect on the small business sector of the large number of taxes levied on business generally. In effect, this argument is really a combination of the other arguments summarized above. It is argued that because small businesses have difficulty attracting investment capital, tend to be labour intensive, experience high compliance costs for the large number of taxes they either collect (on behalf of the government) or pay (based on their own operations), and are most likely to be hurt by the tax system's bias against risk taking, their operations are particularly constrained by the combined effect of all taxes, and particularly those taxes that are not related to the income generated by the operation.

Ensuring Equivalent Tax Treatment for Different Forms of Business Organization

Most of the arguments for special treatment of small business relate to one form or another of systemic discrimination in the economy. These arguments identify economic factors or tax provisions that apply equally to all businesses, but have a particularly adverse impact on the small business sector. Special tax provisions are then identified as necessary either to compensate for adverse economic impacts or to offset adverse tax impacts. Other arguments, such as those based on administration and compliance costs, suggest that the fact that a business is small is, in itself, a justification for special treatment.

In addition to these arguments, which are based either on economic policy or on practical considerations, special treatment for small business may be justified on the basis of the need to maintain consistency in the tax treatment of different forms of business organization. For many small businesses, it is feasible to carry on the same business activity either as a corporation or unincorporated as a sole proprietorship or partnership. For these kinds of businesses, if the tax system does not provide for equivalent treatment of income regardless of the organizational form in which it is earned, the tax system itself may determine the choice an individual makes between incorporating or carrying on business as an individual. On the one hand, if the total tax paid by an individual earning income in a corporation and paying out the proceeds in the form of a dividend exceeds the tax that would be paid if the income had been earned directly by the individual, the tax system would be introducing a bias against carrying on a business through a corporation. On the other hand, if the total tax paid on income earned through a corporation is less than what would be paid on the same income earned directly by an individual, the tax system would be introducing a bias in favour of carrying on business through a corporation.

In Canada, one of the functions of the reduced rate of tax on small business and the dividend tax credit system is to address this issue of bias by providing for equivalent treatment through integration of the corporate and personal income tax systems.

Assessing the Arguments

The two main arguments against special treatment for small business are based on opposite premises about the appropriate role for government policy in influencing economic activity. The first is that incentives delivered to business, whether through the tax system or through other forms of government intervention, are not appropriate in a market economy because they alter the allocation of resources in the economy and, therefore, reduce economic efficiency. The second argument accepts the case for using public policies generally – and taxation policies in particular – to promote economic development, but asserts that these incentives are not well targeted, given the needs of a modern economy. This argument suggests that incentives for small business should be redirected to support economic activities that are more closely related to the critical needs of the Ontario economy today. In recent years, a broad consensus has emerged that the key to Ontario's economic future lies in promoting critical activities and processes such as research and development, technological diffusion, and education and training, and in enhancing the ability of Ontario industry to compete in sectors that are affected by international trade (Premier's Council on Technology 1988; Porter 1991; Drache 1992; United Steelworkers of America 1992).

An implication of this second argument is that it is the presence or absence of these activities, rather than the size of the business, that should drive the allocation of public subsidies for business activity in Ontario in the 1990s. Measured against this standard, the current incentives for small business are not well targeted. The incentives are directed to a broad cross-section of taxpayers based not on their exposure to external competition, but on some measure of their size. The incentives are not tied to activities of investment, research and development, or skills training, but to general characteristics such as payroll, income, ownership, or capital employed. From this perspective, assistance to small business could be replaced by incentives that would be much more effective. Under this approach, small business could still receive incentives, but they would be based on the type of business activities the firm was involved in, not size characteristics.

Although in general we accept the arguments outlined above in favour of directing incentives strategically based on a vision of the future development of the economy, we find it difficult to identify potential tax provisions, other than those for research and development, that could actually be effective in encouraging the desired activity. Indeed, we question whether even the tax provisions for research and development might not better be delivered outside the tax system.

In our view, the critical arguments in favour of special tax treatment for small business concern access to financing, the need to encourage high-risk investment, the costs of administration and compliance, and the more general issue of the overall level of taxation on small business.

Evaluation of Major Tax Provisions for Small Business

As we noted earlier in this chapter, virtually every tax affecting business in general has some special provisions for small business. These special provisions include:

- the small business deduction in the Ontario corporate income tax, with a tax expenditure value in 1989 of $435 million (Ontario Ministry of Treasury and Economics 1989a, 100);
- the special capital gains exemption for small business shares, with an estimated tax expenditure value in 1989 of $167 million;[2]
- the income tax provisions that allow small business capital losses to be deducted from ordinary income rather than the general rule that only permits capital losses to be offset against capital gains, with a tax expenditure value in 1989 of $12 million;[3]
- the preferential tax treatment of employee benefits provided in the form of stock options;
- the series of flat rates in the Ontario paid-up capital tax, with a tax expenditure value in 1989 of $120 million (Block and Maslove n.d.); and
- the graduated rate in the Employer Health Tax, with a tax expenditure value in 1989 of $150 million (Block and Maslove n.d.).

Rather than review all these provisions in detail, we decided to focus on three provisions that relate specifically to small business and that have the highest tax expenditure value: the small business deduction and the related system for personal and corporate tax integration; the flat rates of the capital tax; and the graduated rate

---

2 This estimate is based on a breakdown of the tax expenditure for the capital gains exemption reported in the personal tax expenditure accounts by the federal government (Canada Department of Finance 1992b, 12–13). The information on the breakdown of the exemption into its small business component was then combined with the estimate of the total tax expenditure value of the capital gains exemption for Ontario in 1989 ($529 million).

3 This is based on the federal revenue cost of $66 million for 1989 as provided in the recently released *Government of Canada Personal Income Tax Expenditures*. The federal revenue cost is adjusted for the lower Ontario tax rate and Ontario's typical share of the tax base to obtain an estimate for Ontario. It should be considered an indicator of order of magnitude only.

schedule in the payroll tax. We also address the impact on small business of our recommendation in chapter 17 for the elimination of the special capital gains exemption for small business shares.

The Small Business Deduction and Integration of Personal and Corporate Income Taxation

The small business deduction reduces the Ontario rate of corporate tax to 9.5 per cent on the first $200,000 of active business income of a Canadian-controlled private corporation from the regular rate of 15.5 per cent or the manufacturing and processing rate of 13.5 per cent. The government attempts to limit the benefit to smaller companies by applying a claw-back of the benefit through a higher tax rate in the $200,000–$500,000 income range. The tax rate in this income range is 17.5 per cent for manufacturing and processing income, and 19.5 per cent for other income. Although this rate tends to limit the beneficiaries from the incentive to smaller companies, large companies are eligible for the lower rate in low-income years.

When the preferential small business rate was introduced at the federal level, the rationale was that small businesses have less access to capital markets than larger firms. The small business deduction means that, after tax, small businesses have more funds available for reinvestment out of each dollar of pre-tax retained earnings. The deduction is a major incentive. It currently reduces by almost 40 per cent (from a tax rate of 15.5 per cent to a tax rate of 9.5 per cent) the income tax otherwise payable in the province by eligible small business corporations. The maximum Ontario tax reduction any small business may receive is $12,000 (the six percentage point difference in tax rates times the maximum eligible income of $200,000). The corresponding reduction for a small business as a result of the federal small business rate is $32,000.

The small business deduction also plays an important role as part of the mechanism which ensures that the taxes paid on income earned through an incorporated small business (through the corporate tax system) are comparable to taxes paid on income earned through an unincorporated small business (through the personal income tax system). The other part of the mechanism for ensuring that the effective tax rate on small business income does not vary with the way the business is organized is the dividend "gross-up" and tax credit. Together, these provisions ensure what is referred to as corporate and personal income tax integration. Dividend income received by an individual from a corporation is increased (grossed up) by 25 per cent of its actual cash value. A tax credit equal to 13 1/3 per cent of the taxable amount of the dividend (including the gross-up) is then permitted. This arrangement is intended to make allowance for the tax assumed to have been paid by the corporation before the dividend was paid out.

The dividend gross-up and tax credit is based on a hypothetical model of provincial taxes involving assumptions about the provincial corporate tax rate and the provincial personal tax rate. When a province has tax rates that differ from these parameters, integration will, in general, no longer be achieved. A change in the federal corporate tax rate (such as by imposition or elimination of a surtax) without a coincidental change to the dividend tax credit and gross-up will also move the system away from integration. In these cases, there may be a tax advantage to earning income directly at the personal level (distributed corporate income is underintegrated) or in a corporation (distributed corporate income is overintegrated).

It should be emphasized that the dividend gross-up and tax credit is not exclusively a small business measure. It is available for dividends of any taxable Canadian corporation. However, when taken in conjunction with the special, low tax rate for eligible small business income, it is a significant benefit for small businesses.[4]

The lower corporate tax rate on small business, when looked at from the perspective of the overall federal-provincial tax system, in a sense consists of two elements of reduced rates. The first element relates to the fact that the general corporate rate is less than the top marginal rate at the personal level. The top marginal tax rate in Ontario at the personal level in 1994, including both federal and provincial taxes and surtaxes, is 53.2 per cent. The general corporate tax rate is 44.34 per cent, combining federal and provincial rates. If manufacturing and processing income is involved, the combined corporate rate is 35.34 per cent. Corporate rates are thus significantly below the rates prevailing at the personal level. Issues raised by this differential relate to the tax advantages in retaining and investing income at the corporate level relative to the personal level. The second

[4] Other special provisions for private corporations extend the integration mechanism to capital gains income.

element of reduced rates is the small business rate of 9.5 per cent for Ontario, which when combined with the federal rate leads to a federal-provincial rate of 22.34 per cent.

The lower tax rate for small business is not consistent with the objectives identified earlier in this chapter for preferential treatment for small businesses in the tax system. The incentive provided through the low tax rate essentially operates as a tax deferral when income from past investments is retained and reinvested in a small business corporation. However, small business concerns relating to investment incentives, risk taking, market imperfections, and compliance and administration costs are addressed by the lower tax rate in only a limited and indirect fashion. For example, the low rate provides no immediate incentive for any investments other than those being financed out of retained earnings.

Support targeted directly at these concerns might therefore seem the more appropriate approach. In general, this could involve incentives for capital investment (such as investment tax credits), incentives for equity or debt investment, or measures to allow full recognition of losses in the tax system. However, all these options also have significant problems attached to their use as a way of providing support to the small business sector, and we eventually rejected them. The general conclusion we reached was that the current approach, providing the principal incentive to small business corporations as a reduced tax rate for the first $200,000 of income, should be retained. Several considerations went into this conclusion.

First, the current incentive is available only to those entrepreneurs who have demonstrated the ability to operate a profitable small business, as evidenced by the existence of taxable profits. This provision helps target the benefits of the tax deferral associated with the lower tax rate to investments with a higher likelihood of success. In the case of small businesses, where there are many failures, this may be a useful test for eligibility.

Second, all provinces and the federal government provide a lower tax rate on small business income. We have already noted the dangers associated with Ontario's attempting to apply tax rates that are out of line with other jurisdictions. Although the "mobility of capital" argument may not be as strong in the case of small business as it is for some other investments, we believe it would be contentious and possibly counterproductive for Ontario to deviate significantly from the small business tax structure in place in other provinces.

Third, the current system of small business corporate taxation has been in place for a long time and enjoys a high degree of support not only from the small business sector, but also, apparently, from the broader public. Given the other important changes we are proposing, with their implications for the small business sector, it may be appropriate to retain this well-established structural feature intact.

The desirability of treating, in a fairly standard fashion, small business income earned in different ways is one other important reason for retaining the lower small business rate. Through the combined effect of the lower corporate income tax rate for small business and the dividend gross-up and tax credit, there is relatively equal treatment of small business income received by individuals, whether it has been earned through an incorporated or an unincorporated business. Eliminating the small business deduction in Ontario and substituting another form of incentive system related to investment activities or financing would destroy this integration, which could be reinstituted only by far-reaching changes that would not be feasible under the terms of the Tax Collection Agreements.[5]

Achieving equal tax treatment of small business income, regardless of whether it has been earned through an incorporated or an unincorporated business, depends on the federal government's selection of the dividend gross-up and tax credit parameters. It also depends on the provinces' setting their corporate income tax rate at 8 per cent and their personal income tax rate, expressed as a percentage of the federal rate, at 50 per cent. Using these rates, table 21.1 sets out the tax calculation that would apply on $100 of income earned through a small business. The calculation for income earned at the corporate level and distributed to a shareholder is shown on the left side of the table. The calculation for income earned at the personal level appears on the right. The tax parameters used are at the bottom of the table.

---

[5] One approach of this type would be treat small corporations in a fashion similar to partnerships and, for tax purposes, flow the income out to the shareholders. However, this method would make taxable income at the personal level different for Ontario and federal income tax purposes. This arrangement is not feasible within the federal-provincial agreements on the personal income tax.

TABLE 21.1
Tax Treatment of Small Business Income Earned in Ontario at the Corporate and Personal Levels: Full Integration Scenario

Corporate level	Amount	Personal level	Amount
Corporate income	$100.00		
Federal CIT	$12.00		
Federal CIT surtax	—		
Provincial CIT	$8.00		
Dividend distributed	$80.00		
Grossed-up income	$100.00	Personal income	$100.00
Federal income tax	$29.00	Federal PIT	$29.00
Dividend tax credit	$13.33		
Basic federal income tax	$15.67	Basic federal PIT	$29.00
Federal PIT and surtax	$15.67	Federal PIT and surtax	$29.00
Provincial PIT	$7.83	Provincial PIT	$14.50
Provincial PIT surtax	—	Provincial PIT surtax	—
Total provincial PIT	$7.83	Total provincial PIT	$14.50
Federal CIT and PIT	$27.67	Total federal PIT	$29.00
Provincial CIT and PIT	$15.83	Total provincial PIT	$14.50
Total tax[a]	$43.50	Total tax[a]	$43.50

Applicable rates	Per cent
Corporate income tax rate	
Federal	12%
Provincial	8%
Personal income tax rate	
Federal	29%
Provincial	50%
Dividend gross-up	25% of cash dividends
Dividend tax credit	13.33% of taxable dividends

a. Total tax on income earned in a corporation and distributed equals total tax on income earned at the personal level. Therefore, the system is fully integrated.

Table 21.1 sets out federal and provincial corporate income tax (CIT) and personal income tax (PIT) under the assumed tax rates. As the table shows, the system is perfectly integrated. On earnings of \$100, the total amount of tax is \$43.50, whether income is earned by way of a corporation or directly. Although the federal marginal tax rate used is 29 per cent (the maximum federal rate at the current time), the system is also integrated in all rate brackets under this set of tax parameters. For example, if the income were taxable at a personal rate of 26 per cent (the current middle-rate bracket federally), tax payable would be the same whether earned inside the corporation or outside of it.

Ontario corporate and personal tax rates do not, however, match the rates used in the hypothetical system implied by our example. The corporate rate will be 9.5 per cent in 1994 rather than 8 per cent, and the personal rate is 58 per cent of Basic Federal Tax rather than 50 per cent. However, as table 21.2 indicates, for practical purposes the system does not significantly favour earning small business income through one route compared to another with such rates, since there would be only a 3¢ difference in tax treatment per \$100 of income. This result occurs because a higher corporate rate tends to favour declaring small business income in the personal income tax system, and a higher personal rate favours declaring small business income in the corporate income tax system. Thus, the two effects balance. The underlying structure of small business taxation therefore does not significantly favour earning income through an incorporated small business or through an unincorporated small business.

However, both the federal and provincial governments have adopted personal income tax surtaxes, and the federal government has a corporate income tax surtax on small business income. The implications of the federal and provincial surtaxes are seen in table 21.3. In this case, the personal income surtaxes dominate the corporate surtax, which results in a tax advantage for income earned through an incorporated small business. If the surtaxes are applied to the full \$200,000 of income eligible for the small business deduction, there would be a \$5907.53 tax advantage available from earning income through a corporation when it is eligible for the deduction.

TABLE 21.2
Tax Treatment of Small Business Income Earned in Ontario at the Corporate and Personal Levels: 1994 Tax Rates (Not Including Surtaxes)

Corporate level	Amount	Personal level	Amount
Corporate income	$100.00		
Federal CIT	$12.00		
Federal CIT surtax	—		
Provincial CIT	$9.50		
Dividend distributed	$78.50		
Grossed-up income	$98.13	Personal income	$100.00
Federal income tax	$28.46	Federal PIT	$29.00
Dividend tax credit	$13.08		
Basic federal income tax	$15.37	Basic federal PIT	$29.00
Federal PIT and surtax	$15.37	Federal PIT and surtax	$29.00
Provincial PIT	$8.92	Provincial PIT	$16.82
Provincial PIT surtax	—	Provincial PIT surtax	—
Total provincial PIT	$8.92	Total provincial PIT	$16.82
Federal CIT and PIT	$27.37	Total federal PIT	$29.00
Provincial CIT and PIT	$18.42	Total provincial PIT	$16.82
Total tax[a]	$45.79	Total tax[a]	$45.82

Applicable rates	Per cent
Corporate income tax rate	
Federal	12%
Provincial	9.5%
Personal income tax rate	
Federal	29%
Provincial	58%
Dividend gross-up	25% of cash dividends
Dividend tax credit	13.33% of taxable dividends

a. Total tax on $100 income earned in a corporation and distributed is $0.03 less than total tax on $100 income earned at the personal level. Maximum advantage on $200,000 of income is $61.58. The system is essentially fully integrated.

TABLE 21.3
Tax Treatment of Small Business Income Earned in Ontario at the Corporate and Personal Levels: 1994 Tax Rates (Including Surtaxes)

Corporate level	Amount	Personal level	Amount
Corporate income	$100.00		
Federal CIT	$12.00		
Federal CIT surtax	$0.84		
Provincial CIT	$9.50		
Dividend distributed	$77.66		
Grossed-up income	$97.08	Personal income	$100.00
Federal income tax	$28.15	Federal PIT	$29.00
Dividend tax credit	$12.94		
Basic federal income tax	$15.21	Basic federal PIT	$29.00
Federal PIT and surtax	$16.43	Federal PIT and surtax	$31.32
Provincial PIT	$8.82	Provincial PIT	$16.82
Provincial PIT surtax	$2.65	Provincial PIT surtax	$5.05
Total provincial PIT	$11.47	Total provincial PIT	$21.87
Federal CIT and PIT	$29.27	Total federal PIT	$31.32
Provincial CIT and PIT	$20.97	Total provincial PIT	$21.87
Total tax[a]	$50.23	Total tax[a]	$53.19
Applicable rates	**Per cent**		
Corporate income tax rate			
Federal	12%	CIT surtax	3%
Provincial	9.5%	PIT surtax: federal	8%
Personal income tax rate		PIT surtax: provincial	30%
Federal	29%		
Provincial	58%		
Dividend gross-up	25% of cash dividends		
Dividend tax credit	13.33% of taxable dividends		

a. Total tax on $100 income earned in a corporation and distributed is $2.95 less than total tax on $100 earned at the personal level. Maximum advantage on $200,000 of income is $5907.53. The system is significantly overintegrated.

This point leads to another aspect of the issue raised in chapter 20 on corporate income tax, which noted that because of a divergence between the top corporate and top personal marginal tax rates, it can be advantageous to earn income through a corporation. For small businesses, the increase in personal tax rates without an equivalent increase in the small business rate has led to a tax advantage in operating through a corporation. However, it should be emphasized that this result applies only where the income at the personal level is subject to the personal surtax.

The relationship between personal income and small business corporate income rates should be revisited in the future, as provincial personal tax rates are changed. The federal government has adjusted the dividend gross-up and tax credit whenever significant changes in the federal personal and corporate tax rates have occurred, and it would be appropriate for the provincial government to take this issue into account as it changes personal rates. On fairness grounds, the province might also wish to apply a surtax to corporate small business rates in periods when personal surtaxes are in place, as long as this measure is consistent with the objective of the surtax.

RECOMMENDATION 41

Ontario should maintain a tax rate lower than the general corporate tax rate for the first $200,000 of small business income. The small business rate should be adjusted periodically to ensure equal tax treatment of small business income received by individuals that has been earned through either an incorporated or an unincorporated business.

Ontario Capital Tax: Flat Capital Tax for Small Business

The Ontario paid-up capital tax provides a sliding scale of flat rate payments for corporations reporting taxable capital of less than $2.3 million. This means smaller corporations pay significantly less capital tax than they would if the tax liability were calculated at the general capital tax rate of 0.3 per cent of capital employed.

General eligibility for taxation at the flat rate is determined according to the gross revenues and total assets of the corporation as recorded in its books, as well as the taxable capital employed by the firm. An exemption applies for corporations with assets and revenues below $1 million. Above $2.3 million of taxable capital, the rate is 0.3 per cent. In between these thresholds, a sliding scale of flat rates of $100, $200, and $500 applies, as well as a "notch" provision for the $2 million to $2.3 million range of taxable capital, designed to avoid the imposition of high marginal tax rates in the transition range from the flat tax to the general 0.3 per cent rate.

The tax expenditure associated with the special flat rates of capital tax was estimated at $120 million in 1989 (Block and Maslove n.d.). A corporation could see its tax liabilities lowered by as much as $5800 (a flat tax of $200 versus a tax otherwise payable of $6000). This reduction would occur for a corporation operating exclusively in Ontario, with assets and revenue between $1 million and $1.5 million and taxable capital of just under $2 million. Smaller corporations eligible for an exemption because total assets and revenues are less than $1 million could see taxes payable being reduced by approximately $3000 if taxable capital is close to the $1 million threshold.

The exemption from the Ontario Capital Tax for corporations with assets and sales of under $1 million and the application of the flat capital tax (with graduated rates) to corporations with capital employed of up to $2.3 million can be justified on a number of the grounds identified as reasons for offering special tax provisions to small business.

Compliance considerations are certainly important, since there would be a relatively large cost for smaller businesses to calculate their liabilities for this tax. Many of these businesses do not keep the records and information that would allow for a straightforward calculation of the tax. From an administrative viewpoint, there are obvious advantages to not requiring the authorities to attempt to administer a tax on a large number of taxpayers where the audit requirements would be difficult, but the amounts of tax payable quite limited.

The exemption and graduated flat rates also apply to those corporations most likely to find it onerous to pay a tax that is unrelated to ability to pay. In the most general sense , the exemption and flat rates mean that smaller corporations are not faced with this fixed drain on the funds they have available for use in their businesses.

RECOMMENDATION 42

Ontario should retain the exemption and graduated set of flat rates for the Ontario capital tax in its current form.

$500,000 Lifetime Capital Gains Exemption for Sale of Small Business Shares

A $500,000 lifetime exemption is available for gains realized as a result of the disposition of qualified small business shares (and qualified farm property). The standard exemption available for capital gains on other types of property is $100,000. Although the exemption was originally available for most types of property, the 1992 federal budget excluded gains on real property as a qualified source of gains. This change significantly reduced the coverage of the exemption, since about 50 per cent of capital gains relate to real property.

The capital gains exemption is in fact available for shares of medium and large corporations that are privately owned, since the definition of a small business corporation for purposes of the exemption is a Canadian-controlled private corporation, all or substantially all the assets of which are used in an active business in Canada. Holding companies for such corporations are also eligible. In introducing the exemption in the May 1985 budget, the finance minister justified the measure and its structure as an incentive for capital investment in new ventures to generate new economic activity and employment (Canada Department of Finance 1985a).

The personal tax expenditure associated with the extra $400,000 capital gains exemption for small business owners is estimated at about $167 million (1989).[6] However, this figure is an overstatement of actual revenue implications for the government, because it does not take into account an important behavioural reaction. A major ef-

---

[6] This estimate is based on a breakdown of the tax expenditure for the capital gains exemption reported in the personal tax expenditure accounts by the federal government (Canada Department of Finance 1992b, 12–13). The information on the breakdown of the exemption into its small business component was then combined with the estimate of the total tax expenditure value of the capital gains exemption for Ontario in 1989 ($529 million).

fect of the capital gains exemption as it concerns small business shares has been "crystallization"; that is, tax planning to recognize the gains for tax purposes in order to take full advantage of the exemption lest it be reduced or eliminated in the future. Since in the absence of the exemption many of the gains would be realized at a later date, the current value of the tax expenditure likely overstates the impact on revenues of its elimination. Nevertheless, it is a major tax subsidy. The lifetime capital gains exemption of $500,000, as compared against treating the gain as normal income, means Ontario personal income taxes may be lowered by as much as $82,000 and federal taxes by as much as $117,000 on the sale of a small business.

As we discussed in greater detail in chapter 17, we believe that none of the exemptions from capital gains taxation provided for in the personal income tax is justified on the basis of tax fairness. Indeed, we believe that the special treatment afforded capital gains is a major contributor to unfairness in the income tax system. In reaching our conclusion that these exemptions should be abolished, however, we considered the particular arguments advanced in favour of the exemption for gains on the shares of small business.

The principal argument in favour of this special exemption from capital gains is that, by increasing the eventual after-tax return on small business investments, it supports risk taking in the economy and is therefore of economic benefit. Although we would obviously agree that, as a mathematical fact, the exemption from capital gains on the sale of shares of small businesses increases the lifetime after-tax return on the original investment, we cannot conclude that this fact has any appreciable impact on the willingness of the original investor to make a risky investment. First, the tax benefit itself is clearly speculative. It did not exist before it was introduced by the federal government in 1985, and there is clearly no guarantee (and some would argue not even a high probability) that the exemption will still be a feature of the tax system when a gain is realized. Indeed, the rush of small business owners to "crystallize" their gains is evidence that many people believe the exemption to be temporary. Second, it is extremely doubtful that an investor, in making the decision to start a small business, gives any consideration to the taxation of any eventual capital gain. Third, we doubt very much that the prospect of a tax-free capital gain is an important motivating factor in the creation of a new small business when compared with such factors as the wish to be economically independent rather than an employee and the desire to be responsible for one's own destiny.

As a result, we considered all the exemptions from capital gains taxation to be inappropriate from the perspective of tax fairness and unjustified from the perspective of economic policy.

Employer Health Tax: The Lower Rates for Small Business

The Employer Health Tax (EHT) has a sliding rate schedule for smaller employers. If an employer has less than $200,000 of Ontario remuneration, the tax rate is 0.98 per cent. If total remuneration is more than $400,000, the tax rate on *all* remuneration is 1.95 per cent. If total remuneration falls between these amounts, the total tax rate is chosen according to a sliding scale of seven brackets.[7]

To ensure that this preferential treatment does not also benefit large businesses, the government adopted a graduated rate structure. All remuneration of a given employer is taxed at the same rate, and none of the benefit of the lower rates for smaller businesses is available to medium or large businesses.

The structure chosen to provide a small business preference is seriously flawed, both technically and from a policy viewpoint. For example, the additional payroll tax incurred by hiring a new employee is higher than for existing employees. The tax is also higher for small firms in the payroll range subject to the graduated rates than it is for large firms. The EHT structure thus tends to discourage expansion of employment by firms in the range of increasing EHT rates. Further, the "notches" in the structure mean that small increases in remuneration can lead to larger jumps in tax.

The current structure has unusual policy implications given that labour rather than the employer is likely – ultimately – to bear the tax. (This passing forward of the tax is the major conclusion that emerges from the economic analysis of payroll taxation[8]). If the tax is passed on to labour, the effective tax rate for a given employee or a group of employees is determined by the size of the business worked for, not by any characteristic of the employee. For example, a high-

---

[7] The rate schedule and the problems with "notches" it creates are discussed in detail in Dahlby's research study on the tax (1993).

[8] This and other aspects of payroll taxation are fully discussed in chapter 22.

paid employee of a small employer would be subject to a lower tax rate than a low-paid employee of a large employer. Such differentials cannot be justified on principles of either fairness or efficient operation of labour markets.

A major conclusion of chapter 22 on payroll taxation, and one that applies here, is that, in general, the rationales for special treatment of small businesses are less relevant for a payroll tax than for other taxes, such as the income tax and the capital tax. The reasons advanced for having special rules for small business do not have merit where the tax is actually borne by labour. This conclusion leads to the basic proposal with reference to small business and the EHT: to eliminate the graduated rate structure in favour of a uniform rate on all wages and salaries. (The argument is developed in chapter 22.)

However, payroll taxes form a larger share of expenses for small businesses than they do for large ones, and represent a larger share of the taxes collected from such taxpayers. Increases in the use of the tax, or in the impact of the tax (where it is not passed on to labour), are thus likely to have greater implications for small businesses. The cost of compliance also tends to involve some fixed costs and is generally higher for small business taxpayers.

Taxation of Cooperatives

Cooperatives are part of both the corporate economy and the voluntary sector. More than 2 million Ontarians report membership in almost 2000 cooperatives, credit unions, and caisses populaires. The cooperative system in Ontario owns $13 billion in assets (Advisory Group on Taxation of Cooperatives 1993, 2). They are community-based organizations but, to serve the local level, cooperatives also organize at provincial, national, and international levels.

The cooperative system is an important part of the business sector in Ontario, particularly in rural parts of the province. We heard, for example, from a representative of the Association canadienne-française de l'Ontario that the caisses populaires (credit unions) are a primary source of funding for economic development in francophone communities. However, reviews of the tax system often overlook this sector.

The cooperative form of organization is not formally defined in the Ontario Co-operative Corporations Act, although the act does require that cooperatives operate in accordance with "cooperative principles." A cornerstone of these principles is democratic control, with one vote per member. Representation of each member's interest is unrelated to the amount of capital each member has at stake. These principles shape both not-for-profit and commercial cooperatives. Of particular interest here are the ways in which commercial cooperatives differ from conventional joint-stock enterprises:

- In a cooperative, each member is allowed one vote. In a company, each common share entitles its owner to one vote.
- A cooperative distributes surplus earnings primarily through allocations to members in proportion to their transactions with the cooperative, but also in the form of dividends or shares, with the rate limited by legislation or by-laws. A company usually distributes its surplus as dividends associated with shares.
- In a cooperative, capital stock is non-speculative and redeemable at par, and its yield (when there is one) is limited. In a company, the value of common shares is usually speculative and non-refundable by the corporation, and its yield is unlimited.
- A cooperative, at liquidation, must distribute property equally among the members regardless of the number of shares or loans a member holds; or among members in proportion to their patronage during the five preceding fiscal years; or to charitable organizations. On dissolution of a company, all shareholders share in the company's assets and surplus in proportion to shares owned.

Our concern about the taxation of cooperatives is whether the tax system works to the disadvantage of cooperatives relative to other forms of business organization. Correcting any anomalies while respecting the specificity of cooperative structure and philosophy would clearly enhance tax fairness. If tax provisions are not neutral in their application to cooperatives in comparison with other enterprises, recommendations should be made to restructure these provisions to address the lack of neutrality. Where tax provisions that affect conventional enterprises cannot be structured to apply equally to cooperatives because of their form of organization, the government should consider recommendations specific to cooperatives, to balance the provisions affecting conventional enterprises.

Beyond that, the tax system could be used as an instrument to foster the development of cooperatives in Ontario. Our view is that using the tax system in this manner is a political decision, not a tax fairness issue.

Cooperatives and the Tax Policy Process

To assist in our consideration of cooperative tax issues, the commission established an Advisory Group on Taxation of Cooperatives, composed of volunteer members from a broad spectrum of cooperative enterprises. In the experience of members of the advisory group, cooperatives suffer from "benign neglect" when tax rules are being developed (Advisory Group on Taxation of Cooperatives 1993, iii). In some cases, no effort is made to structure the benefits available to other forms of business organization to apply equally to the cooperative form of organization. In other cases, rules are introduced or applied in ways that inadvertently affect cooperatives in a negative fashion. It is then time-consuming and sometimes difficult to remedy the problems or oversights. We concluded that cooperatives should receive explicit consideration when tax measures are being formulated.

RECOMMENDATION 43

Ontario should encourage the federal and provincial governments to consider the ownership and governing structure of cooperatives when developing tax policy, programs, and legislation. Programs should be structured so that:

a) the requirements can be met as easily by co-operatives as by other enterprises, and
b) the benefits are equally available to cooperatives and other enterprises.

Tax Provisions Affecting Capitalization

The primary tax issue in the cooperative sector is that incentives provided by governments to encourage Canadians to invest in the equity of a business are often not available to cooperatives and their member/owners (Fédération des caisses populaires de l'Ontario

1993). Existing incentives either are not beneficial to investors or do not apply to cooperative investments. Among such incentives are the capital gains exemption, the 25 per cent capital gains exclusion, and tax credits for worker ownership.

Among the major barriers to capitalization of cooperatives:

- Cooperative shares do not increase in value. Because they are par value shares, no appreciation of shareholders' equity investment occurs, even if the underlying value of the shares increases. As a result, capital gains tax provisions act as an incentive to invest in businesses other than cooperatives.
- Common shares may be issued only to members, and members are entitled to only one vote, regardless of the number of shares held. (Preferred shares may be issued to non-members.) Some government programs limit the provision of tax incentives for the investment of capital funds to investments in shares carrying voting rights.
- There is no secondary market for cooperative shares. Members wishing to dispose of their shares must sell them back to the cooperative, which must redeem them. This requirement effectively reduces the cooperative's total capital.
- Cooperatives are unable to prevent the erosion of their capital base by the withdrawal of members, because cooperatives are required by Ontario legislation to begin redemption of shares within six months of a member's withdrawal (except where the cooperative's liabilities exceed its assets).
- Because of a legislated cap on the dividends payable on both common and preferred shares, many cooperatives (particularly those starting up) are hindered in their ability to provide investors with a risk-adjusted rate of return.
- Pressure from members to pay out any surplus in the form of patronage allocations limits reinvestment and growth of capital stock. Although business corporations also come under pressure to distribute earnings (in the form of dividends), a high level of retained earnings in a corporation will generally be reflected in a higher market value of the stock.
- Cooperatives may have difficulties in obtaining debt financing because of the diffuse nature of their corporate ownership and control. Financial institutions respond more favourably to enterprises

in which the principals have made a significant personal investment and have a commensurate degree of control.

The Small Business Development Corporation (SBDC) program, which will be phased out some time after 1993, provides an example of an incentive for capitalization that was not applicable to cooperatives. The SBDC was introduced in Ontario in 1979 to provide a source of equity capital for small business. Investors purchased equity shares in an SBDC, which in turn purchased equity shares in eligible small businesses. Individual investors received a 25 or 30 per cent grant from the Ontario government; corporate investors received a 30 per cent income tax credit. An SBDC could invest only in shares carrying voting rights, so this pool of investment capital was not available to cooperatives.

The Ontario Investment and Worker Ownership Program provides a further example of the partial exclusion of cooperatives from benefits available to other forms of business. In 1985 the federal government established tax credits for individuals who invest in labour-sponsored venture capital corporations. Ontario established a matching program in 1991, through its Ontario Investment and Worker Ownership Program. The Ontario program, unlike the federal program, does allow the venture capital corporation to invest in the non-voting shares of cooperatives and permits sponsorship of venture capital corporations by associations of worker cooperatives.

However, the worker ownership component of the Ontario program, which provides tax credits to employees for investing in their employer, stipulates that only voting shares of companies are eligible investments for tax credits. Without this requirement, companies could obtain capital from employees through the issuance of non-voting, non-participating shares, thus undermining the objective of the program. But this requirement, as it stands, means that the program cannot be used by employees to convert their companies to worker cooperatives.

RECOMMENDATION 44

Ontario should amend the worker ownership component of the Ontario Investment and Worker Ownership Program to permit employees to operate a worker-owned enterprise as a cooperative.

Not-for-Profit Housing Cooperatives

Another example of the formulation and application of rules that affect cooperatives in a negative fashion can be drawn from two cases in the experience of not-for-profit housing cooperatives.

- The cooperative housing sector has initiated the use of not-for-profit land trusts as a way of further ensuring the not-for-profit operation of housing cooperatives over the long term. Property tax assessors have on occasion assessed housing cooperatives on leased land differently from housing cooperatives that have freehold ownership of their land. Property taxes are assessed under section 60(3) of the Assessment Act on not-for-profit housing cooperatives at the same percentage of market value as owner-occupied, single family residences in the vicinity. Rental properties are assessed at a higher percentage of market value, and some cooperatives on leased land have been assessed as if they were rental properties.
- In the administration of the Land Transfer Tax Act, an issue has arisen involving the application of the tax to the value of the building of a newly developed housing cooperative, as well as to the value of the land. When the land and building are supplied by separate corporations, it would appear that the construction of the building should not be considered "part of an arrangement relating to a conveyance of land" under the act. However, in some instances the tax has been applied to both land and building. This inconsistency creates uncertainty about the costs of a new housing cooperative. It also means that the Ministry of Housing supplies funds (capitalized in the cost of the cooperative) to be paid to the Ministry of Revenue as land transfer taxes on buildings that are not part of the same "arrangement" (Holland 1992, 34).

RECOMMENDATION 45

Ontario should ensure that property held by not-for-profit housing cooperatives be assessed on the same basis, whether they own or lease the land. Ontario should amend the Land Transfer Tax Act to ensure that it is not applied to the value of the building of a newly developed housing cooperative when the land and the building originate with different corporations.

22 Payroll Taxation

Payroll taxation is relatively new to Ontario's general revenue system.[1] Ontario's payroll tax was introduced in 1990 as the Employer Health Tax (EHT). Although it has been part of the revenue system for only three years, the EHT has generated considerable public interest. Some of that interest stems from the fact that federal and provincial payroll taxes combined are lower in Ontario than in many other jurisdictions. It has been suggested that Ontario could increase its reliance on payroll taxation and use the additional revenue either to fund workplace training programs or to reduce other taxes that some consider have a more serious impact on the economy. The introduction of payroll taxes at the provincial level has also attracted the interest of the federal government, which has raised concerns about the impact of the deductibility of payroll taxes on its revenue from corporate income taxes and has moved to limit that deductibility.

The name of the tax itself has been controversial. Although the EHT was introduced at the same time that the provincial government eliminated premiums in the Ontario Health Insurance Plan (OHIP) and the name suggests some form of earmarking of revenue,

---

[1] Although employer premium payments to the Workers' Compensation Board have some of the characteristics of a payroll tax in that they are related to wages, the payments are also similar in nature to insurance premiums in that they also vary with claims experience. In any case, WCB premiums are not part of the consolidated revenues of the provincial government.

the tax in fact has nothing to do with health care spending. In our discussion of earmarking in chapter 11, we recommended that taxes whose revenues are not earmarked for a specific purpose be given names that identify the base of the tax.

Two technical features of the EHT that distinguish it from the two payroll taxes levied by the federal government (the employer and employee contributions to the Canada Pension Plan and the premiums for unemployment insurance) have also attracted public interest. First, the EHT has an unusual graduated rate structure, with a bottom rate of 0.98 per cent that applies to employers with total payrolls up to $200,000; a regular rate of 1.95 per cent applicable to employers with total payrolls over $400,000; and a graduated rate structure applicable to total payrolls between these two amounts. Second, unlike the two federal payroll taxes, there is no maximum earnings level to which the EHT applies. This gives rise to complexities in the application of the tax to income from self-employment.

Our review of the Employer Health Tax focuses on four aspects of payroll taxation in Ontario: the potential for payroll taxation to play a more significant role in the mix of taxes levied by Ontario; the graduated rate structure; the application of the tax to income from self-employment; and the proposal by the federal government to limit the deductibility of provincial payroll taxes from income for corporate income tax purposes.

Should Ontario Rely More Heavily on Payroll Taxes?

Payroll taxes are a much less important source of revenue in Canada than they are in most other industrialized countries. Table 22.1 shows that in 1990, payroll taxes, including social security contributions, were higher in all but one of the OECD countries shown than they were in Canada as a proportion of gross domestic product and as a proportion of tax revenue.

Within Canada, only Quebec relies substantially on payroll taxes. In 1991–92, payroll tax revenue made up 11 per cent of the provincial government's revenue, compared with 6 per cent in Ontario (Statistics Canada 1992e). Quebec's payroll tax rate is currently 3.75 per cent while Ontario's is 1.95 per cent (Canadian Tax Foundation 1992b, 10:27). This comparative evidence suggests that it is certainly possible to sustain much higher rates of payroll tax than are typical in Canada without adverse economic impact. It also suggests that, to the extent that international comparisons of levels of individual taxes are meaningful at all, there is room for Ontario to raise its rates of taxation in this area. In particular, taxes on which Ontario relies more heavily than other jurisdictions could be reduced and the revenue replaced by higher payroll taxes, thereby moving Ontario's tax structure more into line with those of other jurisdictions and neutralizing any impact that taxes might have on Ontario's relative economic position.

A study for the Ontario Ministry of Finance comparing taxes in Ontario with those in Quebec and a number of US states underlines this point. The study notes that in international tax comparisons, payroll taxes are often ignored and, when taken into account in broader economic comparisons, are buried in the analysis along with wages and exchange rates. As a result, the high-profile comparisons of taxation commonly cited in the business press unfairly put taxes in Ontario at levels much higher than those in competing jurisdictions in the United States. The study finds that when payroll taxes are included in a tax comparison, there is little difference between Ontario and competing jurisdictions in the United States (Ontario Ministry of Treasury and Economics 1991a). Two conclusions can be reached from this analysis: first, that tax-only comparisons between jurisdictions are inadequate; and second, that Ontario could position itself better in the current economic environment if it had a tax system more closely aligned with those in other jurisdictions.

Another general argument in favour of increased reliance on payroll taxes flows from our earlier analysis (chapter 7) of issues in maintaining the fiscal capacity of government in the face of capital mobility. High payroll taxes and high sales taxes are characteristic of countries that have a large public sector and highly developed public health, social service, and income security systems, suggesting that other countries with public services similar to Canada's have found it necessary to rely on taxes that are borne largely by residents. In chapter 7, we suggested that in an integrated international financial and trading system, Canada and Ontario may find it necessary to rely more heavily on these types of taxes in the future.

TABLE 22.1
Payroll Taxes and Social Security Contributions
Selected OECD Countries, 1990

	% of GDP	% of tax revenue
France	20.1	46.1
Sweden	17.5	30.8
Netherlands	16.9	37.3
Germany	13.9	36.8
Italy	13.0	33.2
Norway	12.1	26.2
Japan	9.2	29.2
United States	8.8	29.5
United Kingdom	6.4	17.5
Canada	**5.3**	**14.2**
Finland	2.8	7.4

Source: Organisation for Economic Co-operation and Development, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992).

A third reason why Ontario might wish to rely relatively more heavily on payroll taxes is that the very large base of the payroll tax makes it possible to raise substantial amounts of revenue at low rates of tax. A research study on payroll taxation carried out for the commission noted that total employer remuneration, the base for the Employer Health Tax, was $132.4 billion in 1990, compared with a base of $19.8 billion for the corporate income tax (Dahlby 1993, 83). We have estimated that in 1993–94 each 0.1 percentage point increase in the payroll tax rate would generate $140 million in additional tax revenue. An increase in the Ontario tax rate to the same rate as is applied in Quebec (3.75 per cent) would generate additional revenue of $2.5 billion.

The fact that there may be room for Ontario to increase payroll taxes does not necessarily mean that higher payroll taxes should be adopted as part of a fair tax system in Ontario. In our review, we identified three major areas of concern: the incidence of payroll taxes; their impact on employment; and their impact on small business.

Incidence of Payroll Taxes

Are payroll taxes ultimately borne by workers through lower wages, by business owners through lower profits, or by consumers in the form of higher prices? In a legal sense, the EHT is a tax on employers and is a tax obligation of the owner of the business. This legal obligation forms the basis for the general public perception that "a payroll tax which is collected from employers is not borne by employees" (Dahlby 1993, 81). From the perspective of the individual taxpayer, this is obviously true. However, in assessing the impact of a tax, it is necessary to look at how the burden of the tax is distributed among people after markets have adjusted to its imposition. In the case of payroll taxes, the ultimate incidence of the tax depends critically on the working of the markets for labour compared with those for goods and capital. Dahlby surveyed the many incidence studies on payroll taxes and concluded, based on his survey and his views on which studies carry the most weight, that the evidence suggests that "labour bears over 80 per cent of the employer payroll tax burden in the long-run"(Dahlby 1993, 133).

While this view of who actually pays payroll taxes is the one generally held by economists, a contrary view is advanced by some who support increased reliance on consumption taxes on economic efficiency grounds. They argue that, under certain assumptions, payroll taxes may be seen as equivalent to general consumption taxes (Whalley and Fretz 1990, 130). In this view, the impact of sales and payroll taxes is the same, when considered over the lifetime of the taxpayer. For the purposes of this discussion, this implies that the sharing of the burden of taxation among workers, consumers, and owners of capital is the same for payroll taxes as it would be for a comprehensive consumption tax, and that increasing payroll taxes has essentially the same impact as increasing consumption taxes.

The principal problem with this analysis is that the assumptions required to demonstrate equivalence between payroll and consumption taxes are extremely restrictive. The taxes can be demonstrated to be equivalent only if the following conditions are met:

- exports and imports are in balance (a trade surplus or deficit will result in labour income falling short of or exceeding consumption);
- there are no transfers of wealth between generations;

- corporations are not subject to any other tax;
- the consumption tax is a comprehensive tax on all expenditures on goods and services (in practice, consumption taxes normally provide for many exemptions or special rates for food, housing, and certain services);
- the payroll tax applies uniformly to all labour income (in practice, many payroll taxes contain different exemptions, tax rates, and ceilings); and
- the impacts are compared over the lifetime of the taxpayer (on an annual basis, the two types of tax would have quite different impacts even if all the other restrictive assumptions were valid).

While these implications may be of interest from an academic perspective, the assumptions required to demonstrate an equivalence between payroll and consumption taxes are so restrictive that they would appear to have little relevance to a comparison of the impacts of payroll and consumption taxes as they actually apply in practice.

Impact on Employment

The shifting of the burden of payroll taxation to labour income implied by the consensus view of payroll tax incidence might work as follows. If a business were supplying a product that is also available from outside the province on a competitive basis, the introduction of a provincial payroll tax, or an increase in it, would raise costs to the local business. Because the product is also available from outside the province, however, it would not be possible to raise the price at which the product is sold. At the same time, the owners would be unwilling to see their rate of return fall if they could transfer their production outside the province. Given this inflexibility in the sale price of the product and the return on invested capital, there would be pressure to reduce the wages paid to labour to absorb the impact of the tax, either in the form of reduced wage rates or, particularly in the short term, in the form of lay-offs. There are other adjustment processes through which labour would come to bear the tax, but in general they reflect the fact that the factor of production with the least ability to move to avoid an increased tax tends to end up making the adjustments.

There are several circumstances in which the impact of the tax may differ from that implied by this general conclusion. Statutory restrictions such as wage laws, or institutional relationships such as national wage agreements, may prevent wages from declining to absorb an increase in payroll taxation. There may also be restrictions on the short-term or long-term mobility of other factors of production or of goods and services. To the extent that the mobility of capital or goods and services is restricted, either owners of businesses or consumers may bear a portion of the burden of payroll taxes in the form of reduced profits on invested capital (owners) and higher prices for goods and services (consumers). These departures from the general rule would account for as much as 20 per cent of the burden of payroll taxes working their way through the economy in a form other than a decline in labour income.

In addition, the burden of the tax may be distributed differently in the short term than in the long term. Because wages tend to be relatively inflexible in the short term, payroll tax increases may result in reduced employment, reduced business income, or, to a limited extent, higher prices for goods and services. Labour income will tend to adjust over time as contracts are negotiated or the effects of a reduced demand for labour are felt. This difference between the short-term and longer-term impact of payroll taxes likely explains the discrepancy between the strong economic evidence that labour income bears the burden of the tax, and the perception by businesses that the tax is a cost of doing business and reduces their ability to earn income.

Although market adjustments occur that result in the tax being passed on to labour, these general adjustments may not be obvious either to business or to labour. Because the timing of the adjustment may be delayed to varying degrees, depending on market conditions, the adjustment may not even be easily linked to the introduction of the tax. If the tax is ultimately borne by labour, however, it cannot legitimately be considered an alternative to other types of taxes on business activity. From the perspective of an evaluation of changes in tax mix, it is misleading to view payroll taxes as falling on business.

As we noted above, increases in payroll taxes may be associated with lower levels of employment. Although attention has often been directed to such short-run effects on employment, some studies have suggested that significantly higher unemployment may persist even over the long run as a result of increased reliance on payroll taxes (Coe 1991). The evidence on the importance of this effect is mixed, however, and other authors have argued that the effects on employment are likely to be relatively insignificant (Whalley and Fretz 1990).

Impact on Small Business

Somewhat different issues surround the impact of payroll taxes on the small business sector (Dahlby 1993, 78–86). An important observation is that small firms tend to be more labour intensive than large firms. For small firms, payroll costs tend to be a higher percentage of total expenses. An increase in payroll taxation will be more significant for small firms on average than large ones, because its initial impact will be to increase expenses by a proportionately greater amount. Dahlby also notes research that indicates payroll taxes are a larger portion of total taxes for small firms than for large ones. From this perspective, payroll taxes are likely to attract special attention from the small business sector. The adjustment to an increased payroll tax can take several forms: lower effective wage rates, reduced employment, or reduced returns to owners. In any case, the necessary adjustment will tend to be larger for small businesses. Even if the eventual result is that labour bears the tax, the transitional period may be more difficult for small business.

For several reasons, we were not persuaded that increased reliance on payroll taxes would be appropriate for Ontario at this time, despite the fact that these taxes are much higher in other jurisdictions. First, to the extent that payroll taxes are borne by workers in the form of lower wages, there are alternative sources of revenue that result in a fairer distribution of the burden of taxation among the population as a whole. Second, we are concerned by the evidence that employment would be reduced as a result of a payroll tax increase, even if such a reduction were only in the short term. With unemployment currently at unacceptably high levels and projected to stay at those levels for a number of years, and with structural changes in the economy making it difficult for older and less well educated workers to find new jobs when they are laid off, we could not justify a recommendation that might put employment at risk. Third, we are also concerned about the impact that a general increase in the rate of payroll taxation might initially have on the shaky financial state of the business sector in Ontario.

Graduated Rate Structure of the Employer Health Tax

The description of the payroll tax in the appendix to chapter 8 indicates that all employment income is subject to the tax, but with the rate structure rising from 0.98 per cent for employers with total payrolls of less than $200,000 to 1.95 per cent for employers with total payrolls exceeding $400,000. In between these thresholds are seven intermediate rate brackets, with ascending tax rates applied as total payroll increases (see table 8A.6). The tax rate applying to the total remuneration paid by any given employer is the applicable tax rate as determined by the rate bracket into which the employer's total remuneration falls. In other words, the rate structure is not incremental, where a higher-rate bracket applies only to the tax base in excess of the lower threshold (as is the case for the personal income tax). The rate structure of the EHT is, in fact, somewhat unusual in this respect, and this characteristic leads to a number of undesirable results in the application of the tax.

The rate structure adopted in 1990 was based on the desire to provide a preference for small business in the payroll tax replacing existing OHIP premiums. The preference was instituted by setting the rate for the smallest businesses, those with payrolls under $200,000, at half the rate for larger businesses. However, to ensure that the low rate would not benefit large businesses, a graduated rate structure was adopted. All remuneration of a given employer was taxed at the same rate, and none of the benefit of the lower rates for smaller businesses was available to medium-sized or large businesses. A secondary consideration in the choice of structure was that OHIP premiums had been employer-paid to a much greater extent in large businesses than in small businesses. The split rate may have emerged as a "rough-justice" way to reduce the overall impact of the switch from the OHIP premium system to the payroll tax.

While some people may argue that small business should benefit from a preferential rate of tax, there are both technical and policy reasons why this might not be desirable.

First, when an employer moves from one bracket to the next, for example by hiring an additional employee, the higher EHT rate is incurred not only for the new employee, but also for existing ones. This means that the extra payroll tax incurred by hiring a new employee is higher than it is for existing employees, and is higher for the small firms in the transition set of tax brackets than it is for large firms. As Dahlby notes:

> Since the decision to expand employment involves a comparison of the extra revenue an additional employee can generate versus the additional cost of hiring that employee, the EHT rate structure tends to discourage the expansion of employment by firms in the range of the increasing EHT rates. (Dahlby 1992, 150)

Second, the structure means that if an employer discovers at the end of the year that his or her total remuneration for the year just puts the business into a new bracket, the effective tax rate on the additional remuneration can be unreasonably high. For example, in the extreme case, $1 of additional pay could lead to additional tax of $484. Such large increases in tax for small differences in circumstances are often referred to as "notches." It is desirable to avoid such notches in any tax structure because they are unfair and can have undesirable incentive effects for taxpayers affected by them.

The current rate structure has other negative implications for employers and employees. The effective tax rate for a given employee or group of employees is determined by the size of business for which they work, not by any characteristic of the employee. For example, a high-paid employee for a small employer would be subject to a lower tax rate than a low-paid employee of a large employer. Such distortions cannot be justified on principles of either fairness or efficient operation of labour markets. If the payroll tax is essentially a tax on labour income, then it is most appropriate to apply a single rate of tax to all such income. There is no particular policy reason to graduate the tax, and the current means of doing so creates a number of structural flaws in its operation.

RECOMMENDATION 46

Ontario should eliminate the graduated rate structure for its existing payroll tax and replace it with a uniform rate of tax based on all remuneration.

Adoption of this proposal would raise some $150 million of revenues at current tax rates (Block and Maslove n.d.).

We considered whether some other form of allowance should exist for small businesses based on the argument that their compliance costs are proportionately higher than those for larger businesses. After considering the arguments and options, we decided that no special provision for small business is warranted. There were a number of reasons for reaching this conclusion. We were not convinced that the compliance costs associated with the Ontario payroll tax are particularly onerous, even for small firms. For employers already complying with income tax withholding requirements and federal payroll tax contributions (for unemployment insurance and the Canadian Pension Plan), the additional cost to deal with the Ontario tax is not large. This is especially so given that the Ontario tax is based on total remuneration; no calculations based on individual wage or salary amounts are required. The federal government does not offer any special relief to small businesses for its UI and CPP premiums, even though the design of these taxes makes compliance more costly.

We also took note of the substantial revenue loss implications associated with any option that constituted a meaningful small business allowance. For example, exempting the first $100,000 of remuneration would cost $320 million in forgone revenue, with almost two-thirds of that amount actually accruing to larger employers (with payrolls in excess of $400,000). An exemption with a tax-back would correct this latter problem to a significant extent, but it would still result in revenue losses of more than $200 million per year (Fair Tax Commission calculation based on Dahlby 1993). In our view, such large revenue losses are not justifiable given the small compliance costs associated with the tax.

Payroll Tax on Self-Employment Income

Beginning 1 January 1993, self-employed individuals and members of partnerships became subject to the Employer Health Tax. The rationale for this extension is straightforward. Individuals working in partnerships and as self-employed persons receive, in effect, a return for their labour just as employees of other businesses do. If labour income is to be subject to a tax, these other forms of labour income should be taxable as well. We accept this rationale and recognize that, in theory, such a treatment would improve the neutrality of the tax, eliminating any advantage of these forms of business organization.

Nevertheless, there are several problems with the tax as it currently applies in these situations. Underlying these flaws is the fact that, while the tax base is defined in principle as the labour income for the individuals affected, in practice labour income is measured using net income from self-employment as calculated for the income tax. Although such self-employment income does include revenue that is generated by the labour of the individual in his or her unincorporated business or partnership, it also includes a return to the capital that has been invested in the business. This means in effect that the current payroll tax functions as an income tax in the case of the self-employed, rather than as a payroll tax on labour income. The existing structure provides an exemption of $40,000 in the calculation of EHT on net self-employment income, which is seen as a "rough justice" form of recognition of such concerns. The self-employed are also subject to a tax rate of 0.98 per cent on the first $200,000 of income, which is also beneficial relative to most employees covered by the payroll tax.

However, these very general forms of relief do not deal with the essential problems. Consideration needs to be given to whether a more appropriate structure can be identified. A number of other concerns must first be identified.

First, the federal government has taken the position that the EHT on self-employment income is, in fact, an income tax. As such, the tax is not deductible for income tax purposes. The effective tax rate would thus be different for a self-employed individual than it would for an individual in identical circumstances, but treated as an employee. The legislation to enact the tax on self-employment income responded to this concern by setting the tax at a rate of 78 per cent relative to the tax that would otherwise apply (Ontario Ministry of Finance 1993a, 23). This rate is intended to compensate for the lack of deductibility, but does so only for the Ontario portion of the personal income tax. To compensate for the lack of deductibility from federal income taxes as well, the special payroll tax rate would have to be lower – approximately 50 per cent of the regular payroll tax rate.

Despite the modification in structure, a tax incentive to incorporate will remain in many cases, because an owner-manager of an incorporated business in calculating corporate income tax will be able to deduct the payroll tax paid on his or her own salary. Such an incentive to change the organizational form of a business exclusively for tax reasons is undesirable.

Although incorporating is one way to reduce the impact of the tax, individuals may not be able to incorporate because of other cost or regulatory considerations. For example, certain professions are not allowed to operate as corporations. These individuals have no way of avoiding the effect of what is essentially a federal-provincial disagreement on the nature of a particular tax. This difference may be resolved as part of the federal-provincial discussions on the federal proposals concerning the deductibility of capital and payroll taxes, but the situation will clearly be undesirable as long as it exists. Since this presumably is a short-term problem and is under discussion by governments, it is not a topic upon which the commission can usefully make recommendations, apart from noting its unfairness.

Second, problems arise in the application of payroll taxes to owner-managers of private corporations. These individuals not only have equity ownership of the corporation, but also work in the firm as managers. In some circumstances, they may receive both a salary based on their labour activity in the firm and dividends (or eventually capital gains) for their investment. In these cases, the payroll tax applies only to their labour income and will appropriately capture remuneration on a basis comparable with other employees. However, in many firms, where ownership is tightly held, the mix between dividends and salary is determined according to quite different criteria, essentially as a result of the income tax structure applied to small business corporations. In general, this structure dictates that a high proportion of payments be as wages and salaries below a certain income level, with a higher proportion of income then paid as dividends up to $200,000 of income. Above $200,000 of income, payments are again largely structured as salary to avoid the double taxation of income that occurs when income is taxed at full corporate tax rates (not at the small business rate), and then taxed again as dividends at the individual level.

In these circumstances, wages and salaries may be underestimated for corporations with taxable profits under $200,000 and overestimated for corporations with underlying profits exceeding $200,000. Thus, payroll taxation cannot be applied accurately to wage and salary income in the case of owner-managers. The basic cause of this is the same as for the self-employed: the mixing of income from labour and capital.

It might be noted that the government experienced considerable difficulty and some delays in making public the detailed rules for operation of this part of the EHT. For the most part, this experience reflected the general problems of putting provisions into operation when the underlying structure is flawed.

The ideal approach would be to separate these two types of income and to tax only the labour component. However, this is not a feasible solution because, in most cases, such a division would be impossible to achieve objectively. An alternative approach would be to tax the net income of both the self-employed and owner-managers (net income for payroll taxes to equal dividends plus wages and salaries) fully as labour income, up to a certain level of income. Above this threshold, only a proportion of net income would be included, since there would be an allowance for a return on invested capital.

RECOMMENDATION 47

Ontario should establish a new method of calculating remuneration for payroll tax purposes for owner-managers of corporations and self-employed individuals. For owner-managers of corporations, remuneration above an exemption level up to a threshold amount, whether in the form of salary or dividends, should be fully taxable. Above this threshold amount, a portion of remuneration would be excluded from the base as an allowance for the owner-manager's return on capital. For self-employed individuals, a portion of remuneration above the threshold amount would be excluded from the base as an allowance for the return on capital included in earnings.

As a purely practical matter it would probably be desirable to exclude a small initial portion of self-employed income. This would avoid the costs of administering that tax with respect to individuals who receive very small amounts of self-employment income, say under $10,000 per year.

Deductibility of Payroll Taxes in the Corporate Income Tax

In any consideration of increased reliance on payroll taxes at the provincial level, an important issue is their deductibility for income tax purposes. Current income taxation rules follow accounting practice in treating payroll taxes payable by the employer as a business expense. As a result, an increase in payroll taxes causes a reduction in the income tax base. Accordingly, federal (and provincial) income tax revenues decline as payroll taxation increases, and the impact of new payroll taxes on business is partially offset by reduced income tax payments.

In response to increased use of deductible taxes such as payroll taxes and capital taxes by some provincial governments, the federal government in 1991 indicated that it intended "to limit the deductibility of provincial payroll taxes and capital taxes from federal corporate income tax"(Canada Department of Finance 1991a, 16). Although the actual implementation of limitations on the deduction of payroll and capital taxes has been delayed twice and federal-provincial discussions on the proposal are ongoing, the federal government continues to indicate it will introduce such measures in due course.

These proposals by the federal government would have the effect of limiting the ability of provincial governments to structure their mix of direct taxes to meet provincial priorities. It is even more regrettable when such steps are taken without consultation and without recognition of the variety of provincial circumstances. However, the interdependence of the fiscal systems of the federal and provincial governments is an important feature of the federal system in Canada. When steps taken by one level of government affect the revenues or expenditures of the other, there is always the potential for conflict. Clearly, there needs to be a more cooperative attitude by all governments.

It would be inappropriate for the federal government to disallow a deduction for income tax purposes of an increase in payroll taxes that involved a substitution of a payroll-type of tax for some other (deductible) tax. For example, if property taxes for businesses were reduced as a trade-off for an increase in payroll taxes, there would be, as a first approximation, no change in the level of tax being deducted for income tax purposes. If the Ontario government were to make this type of substitution, it would appear reasonable for the federal government to recognize it as a revenue-neutral change without imposing non-deductibility. However, this arrangement would presumably require intergovernmental discussions to implement, given the current federal position on payroll and capital taxes.

RECOMMENDATION 48

Ontario should seek the agreement of the federal government to make payroll taxes fully deductible for corporate income tax purposes.

23 Resource Taxation

Ontario's mining and forest wealth has made this province one of the largest resource producers in the world. However, after more than 100 years, mining and forestry are mature industries in which employment has been dropping steadily over the past 20 years. Primary industries other than agriculture in 1990 accounted for about 0.5 per cent of total employment in Ontario (Statistics Canada 1993d, table 1) and 1.5 per cent of gross domestic product (Statistics Canada 1993l). In addition to generating employment and economic activity, these resources, because they are owned by the people of Ontario, are a potential source of revenue for the provincial government.

Resource taxes should be designed to generate a fair value for Ontario's mineral and forest products. If these mineral and forest products could be sold by the provincial government directly, the measurement of their fair value would be relatively straightforward. The fair value would be the price at which the resource could be sold on an open market. Because resource products are almost never sold in their raw form, it is generally not possible to establish their value directly. Resource taxes are intended to establish prices indirectly for products that cannot be priced directly. The goal in designing these taxes is to isolate the underlying value of the resource itself from the profits made by the companies engaged in resource extraction on the assets they employ in the process. Economists refer to this underlying value as the "resource rent," the value that remains after normal profits from resource extraction have been deducted from the price of the resource product. Normal profits are defined as the return that would be earned by the capital employed in the extraction process in another use. In this chapter, we use the term "underlying value" to refer to the concept of resource rents as it is understood by economists.

Taxation of Resource Values

Just as a resource tax plays a different role in the tax system than other taxes, so fairness has a different meaning when applied to resource taxes. A fair resource tax is one that provides the highest return on the underlying value of the resource consistent with provincial objectives for employment and economic activity in the industry.

Governments use a variety of special taxes on resources to accomplish this objective. These taxes typically take one of two broad forms: taxes based only on characteristics of the resource product itself; and taxes whose base reflects the economics of particular resource operations and operators.

Taxes Based Exclusively on Characteristics of the Resource

The simplest form of resource tax is a severance tax, which is levied as a flat amount for each physical unit of the resource extracted. Although no attempt is made to define a value base for the tax, a severance tax whose level takes into account current prices and extraction costs could be designed to reflect fairly accurately the value of the raw resource, if the price of the resource is stable and the costs of extraction per unit are similar across the industry. For example, during the period of oil price stability that ended in the early 1970s, both prices and cost structures in the fossil fuel industries were likely sufficiently stable to permit a severance tax to function as a tax to capture the value of the raw resource. The only major resource taxes currently levied by Ontario that are based on physical characteristics solely are the water rental rates charged to Ontario Hydro and private hydroelectric power generators.

Some mining jurisdictions, including Saskatchewan, New Zealand, and Australia, levy taxes based only on the volume of mineral extracted in certain mineral sectors (Caragata 1991). In addition to Ontario, both British Columbia and Quebec apply volume-based charges for forest products (Ernst & Young and Ministry of Natural Resources 1992). Because severance taxes are insensitive both to the costs of bringing the resource to market and to price fluctuations, they cannot be designed to reflect the underlying value of the raw resource in industries in which prices fluctuate or extraction costs vary among different operations. For this reason, they also provide an incentive to extract the highest-quality resources while leaving lower-quality resources behind.

Royalties are similar to severance taxes in that they are based only on characteristics of the resource product itself, without specific reference to costs of extraction. Royalties are based on the value of the resource when sold. Royalties, or value-based taxes, can be designed to reflect the value of the resource in its raw state where the costs of extraction are broadly similar throughout the industry concerned. "Conventional oil" (oil extracted using conventional methods and technologies) in Alberta might be an example in which extraction costs are so similar throughout the industry that a price-sensitive royalty could be designed to capture the value of the raw resource. Although Ontario does not levy royalties in the mining industry, the stumpage fee system in the forestry sector is a royalty-type resource tax.

Royalties based on the sale price of the mineral are commonly applied in other mining jurisdictions. British Columbia, New Brunswick, Nova Scotia, and Saskatchewan are among the Canadian provinces that apply royalties to different types of ore.

Although royalties are often advocated because the revenue they generate is independent of the economic circumstances of particular operations and therefore provide a more predictable stream of revenue, the economic incentives they create are not particularly desirable. Royalties affect the speed with which companies extract resources. They also affect the cut-off grade (the grade below which resources will not be extracted) because they increase extraction costs (McKenzie 1991). For example, ore bodies typically contain varying percentages of mineralization. The lower the percentage of mineralization the greater the mining activity required to produce a given amount of the mineral. Eventually, the grade drops to the point where the extra mining costs cannot be recovered. Because royalties increase costs, they increase the grade below which extraction is not viable. Furthermore, because royalties are insensitive to the costs of bringing resources to market, they will generally overstate or understate the underlying value of the raw resource. As a result, they will tend to have unintended impacts on investment decisions.

Taxes Based on the Economics of Resource Extraction

Where costs of extraction are not uniform across the industry, however, severance taxes and royalties cannot be designed to reflect accurately the value of the resource in its raw form. The same mineral or forest product may require significantly different expenditures by the mining or forestry company responsible for extraction to bring the product to market. A uniform rate of tax or royalty will invariably fail to reflect the full value of resources that can be brought to market relatively cheaply and will overstate the value of resources that are extremely expensive to bring to market. Resource taxes that take into account the economics of each individual operation attempt to correct for this problem. The idea behind using special taxes to establish a price for publicly owned resources is that the value of a resource can be determined from the sale price of a processed resource product by deducting from that price all the costs incurred in transforming the resource from its raw state to a marketable product. All such taxes allow for normal costs of operation, including wages, salaries, and energy costs that are incurred throughout the extraction process. Costs such as exploration and development, depreciation of machinery and equipment, construction of access roads, and capital are also allowed for in these types of taxes, although the way in which these costs are taken into account can vary. These types of taxes are most common in the mining industry.

Profit Taxes

Profit-based resource taxes are similar to corporate income taxes in their treatment of investment costs such as capital and exploration and development, which are incurred at a particular point in time but produce returns over an extended period corresponding to the life of the asset or, in the case of exploration and development costs, the life of the resource operation itself. The general approach in these taxes is to allow these investment-related costs to be deducted from income over a time period that approximates the period during which the company benefits from the investment. Thus, exploration and development expenses are typically spread out over the life of the operation; machinery and equipment are depreciated for tax purposes over their useful life.

Ontario's mining tax is a profit-based tax, with profit defined essentially as it is for regular corporate income tax. Profit-based taxes are the most common form of tax levied by significant mining jurisdictions around the world. In fact, some competing mining jurisdictions, such as Chile, do not apply any special tax to the mineral sector (Intergovernmental Working Group on the Mineral Industry 1992a, 51–54), relying entirely on the regular profits-based corporate income tax. In contrast, with the exception of the limited application of logging taxes described below, profit-based taxes are rarely applied in the forest industry.

Profit-based taxes are sensitive both to cycles in economic activity in particular resource sectors and to the economic situation of particular companies. They also have the advantage of being similar in structure to corporate income taxes. That similarity is, however, the major problem with these taxes as resource taxes. A profit-based resource tax is essentially a second corporate income tax in the resource sector. The base for the tax is virtually the same. As a result, the base for a profit-based resource tax includes the return earned by the operator on the capital employed in the extraction process as well as the underlying value of the raw resource. The fact that profit taxes do not distinguish between normal returns on capital employed in the extraction process and the underlying value attributable to the raw resource is a serious problem. The only reason for having special resource taxes in the first place is to tax that underlying value.

Profit-based taxes can address this problem in the calculation of taxable income for resource tax purposes by making allowances for a return on assets employed in extraction and processing. Although it was designed for a different purpose, the processing allowance in the Ontario mining tax (described below) has the effect of allowing for a return on assets used in mineral processing. In general, the key to isolating the underlying value of the resource from the general level of profit on the operation is to ensure that deductions reflect the full cost of generating that income, including the normal earnings that the capital employed in the resource operation would have generated in another use (the opportunity cost of the investment). In addition to depreciation and current input costs, the costs of both debt and equity financing should be deductible. This would mean allowing for both interest on debt and a return on investment financed by shareholders' equity (Boadway et al. 1989, 108–15).

It is possible in principle to design a tax that measures the net revenue directly after allowing for the opportunity costs of investment. However, it is extremely complicated to isolate underlying resource values in a profit tax framework. Assumptions which simplify the treatment of costs that must be spread over the life of an asset or project would have to be replaced by direct measures. For example, using depreciation schedules would be replaced by estimating the rate at which each asset employed in resource exploitation is used up. It is also difficult to determine how to recognize current costs that should be amortized over the life of resource extraction projects. These problems make it difficult to determine tax liability when the timing of expenditure and revenue is not matched over the life of an investment (Mintz and Seade 1989). It would also be necessary to determine an arbitrary "normal" rate of return to be allowed as a deduction from income for resource tax purposes.

Cash Flow Taxes

Some observers and analysts have argued for a simple tax on the cash flow of resource companies as a way to avoid the complexities associated with trying to isolate resource values from normal profits in a profit-based resource tax (Mintz and Seade 1989; Boadway et al. 1989). In a cash flow tax, investment costs that are spread out over the life of an asset or project in a profit tax framework would be fully deductible from current income as they are incurred. Capital investment costs as well as operating costs would be immediately deductible. The depreciation or depletion allowances which, in the corporate income tax system, serve to spread these costs out over time would be eliminated. Consequently, there would be no deduction either for depreciation or for interest on money borrowed for capital investment. Any negative cash flow would either generate a tax refund at the rate of tax or be carried forward for deduction against cash flow in the future. To ensure that a company experiencing a negative cash flow was not placed at a disadvantage compared with a company with a positive cash flow, the negative cash flow carried forward each year for deduction in future periods would be increased by an investment allowance at a predetermined rate of interest to reflect the fact that negative cash flow deducted in future periods is worth less to a company than negative cash flow deducted in the current period. The rate of interest used to adjust negative cash flows carried forward would be set to reflect the cost of forgoing other capital investment opportunities; hence, the use of the term "investment allowance." Neither a depreciation allowance nor an interest deduction is necessary because these costs are accounted for in the deduction of capital investment.

Cash flow taxes achieve the same economic result as profit taxes adjusted to reflect normal returns on assets employed, but much more simply. The value of an immediate deduction for capital investment in a cash flow tax is equal (in present-value terms) to the more complex depreciation and investment allowances that would have to be offered under a revenue-based resource tax to isolate resource values from general corporate profits. In addition, the deduction of all costs on a current basis under a cash flow tax is simpler than the potentially complicated calculations involved in amortizing expenditures over the life of a resource extraction project (Boadway et al. 1989, 110).

The attractiveness of these qualities has led a number of mining jurisdictions to introduce cash flow or similar taxes. Indeed, British Columbia relies on a cash flow base for most of its mining revenue. (British Columbia also applies a form of royalty-based tax to the proceeds of mineral sales net of operating expenditures, but only as a secondary source of revenues.) Saskatchewan levies a cash flow tax in the uranium mining industry.

Auctions

In addition to the taxation measures described above, some jurisdictions auction off the right to extract resources in the forestry sector. The idea behind this approach is that the best way to determine the underlying value of a resource in a market economy is to subject the right to exploit the resource to an open bidding process. The difficulty in using auctions as a way to capture the underlying value of a resource is that auctions are effective in doing so only under fairly restrictive market conditions. They do not work effectively where there is substantial risk involved, where there is a limited number of potential bidders, or where one bidder may have a natural advantage over others in exploiting the resource. For this reason, auctions are never used in the mineral sector and are used in the forestry sector only to a limited extent.

Because the mineral sector is highly concentrated and dominated by large multinational corporations, it is far from certain that a market for mineral rights would be competitive. As a result, auction prices would likely understate the underlying value of the raw resource. For example, if a particular operator is, in effect, a monopoly purchaser of ore rights, the government would be unlikely to extract a fair price for the resource in an auction since there would be no competing companies to help bid the price of the resource to its true value. This problem would be particularly likely to arise where the auction involves allocation of new ore rights to an existing operator or a renewal of existing rights. In addition, the high degree of uncertainty concerning ore quality in the ground and future mineral prices will tend to result in auction prices that understate the underlying value of the resource. Individual operators will tend to keep their bids lower to protect themselves against potential future losses if ore quality is low and/or resource prices decline (Boadway et al. 1989, 114).

Similar problems with concentration of ownership may arise in the forestry sector as well. However, auctions are more viable in this sector given that resource quantity and quality are known prior to bidding.

Implications for Resource Taxation in Ontario

In the mineral sector, taxes that are based on the economics of individual operations and that isolate the underlying value of the mineral resource from the overall profits of the mining corporation have the greatest potential to return a fair share of this province's resource wealth to the people of Ontario. In the forestry sector, the implications of this analysis are not nearly as clear. While forest industries and markets for forest products share some of the characteristics that make such an approach attractive in the mining industry, profit-based taxes are rare in the forest industry, and to our knowledge cash flow taxes are not used in any other jurisdiction. In addition, in some sectors of the forest industry, market conditions may make auctioning of forest rights a viable alternative to taxation in capturing the underlying value of the resource.

These implications are explored in more detail in the following sections.

Rethinking Ontario's Approach to Mining Taxation

Main Features of the Current System

Ontario's mining tax is levied on profits from mining operations in Ontario. The tax is levied at a rate of 20 per cent on mining profits in excess of $500,000. In calculating taxable income, the following deductions are allowed:

- depreciation allowances on mining, processing, and transportation assets;
- exploration and development expenses; and
- a processing allowance based on the degree of processing carried out in Canada, with higher allowances for processing in Northern Ontario.

In addition, Ontario offers a tax holiday to new mines, major expansions to existing mines, and rehabilitated mines that began operation after 20 May 1987. The exemption is limited to $10 million of profit per mine earned after 30 April 1991 (Canadian Tax Foundation 1992b, 11:16).

Depreciation

Ontario's mining tax permits mining assets to be deducted from taxable profit at rates of up to 100 per cent when used in new mines, and at 15 to 30 per cent of the original cost of the asset per year when used in other mines.

While the allowance for depreciation in the mining tax exceeds that provided for in the corporate income tax, the depreciation permitted occupies a middle ground between what would be permitted if only economic depreciation were to be deductible and what would be deductible in a cash flow tax.

Exploration and Development

Provisions for fast write-offs in the current Ontario Mining Tax permit a mine operator to deduct exploration and development costs up to 100 per cent in a taxation year and allow any unused portion of the costs to be deducted in future years. A cash flow tax, through an investment allowance, would provide slightly more generous treatment of these costs.

Processing Assets

There is no allowance in the Ontario mining tax for a specific return on assets used in processing. Ontario takes an approach used in a number of other significant mining jurisdictions that treat processing costs differently by offering fast write-offs and other special tax preferences for mineral processing activities. These preferences are termed "processing allowances." Manitoba and Quebec are among the competing mining jurisdictions that offer generous incentives for processing.

The Ontario Mining Tax treatment of processing capital assets is established under rules for depreciation and the processing allowance. Under the processing allowance in the Mining Tax Act, annual deductions from mining revenues are allowed at rates up to 20 per cent of the original cost of processing assets (table 23.1). These deductions are permitted each year throughout the useful life of the asset. As a result, deductions are not limited to the original asset cost. Processing assets also qualify for an annual depreciation allowance of 15 per cent.

There is little doubt that the combined effect of the deduction of depreciation and the processing allowance results in a more generous allowance for a return on processing assets than would appropriately be permitted in a tax designed to capture the underlying value of the resource.

Mine Site Rehabilitation Costs

Beyond mining and processing costs, companies often must incur costs for cleaning up a mine site and leaving it in an acceptable environmental state. These "reclamation" costs are generally deductible in Ontario's current mining tax system. A problem arises, however, when mining companies incur substantial reclamation costs after other mining activities (and, therefore, mining revenues) have ceased. The Mining Tax Act includes no specific provisions for the deduction of current expenditures from previously earned income.

TABLE 23.1
Processing Allowances Available under Ontario Mining Tax

Processing stage	Allowance rate (%)
Concentrator	8
Smelter	12
Refinery located in	
Canada	16
Northern Ontario	20
Further Processing in Northern Ontario	20

Source: Ontario, Mining Tax Act, 1992.

Note: The minimum allowance is 15 per cent of profits before processing allowances. The allowance cannot exceed 65 per cent of profits.

Issues in the Design of a Cash Flow Tax for Mining

As noted above, in a cash flow tax, all cash outlays would be deductible from revenue in determining the tax base, with the exception of interest payments on funds borrowed for the purpose of capital investment. Thus, the special provisions in the Ontario mining tax for depreciation of various kinds of assets would no longer be necessary. Rather, those assets would be fully written off against income in the year the expenses were made.

Investment Allowance

Permitting an immediate deduction from revenue for all costs, including capital investment and exploration and development, addresses the problem of allowing for a return on those investments for companies that have enough revenue to take advantage of the deduction. A problem emerges when the total amount deductible exceeds the revenue from the operation. This situation would in fact be typical for most new mines, where there can be an extended period of development before any product can be sold. The problem could be addressed by, in effect, allowing for a negative tax – a refund at the rate of tax on negative cash flow. An alternative to permitting refunds is to allow negative cash flows to be carried forward, but this would not fully compensate for the earnings that could have been realized on the refunded tax had it been paid in the year of the negative cash flow. To address this problem, negative cash flows should be increased at a defined rate of interest in each year that they are carried forward.

Accounting for Revenues

In the Ontario Mining Tax, revenues used in the calculation of the base include all receipts from the sale of mineral ore. Since most of the operations in Ontario have integrated extraction and processing operations, the best observable revenue component of the base is the quantity of processed ore sold multiplied by its current unit selling price. Revenue from the sale of mineral ore is accounted for on an accrual basis, so that accounts receivable are considered to be part of the revenue base for mining tax purposes. This approach is consistent with the accrual accounting treatment of expenditures in a profit tax.

Accrual accounting for receipts, however, is not consistent with the approach to allocating costs in a cash flow tax. In a cash flow tax, revenues should be counted into the tax base only when they are realized. Changing the base to include revenues on a realization basis may require added compliance costs for mining companies that record revenues on an accrual basis for income tax purposes. However, maintaining the current accrual basis could penalize companies, particularly in times of inflation. These considerations would have to be balanced when designing a cash flow tax.

Mine Site Rehabilitation

Because reclamation costs arise after a mine has finished production, they may be incurred at a time when there is no revenue from the mine against which to deduct the costs. For larger operations, this may not be a serious problem because they may have other active mines against whose revenues these costs may be offset. For standalone operations, however, this problem could be serious.

One possible solution to the issue of matching current income with future expenses on mine site rehabilitation is for mining companies to pay for reclamation and deduct these expenses in periods when revenues are available. This could be achieved through the establishment of reclamation funds into which mining companies would deposit the estimated costs of future reclamation over the life of the mine. Contributions to such a fund would be deductible upon deposit. Interest would accrue in this fund tax free and the total proceeds would be put towards future reclamation. Any extra funds flowing back to the company after rehabilitation would be included in its resource tax base.

Under a cash flow tax, the complications involved in developing a special reclamation fund might be avoided. If companies spend money on reclamation after revenues have ceased, the tax structure need only permit a deduction against past cash flow. This deduction would take the form of a refund equal to the tax paid on the value of expenditures on reclamation.

A New Mining Tax System

We believe that a mining tax based on cash flow is the best approach to the taxation of the underlying value of mineral resources in Ontario. This form of tax is particularly well suited to Ontario's mining industry, which is subject to extreme volatility in prices and consists of mining operations with widely varying production cost structures. Of all the forms of resource tax, a cash flow tax is best able to isolate the underlying value of the mineral resource under these circumstances.

The new mining tax format would bring profound changes to the existing tax. However, elimination of the processing allowance, and current depreciation of assets at differing rates, depending on the type of asset and the age of the mine, should not be viewed as disincentives to mineral investment. In place of these provisions, all operating and capital expenditures would be eligible for immediate deduction. Any portion of the expenditure not deducted immediately would be carried forward for deduction against future receipts, with an investment allowance that approximates a fair rate of return for mineral investment.

RECOMMENDATION 49

The Ontario Mining Tax should be changed from its current format as a tax on profits to one on cash flow, which would:

a) allow for the immediate deduction of all capital and operating expenditures;

b) provide for any expenditures not deducted in the current period to be carried forward with an investment allowance for deduction in future periods; and

c) exclude any further deduction for depreciation or interest.

Since these features allow full credit for returns on processing assets, there would be no justification for the processing allowance provided for in the current tax format.

Creditability of the Mining Tax

One consideration in choosing the base and design of a mining tax is whether tax paid in Ontario will be creditable against income tax paid in the United States. If parent companies in the United States can deduct mining tax paid by their Canadian subsidiaries in Ontario from their US tax liabilities, they may be more inclined to invest in Ontario than they would under a mining tax that is not creditable. Creditability of the tax has the potential to provide financial assistance to companies operating in Ontario, at no additional cost to the province. This consideration prompted us to investigate the issue of creditability of our proposed cash flow tax. In particular, we wanted to ensure that changing the tax base from profits to cash flow would not reduce the incentive to invest in Ontario based on the issue of creditability.

For a foreign tax to be creditable against US income tax, it must satisfy three criteria. The first criterion, termed "realization," is that foreign tax should apply subsequent to the occurrence of events that would result in realization of income. This criterion is likely to rule out the creditability of most types of royalties because they do not always apply after income is realized. The second and third criteria are the "gross receipts" and "net income" criteria. Together, they imply that the tax must be imposed on the basis of some measure of the sale of product that is unlikely to exceed market value net of costs incurred in the process of generating receipts.

The Ontario Mining Tax is not currently creditable against US income tax. In a recent US court case (*Texasgulf Inc. v United States,* Fed.

Cl. no. 532-83T), the court ruled that the current Ontario Mining Tax satisfies the first two criteria, but not the third. In order to satisfy the third criterion, the tax would have to permit deduction of interest and royalties. This case has been reopened in the context of an Internal Revenue Service hearing on the basis that generous tax incentives contained in the Ontario Mining Tax, such as the processing allowance, exceed the value of non-deductible items such as royalties and interest.

If the current Ontario Mining Tax is ruled to be creditable on this basis, it is likely that the proposed cash flow tax would also be creditable. Its provisions for immediate deductibility of capital assets, together with the proposed investment allowance, are equal, in present-value terms, to depreciation and interest.

A further and perhaps more important consideration is whether the issue of creditability actually matters to the Ontario mining industry. Available data suggest that there is only one US company with a mining subsidiary operating in Ontario. In light of this fact, creditability of the tax may not be a major issue for mining companies carrying out operations in Ontario at this time. Given these considerations, the issue of creditability should not influence to a great extent the decision on whether to maintain the current profit-based tax or to shift to a cash flow base.

Links between Corporate Income Tax and Mining Tax

In principle, since mining taxes can be viewed as a cost of earning income, mining taxes and corporate income taxes paid by the same mining companies should be linked through the deductibility of mining tax from income for corporate income tax purposes. In Canada, resource companies are not permitted to deduct resource taxes from taxable income. Instead, the federal corporate income tax offers a resource allowance, which permits companies to deduct 25 per cent of resource profits from their income in computing their taxable income. In this system, however, the value of the resource allowance often exceeds the value of resource taxes paid. Companies sometimes take a positive resource allowance and pay no mining tax. Moreover, the value of the resource allowance, and the probability that it will exceed mining tax paid, is increased by the fact that Canadian exploration and development expenditures are not deducted from revenue to determine resource profits for the purposes of calculating the resource allowance.

The current rules have been established by the federal government and adopted by Ontario. It would be difficult for the federal government to switch its system to simple deductibility of resource taxes because such a move would be inconsistent with the basis for the allowance in the first place. The federal government adopted the allowance approach out of a concern that an unlimited deduction of resource taxes would be an invitation to provincial governments to increase those taxes, knowing that a portion of the cost would be borne by the federal government through reduced corporate income tax revenue.

Because the resource allowance applies both to profits of Ontario resource companies and to corporate profits allocated to Ontario from out-of-province resources, it would be impractical for Ontario to adopt a completely different system. One way to ensure that the value of the allowance more accurately reflects the amount actually paid, without adopting a completely different approach, would be to limit the allowance to a maximum equal to the resource tax actually paid. The same limit could be extended to all resource companies claiming resource profits in Ontario. By introducing this change, Ontario could maintain the administrative and cost advantages of harmonization, yet protect against unwarranted erosion of income tax revenues.

RECOMMENDATION 50

The resource allowance in the Ontario corporate income tax should be restricted to the lesser of resource taxes actually paid and 25 per cent of resource profits.

Establishing Mining Tax Rates

The objective of recovering the underlying value of Ontario's resource wealth from companies involved in mining is not the only consideration in establishing rates of tax on mining in Ontario. This objective must be tempered by the need to ensure the continued health of an important industry that operates in an extremely competitive worldwide market for mineral products.

The economic importance of the mining industry is underlined by the fact that a substantial proportion of mining activity is based in single industry towns. Fluctuations in mining activity have a more significant economic impact than would fluctuations in an industry of a similar size spread more evenly across the province.

Economic Position of Ontario's Mining Industry

Mining tax revenues provide a useful indicator of the general economic fluctuations affecting the industry. Figure 23.1 shows that revenue from the Ontario Mining Tax has fluctuated widely over the past 20 years.

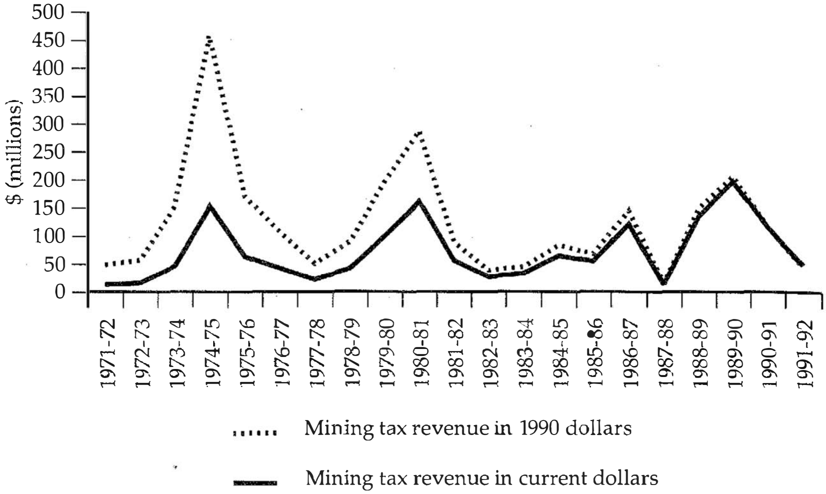
Employment in the industry has been declining since 1989, largely as a result of increases in productivity rather than any decline in the volume of production (figure 23.2). Of more concern for the future is that the value of major metals mined in Ontario has been declining in real terms since 1990 (figure 23.3) and exploration expenditures have declined substantially since 1988 in real terms (after removing the effect of inflation) (figure 23.4).

Ontario's economic position in the mining industry is determined by a number of factors, including geological endowments, land access and security of tenure, environmental regulations, taxation policy, input and mineral prices, exchange rates, and general political and economic stability. In recent years, developments in countries in Asia and Latin America with significant mineral endowments have begun to mitigate factors which had previously made these jurisdictions substantially less attractive than Canada and Ontario as mining investment locations.

Taxation of the Mining Industry in Ontario

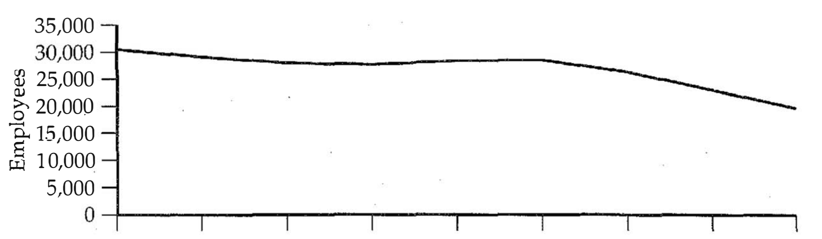
Mining companies in Ontario pay three levels of income tax, including federal and provincial corporate income taxes and Ontario mining taxes, local property taxes, and provincial and federal payroll and capital taxes. Comparisons of statutory corporate income tax and mining tax rates and the average effective rates of these taxes on mining operations show that Ontario's tax system is generally comparable to tax systems elsewhere in Canada and abroad.

FIGURE 23.1
Ontario Mining Tax Revenues, 1971–72 to 1991–92



Source: Ontario, *Public Accounts, 1971–72 to 1991–92;* Statistics Canada, *Consumer Prices and Price Indexes,* Cat. 62-010 (Ottawa, 1993), table 8.

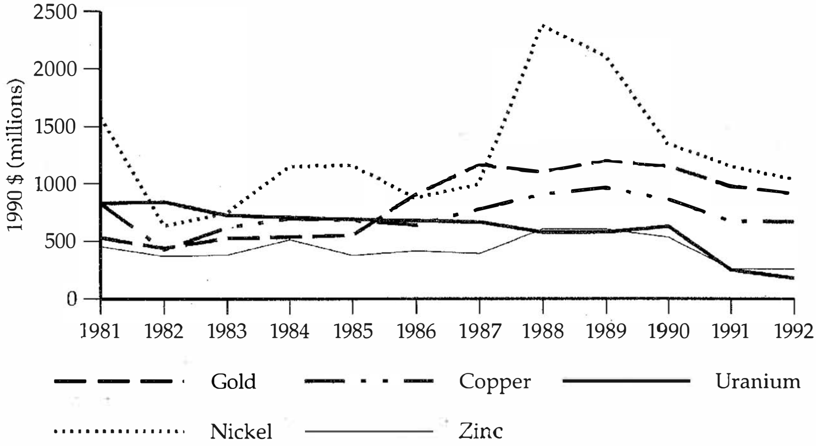
FIGURE 23.2
Mining Employment in Ontario, 1984–92



Source: Ontario, Ministry of Northern Development and Mines, derived from Mines Accident Prevention Association data.

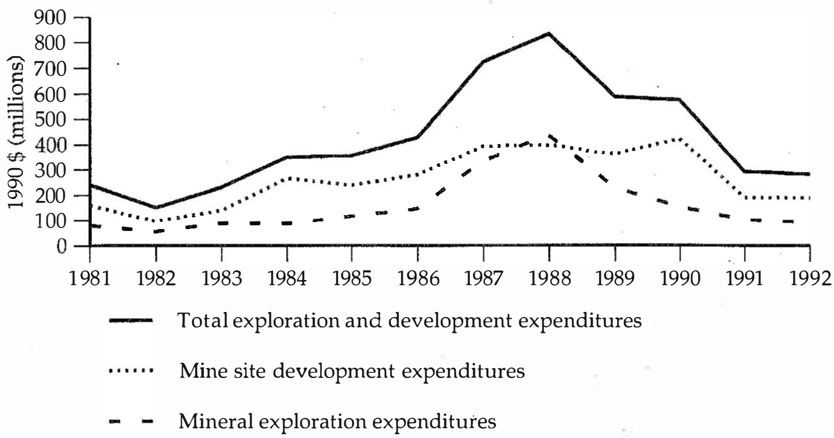
Note: Employment total includes metal mines and industrial mineral mines.

FIGURE 23.3
Value of Production of Selected Minerals, Ontario, 1981–92 (1990 $)



Source: Ontario, Ministry of Northern Development and Mines; Statistics Canada, *Consumer Prices and Price Indexes*, Cat. 62-010 (Ottawa, 1993), table 8.

FIGURE 23.4
Exploration and Development Expenditures, Ontario, 1981–92 (1990 $)



Source: Ontario, Ministry of Northern Development and Mines; Statistics Canada, *Consumer Prices and Price Indexes*, Cat. 62-010 (Ottawa, 1993), table 8.

TABLE 23.2
Selected Corporate Income Tax and Mining Tax Rates, 1993

	Ontario	BC	Manitoba	Quebec
Corporate income tax rate (federal and provincial)	42.3	44.8	45.8	37.7
Corporate income tax rate (federal and provincial) after factoring in the resource allowance	31.7	37.6	34.4	28.3
Mining tax rate	20.0	13.0	20.0	18.0
Mining tax rate after factoring in the processing allowance	7.0	13.0	7.0	4.2
Combined corporate and mining tax rates after allowances	38.7	50.6	41.4	32.5

Source: Canada, Department of Energy, Mines and Resources, Mineral Policy Sector, *The Canadian Minerals Industry: Economic Situation and Current Issues* (Ottawa, March 1993).

Note: British Columbia also applies a royalty of 2 per cent on net current proceeds, which is deductible against cash flow tax payable.

Statutory tax rates on mining companies in Ontario are similar to those in Quebec, British Columbia, and Manitoba. Table 23.2 presents comparisons of statutory tax rates from federal and provincial income taxes as well as provincial mining taxes. Tax rates, calculated by factoring the resource allowance into federal income taxes and the various processing allowances into provincial mining taxes, show that Ontario's combined rates are somewhat higher than Quebec's, but substantially lower than British Columbia's. Extending the comparison to international jurisdictions, table 23.3 demonstrates that Ontario's statutory tax rates are similar to those in other major mining jurisdictions. These mining tax comparisons are complicated by the fact that some jurisdictions use royalties rather than profit-based resource taxes.

Although this analysis provides an indication of how tax regimes compare, it is not particularly helpful in showing how taxes might affect an actual investment in a mining operation. Average effective tax rates are measured as the ratio of the net present value of taxes paid by a mining operation over the life of the operation to the net present value of income generated by the operation. This approach takes into account the impact of differences in the timing of various taxes over the life of a mining operation, and also accounts for special provisions for fast write-offs and tax holidays.

TABLE 23.3
Marginal Tax Rates on Mining in Selected Jurisdictions

Jurisdiction	Statutory rate (%)
Chile	35.0
Ontario	**38.75**
Alaska, US	44.4
Indonesia	35.0 + royalty of 2% gross income
Queensland, Australia	39.0 + royalty of 5% gross income
Brazil	40.0 + 8% tax on mining revenue
Mexico	41.5 + royalty of 3.8–4.2% gross income

Source: Canada, Department of Energy, Mines and Resources, Mineral Policy Sector, *The Canadian Minerals Industry: Economic Situation and Current Issues* (Ottawa, March 1993).

Note: Ontario rates may be viewed as understated since they are adjusted for resource allowance and processing allowance, while rates in other jurisdictions are not adjusted for any deductions. However, in the sense that other nations generally do not offer provisions comparable to the resource and processing allowances, the Ontario rates may be seen as appropriately adjusted to arrive at a comparable figure.

An analysis of average effective tax rate comparisons between Ontario and other jurisdictions indicates that Ontario's taxes on mining companies are lower than those in many other jurisdictions (table 23.4). Quebec's average effective tax rates are substantially lower than those in most other mining jurisdictions.

The fact that municipal, capital, and payroll taxes are excluded from the analysis is a major weakness in both the statutory and average effective tax rate comparisons. In a more comprehensive approach to modelling Ontario's competitiveness in mineral investment, a study prepared for the Ontario Ministry of Finance analysed and compared returns on investment in selected Canadian provinces and US states. The model used in the study generated a comparison of returns on investment by forecasting the financial performance of a hypothetical company over a 12-year period for each of eight jurisdictions. After-tax returns on investment reflect the impact of income taxes, mining taxes, capital taxes, and payroll taxes. The study's results, summarized in table 23.5, indicate that Ontario's position among the eight sampled jurisdictions improved from fifth place before tax to fourth place after tax.

TABLE 23.4
Average Effective Tax Rates on Mining in Selected Jurisdictions

Jurisdiction	Rate (%)
Quebec	2.29
Northwest Territories	5.30
Nevada, US	6.75
Yukon	7.66
Alaska, US	7.98
Alberta	8.40
Chile	8.63
Ontario	**8.68**
British Columbia	9.87
New Brunswick	9.95
Arizona, US	10.69
Nova Scotia	10.28
Newfoundland	10.97
Western Australia, Australia	11.51
Manitoba	11.55
Brazil	13.33
Indonesia	13.80
South Australia, Australia	14.57
New South Wales, Australia	16.44
Queensland, Australia	17.69
Mexico	22.73

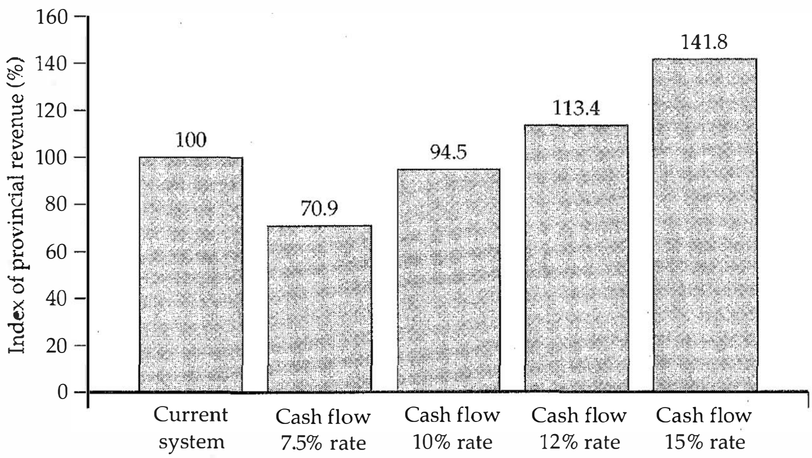
Sources: Canada, Department of Energy, Mines and Resources, Mineral Policy Sector, *The Canadian Minerals Industry: Economic Situation and Current Issues* (Ottawa, March 1993); and Robert B. Parsons, *Canadian Mining Taxation* (Toronto: Price Waterhouse, 1991).

TABLE 23.5
Returns on Mineral Investment in Selected Jurisdictions

Jurisdiction	Return on investment (% before tax)	Return on investment (% after tax)
Ontario	**27.69**	**20.40**
Arizona	28.18	19.89
British Columbia	27.19	18.31
California	26.32	19.49
Colorado	26.21	18.35
Montana	29.61	21.95
Nevada	29.31	22.63
Quebec	27.92	22.17

Source: "A Global Comparison of Mining Tax Systems," prepared for the Fair Tax Commission by K.S. Rachamalla, Ministry of Finance, 2 April 1993.

FIGURE 23.5
Comparison of Ontario Mining Tax Revenue under the Current System and Possible Cash Flow Tax Scenarios, Aggregate of Sampled Companies, 1987–91



Source: Ontario, Ministry of Finance.

Notes: Cash flow scenarios allow immediate write-offs of all capital investments and provide an investment allowance of 12 per cent on any balance. The aggregate sample represents the majority of Ontario's mining tax revenue.

Cash Flow Tax Rates

Comparisons show that mining taxes and returns on mineral investment in Ontario are comparable to those in other jurisdictions. This suggests that the initial rate of cash flow tax should be set to raise approximately the same revenue as is raised by the current mining tax. A computer model of the Ontario mining industry using data from mining tax returns was developed to examine this option and others. We found that a cash flow tax rate of approximately 12 per cent would generate slightly more than the level of revenues generated by the current 20 per cent tax on mining profits (figure 23.5).

Ontario mining tax revenue is, in effect, the result of a bargain struck with mining companies over a sale price for Ontario's raw ore. Ontario is limited in its negotiating position by the price charged by other governments for similar ore bodies in competing mining jurisdictions. As a result, Ontario may be able to levy only moderate mining taxes. For example, Ontario recovers less than 12 per cent of the underlying value of its mineral resources as measured by cash flow after appropriate deductions under the current tax regime (figure 23.5). However, other evidence shows that Ontario is not substantially more generous in its tax treatment of mining than are other jurisdictions. At the same time, Ontario may be able to generate higher mining tax revenues than other jurisdictions if the underlying value of its mineral endowment exceeds that of the mineral resources in other jurisdictions.

Tax Expenditures

Incentives in the current Ontario Mining Tax include both a tax exemption for all mines and a tax holiday for new mines. Both the tax exemption and the tax holiday are meant to provide incentives for mineral investment in Ontario. However, these provisions lead to unnecessary administrative complications and fairness problems among companies.

The tax exemption applies on an annual basis to the first $500,000 of profits of each mining company. The tax exemption can be viewed as a mechanism to increase the post-tax return on mineral investment. The problem with this approach, however, is that an exemption designed to increase private returns should vary with the size of investment. Set at a fixed amount, it will tend to provide greater benefits to smaller companies than larger ones. For example, consider a large company investing $100 and a small company investing $10, and each earning a 20 per cent return. The current mining tax exemption is equivalent to offering a flat exemption of, say, 50 cents to both companies. This flat rate exemption provides little benefit to the large company while it could place the small company in a non-taxable position.

A percentage exemption would be fairer than a flat exemption, since investors are ultimately concerned with rates of return from an investment of a particular size rather than with the dollar values of returns to different-size investments. An exemption based on returns to investment is much easier to build into the design of a cash flow mineral tax. Since the cash flow tax base imputes a fair return to all investments, a relatively low cash flow tax rate is comparable to a tax exemption based on rates of return.

In addition to the fairness problems between small and large companies, the $500,000 exemption significantly undermines the base of the tax. As currently designed, the exemption, which was valued at approximately $2 million in 1991, will tend to erode revenues over the entire life of a mine. Its availability in each year of mining operations provides an incentive for companies to increase revenues for tax purposes in years where less than $500,000 might be reported in the absence of the exemption, and to shift costs into years where more than $500,000 would normally be reported. In this manner, companies can use the exemption to place themselves in a non-taxable position. This makes the tax much less effective as a way to capture a fair share of the underlying value of the resource.

The tax holiday is subject to a similar set of problems. Under the current Ontario Mining Tax, the operator's profits from any new mine that has come into existence after 20 May 1987, or from a major expansion of any existing mine after that date, are exempt from tax for the first 36 months of operations. In 1991–92 a limit of $10 million on the exempt profit was introduced. The definition of a new mine under the act includes mines that are reopened after being shut down for a continuous period of at least 60 months (Canadian Tax Foundation 1992b, 11:16).

The benefits from any tax holiday will be unevenly distributed among mining companies. For an individual company, the benefit from a tax holiday will depend on the timing of its investment relative to the timing of the holiday. It will also depend on tax rules regarding depreciation allowances. Specifically, if an asset is long-lived and depreciation allowances for tax purposes are accelerated, the tax holiday, by preventing the use of depreciation deductions during periods of peak profits, may actually penalize a company for investing during the holiday. The closer the investment to the end of the holiday period, the more severe the penalty (Mintz 1990). In other words, the Ontario Mining Tax, which requires depreciation on mining assets at rates of 30 per cent during the tax holiday, may discriminate against investment of some companies relative to others.

The tax holiday also erodes the tax base. In addition to the $10 million (1989) value of the tax expenditure (Block and Maslove n.d.), the tax holiday gives rise to significant administrative costs and complications. For example, in the case of mine expansions, only the portion of revenues attributable to expanded operations qualifies for the holiday. For the purposes of calculating the proportion of revenues qualifying for the tax holiday, current revenues must be allocated to different operations. The difficulty in properly apportioning revenues and costs to the various operations results in unnecessary complications and costs.

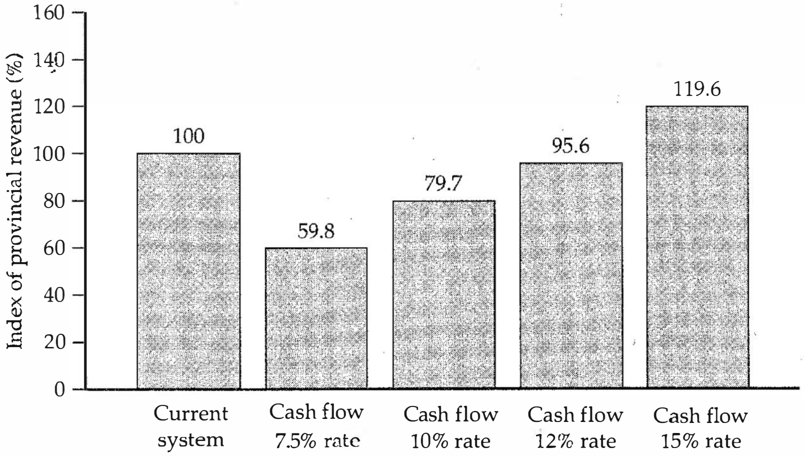
The exemption and holiday for new mines in the Ontario mining tax illustrate clearly the problems associated with this type of tax expenditure in a mining tax. These provisions are of questionable value in the current mining tax and should not be duplicated in a new cash flow tax for mining.

Although the types of tax expenditures in the existing mining tax are difficult to justify, better targeted tax incentives may have a role to play in ensuring the continued health and viability of the industry in this province by encouraging activity in critical areas. For example, we noted earlier that exploration expenditures in Ontario have dropped since 1988. Tax incentives may have a role to play in maintaining levels of exploration activity as well as encouraging research into mining techniques that can enhance the viability of the Ontario industry in the longer term. Similarly, to the extent that environmental regulations affecting the mining industry in Ontario put the industry at a cost disadvantage compared with those of other jurisdictions, incentives may have a role in environmental policies for the mining industry.

Under the basic cash flow format, all expenditures would be eligible for immediate 100 per cent write-offs. Our modelling shows that if mine exploration and development as well as scientific research and development expenditures were made eligible for a 150 per cent write-off, the cash flow tax rate would have to be set at between 12 and 15 per cent to generate the same level of revenue as the current profit-based tax (see figure 23.6).[1] The same incentive could be provided for environmental expenditures by allowing an additional write-off for a defined class of expenditures for environmental enhancement, much as is currently provided for in the corporate income tax.

[1] The Ontario "current cost adjustment," for example, already defines a class of pollution control assets that receive special treatment under the corporate income tax.

FIGURE 23.6
Comparison of Ontario Mining Tax Revenue under the Current System and Possible Cash Flow Tax Scenarios (Includes Special Treatment of Exploration and R&D Expenditures), Aggregate of Sampled Companies, 1987–91



Source: Ontario, Ministry of Finance.

Notes: Cash flow scenarios allow immediate 100 per cent write-offs of all capital investment except for expenditures on exploration and R&D, which are written off at 150 per cent. The scenarios also provide an investment allowance of 12 per cent on any balance. The aggregate sample represents the majority of Ontario's mining tax revenue.

The issue of tax fairness among mining companies of different size might also affect the design of the tax. It is difficult to isolate the impact of cash flow taxes on any category of companies since tax liability varies substantially among companies and over time. However, calculations by the Ontario Ministry of Finance indicate that, in the short term, a flat rate of tax across all mining companies could increase mining taxes paid by smaller companies relative to larger ones. Therefore, as a transitional measure, it may be desirable to levy a graduated rate of tax with higher rates on higher levels of cash flow.

RECOMMENDATION 51

In establishing rates of tax on cash flow in the mining industry, Ontario should monitor closely world economic conditions in the province's key mineral sectors to ensure that Ontario generates the maximum revenue possible from the underlying value of the mineral resources consistent with the need to maintain the long-term viability of the industry.

Ontario should set the initial rate of the tax on cash flow to generate a long-term revenue yield – after allowing for any additional incentives for exploration, research, and environmental costs – equivalent to the yield of the current tax on profits.

RECOMMENDATION 52

A mining tax based on a cash flow format should not provide for:

a) exemptions for cash flow below a threshold or on any basis; or
b) tax holidays for new mines or on any other basis.

Resource Taxes and the Forestry Sector

Ontario's Stumpage Fee System

In most jurisdictions, including Ontario, forestry taxes are levied in the form of "stumpage fees," based on the volume of timber harvested. Ontario's volume-based charges, or "Crown dues," vary with the type of wood harvested and generate the majority of stumpage revenues in the province. The other major forestry-related levy is an area charge that is rent on Crown land licensed for harvesting. A representative rate for Crown dues and total revenue from Crown dues between 1987–88 and 1992–93 are presented in table 23.6.

TABLE 23.6
Rates and Revenues, Ontario Crown Dues

Fiscal year	Crown dues[a] ($/cubic metre)	Crown dues revenues ($ millions)
1987/88	4.55	74.7
1988/89	5.21	78.3
1989/90	7.00	76.5
1990/91	6.86	68.9
1991/92	6.23	54.3
1992/93	4.94	—

Source: Ontario, Ministry of Natural Resources.

a. Crown dues represent rates for conifer cut by integrated licensees.

One of the problems with royalty taxes as a way to capture the underlying value of the forest resource is that they are not sensitive to costs of production. Although Ontario provides subsidies for forest management activities such as protection from pests and fire, as well as for road construction, and maintains separate policies to deal with regeneration, differences in production costs are not reflected in the stumpage system itself.[2] These subsidies came to just over $17 million in 1991–92 for forest maintenance and $1.5 million for roads (Ontario Ministry of Natural Resources 1993a).[3]

Other North American forest-harvesting jurisdictions have stumpage fee systems that are more sensitive to harvest costs. In the United States, for example, timber pricing on federal lands has been largely based on a residual value approach where costs estimated by appraisers are subtracted from forest values (Ernst & Young and Ministry of Natural Resources 1992, 97) to determine the underlying value of the forest resource. Similarly, British Columbia appraises harvest costs through evaluations of stand characteristics (67). The United States and British Columbia systems, which attempt to

---

[2] In certain instances, stumpage rates are also adjusted for the degree of financial responsibility handed down to private companies. For example, forestry companies building and maintaining their own access roads are not subject to the minimum $0.33 per cubic metre bonus rate charge.

[3] As of 1992–93, the Ministry of Natural Resources no longer makes payments for access road construction. The $800,000 is for maintenance of existing infrastructure.

account for harvest costs, will generally lead to fairer sales prices for forestry resources than Ontario's.

Stumpage fees in Ontario bear only a distant relationship to the value of the forest resource. Among all the charges on the harvest of timber in Ontario, only one type varies with the world price of forest products. Crown dues on lands covered by a forest management agreement, which generated approximately 71 per cent of revenue from the harvest of Crown forest in 1990–91, are indexed to the Canadian industrial prices of pulp and paper and softwood lumber (Ontario Ministry of Natural Resources 1993b, table 4). As a result, though the charge is based on the volume harvested, the rate varies to some degree with the world price of timber.

Like Ontario, many competing forestry jurisdictions use only a crude proxy for the true value of forests when calculating stumpage. British Columbia's system of "comparative values," for example, bases forest values on appraisals. The extent to which these values reflect the underlying value of the resource depends almost entirely on the accuracy of these appraisals (Ernst & Young and Ministry of Natural Resources 1992, 67; Schwindt 1987, 195–200). Quebec uses an appraisal system in which timber values vary depending on the zone from which they are harvested (Ernst & Young and Ministry of Natural Resources 1992, 76). As an alternative that better reflects the underlying value of the forest resource, some forestry regions in the United States levy charges based on actual transaction evidence from the sale of forest products on world markets by forest companies rather than appraised values. This method has been found to approximate more closely a fair market value for the resource and is gaining popularity in the United States (Ernst & Young and Ministry of Natural Resources 1992, 97).

Current stumpage fees based on volume harvested distort both investment and harvest decisions. Because Ontario's stumpage fee system makes no attempt to isolate the underlying value of the resource, it risks unintentional overtaxation or subsidization of forestry investment. By reducing the relative profit from harvesting lower-quality logs, volume-based fees provide the incentive for companies to harvest only the highest quality trees in the most accessible locations and leave lower-quality trees to waste (Gray 1992, 44).

Alternatives to the Stumpage System

Profit-based Taxes

The major problem with stumpage/royalty-based systems is that they are insensitive to production costs. Although cash flow taxes have not been applied in the forestry sector (Gray 1992, 84), some jurisdictions have introduced "logging taxes," which tax forest company profits from logging operations. Ontario had a logging tax from 1950 to 1972. The Ontario tax was levied on profits over $10,000 at a rate of 9 per cent (Ontario Ministry of Natural Resources 1993b, table 3). Quebec and British Columbia still apply logging taxes to forest operations.

Logging taxes could be designed to distinguish the underlying value of the forest resource from normal profits on forestry operations. The British Columbia model provides a good example. In setting rules for apportioning profits between logging and processing, the legislation attempts to exclude profits from processing operations and to isolate for taxation values that are strictly attributable to the resource.[4]

In British Columbia, the administrative advantages of an income-based logging tax are thought to counterbalance the fairness and efficiency advantages of a cash flow tax, which is acknowledged to be a better approach to isolating resource values from normal profits. The British Columbia Logging Tax Act is administered at a relatively low cost because, with the exception of processing allowances, it mirrors the design of British Columbia's corporate income tax. The use of the corporate income tax base and administration of the tax in conjunction with the corporate income tax undoubtedly reduce administrative costs compared with the costs of administration in a separate cash flow tax.

In comparison with cash flow taxes, logging taxes may help reduce administrative costs, but they are unlikely to reduce tax avoidance.

---

[4] Processing allowances permitted as deductions from income in logging operations are equal to the median of: 8 per cent of the cost of assets used to manufacture log products; 35 per cent of the net income from log products; and 65 per cent of the net income from log products. (Information provided by British Columbia Ministry of Finance and Corporate Relations, Income Taxation Branch.)

Companies with operations in several jurisdictions can reduce logging tax liability by artificially adjusting the prices charged for forest products and equipment between subsidiary operations. Similarly, family operators can reduce tax liability by artificially inflating salaries that are deducted from revenues in the determination of taxable income. The ready availability of avoidance techniques such as these has been cited as a reason for the low level of reliance on logging taxes to recover resource values relative to other forest charges based on appraised stumpage value.[5]

Cash Flow Taxes

Although cash flow taxes are not used in the forest industry, such taxes are in principle the best suited of all forms of resource taxation for capturing the underlying value of the forest resource reflected in the prices of forest products.

Auctions

In the forestry sector, unlike the mineral sector, auctions are more common around the world than cash flow or profit-based taxes, although they are a relatively minor feature of the forest revenue system in Ontario.

Ontario levies substantial fees, termed "bonus rates," which are negotiated prices per cubic metre that apply to most timber stands under a wide range of licensing agreements and are designed to duplicate the results achieved through the use of auctions. Bonus rates are determined by Ministry of Natural Resources district managers through negotiation with private foresters. In setting bonus rates, district managers consider a range of factors, including the distance from the proposed or existing licence area to the mill, the general quality of the timber and ease of logging on the site, and existing road access to the cutting area. Bonus charges generated just over $2 million in fiscal 1990–91, or approximately 3.2 per cent of revenues generated by Crown dues (Ontario Ministry of Natural Resources 1993b, table 4).

---

[5] Communication with staff of British Columbia Ministry of Finance, Finance and Corporate Relations Division, Income Tax Branch.

Tendered Sale Licences (TSLs) provide for a more competitive form of timber bidding in Ontario than bonus rates. Under TSLs, Crown dues and bonus rates serve as the minimum price at which bidding begins. Bidders are permitted to inspect a stand prior to offering a price for a total actual volume harvested or an expected volume harvested. The total forest activity under TSLs can be measured by revenue or by volume harvested. Revenues generated by bonus charges and Crown dues on these lands totalled approximately $368,000 in 1990–91, compared with approximately $47 million on lands under forest management agreements (Ontario Ministry of Natural Resources 1993b, table 4). The volume of timber harvested under TSLs in Ontario makes up only a small proportion of total timber harvested; approximately 14,000 cubic metres of conifers were harvested, compared with approximately 9.6 million on lands under forest management agreements (Ontario Ministry of Natural Resources 1993b, tables 4.1 and 4.3).

In contrast to its relatively minor role in Ontario, competitive bidding is a central feature of the stumpage fee system in the United States. The United States Forest Service sets a minimum price through forest value appraisal or, where possible, through transaction evidence, and then puts harvest rights up for auction. European countries also use competitive bids in forest pricing. Developing countries such as Malaysia, Thailand, and Nigeria have used competitive bids to a more limited extent (Gray 1992, 56).

Increasing Ontario's Share of Forest Values

Through the Ministry of Natural Resources' Forest Values Project, the government of Ontario is currently engaged in a major review of Ontario's forest policies. That review is considering a wide range of policy options to enhance the contribution of Ontario's forest lands to the provincial economy. In our review of resource taxation, we are approaching many of the same issues from a somewhat different perspective. The focus of our concern is the potential for new approaches to forest resource taxation to better capture the underlying values represented by this province's forest resource wealth for the benefit of all Ontarians. Because the kind of data we used to develop our cash flow tax model for the mining industry was not available to us, we have not been able to model the impact of any specific tax designs in the forestry sector. Our recommendations in this area are intended as a contribution to the debate being carried out in conjunction with the Forest Values Project over the future of forest resource policies in Ontario.

Although cash flow taxation is essentially untried in the forestry sector, our analysis suggests it can function effectively in separating for taxation purposes the underlying value of forest resources from the normal profits earned by forest industry operators on their invested capital. The potential role for such taxes as forest resource taxes should be explored more fully in the context of Ontario's broader review of forestry policies.

We also believe that, at least as an interim measure, an expanded use of forestry rights auctions would enhance Ontario's ability to raise revenue based on the underlying value of its forestry resources. A number of the arguments against the use of auctions or competitive bidding in general do not apply to the Ontario forest industry. One of the main arguments against expanding the use of competitive bids is that revenue is uncertain if markets are not competitive. The current system of competitive bidding in Ontario, however, presents little risk of revenue loss because it starts at a minimum price based on a combination of Crown dues and bonuses. Auctions would serve only to extract values attributable to forest resources that are not flowing to the government under the stumpage fee system. In effect, Crown dues and bonuses would be equivalent to the minimum price system used in the United States.

Some level of competition exists for the right to harvest Ontario's timber. A recent report of the provincial auditor argued that bonus prices paid under tendered bid are often greater than those paid by neighbouring licensees for the same species of timber. In one example cited by the auditor, the tendered sale price was 24 times the bonus rate paid by another company for similar wood under a negotiated bonus (Ontario Office of the Provincial Auditor 1992, 152, 153).

There are serious institutional obstacles to the use of auctions as a general forest revenue source in Ontario. Under current legislation, the substantial proportion of Ontario's forest land under forest management agreements could not become subject to open auctions. Forest management agreements between the Crown and private companies are for a term of 20 years, with automatic renewal every five years subject to compliance with the terms of the agreement. Without a change to the legislation, therefore, licensees could not be made to free land up for an open, competitive bid.

In the absence of significant legislative change, the use of auctions could be expanded on at least some proportion of Ontario's forest lands. In particular, a greater proportion of Crown management units, which cover approximately 20 per cent of Ontario's forest land could be allocated by way of competitive bids.[6] This would increase the value recovered on at least a fraction of Ontario's forest lands.

We believe that there is significant potential for the use of cash flow taxes in the forestry sector to recover for Ontario a greater share of the underlying value of its forest resource, and that Ontario should explore that potential. In the interim, greater reliance on auctions to supplement revenue from stumpage fees would enhance forest revenue potential.

RECOMMENDATION 53

Ontario should explore further the potential role for a tax on cash flow in enhancing Ontario's return from its forestry wealth.

RECOMMENDATION 54

Ontario should increase its reliance on auctions of forest-harvesting rights to recover the public value of forest products until such time as a cash flow tax can be introduced.

Recovery of Regeneration Costs

Of the wide range of costs involved in forest management, the treatment of regeneration costs merits special attention. Investment in regeneration is generally more attractive to the government than it is to private operators because the government takes into account returns such as community stability and regional employment, which are not relevant to the private operator. In addition, the longer time horizon of public investment decisions makes regeneration, with its very long pay-back period, relatively more feasible for the government (Ernst & Young and Ontario Ministry of Natural

[6] Communication with Ontario Ministry of Natural Resources, Forest Industry Services Section.

Resources 1992, 33). In maximizing their profits, forest companies have an incentive to incur certain costs; regeneration is often not one of them. As a result, the government may end up underwriting regeneration costs rather than passing them on to private operators.

The Ministry of Natural Resources spent approximately $93 million on forest renewal in 1992–93 (Ontario Ministry of Natural Resources 1993a). The responsibility for regeneration is set out in forest management agreements and order-in-council licences that determine the nature and scope of private forestry operations on public lands. Where these responsibilities fall on the private operator, they may be partially or fully offset through reductions in Crown dues (Ernst & Young and Ontario Ministry of Natural Resources 1992, 81).

In a cash flow tax framework, if a private sector licensee is responsible for regeneration costs, the treatment of such costs would be straightforward. Private operators would be able to deduct all costs, including the costs of regeneration, necessary to generate revenues. Where the government is responsible for regeneration, however, regeneration costs should be recovered through a separate charge that would be applied before the calculation of the cash flow tax base. This separate charge would then be recognized as a cost of operation to be deducted from the cash flow tax base.

RECOMMENDATION 55

Regeneration costs borne by the forestry operation should be deductible from the cash flow base. Regeneration costs borne by the government should be a charge against cash flow prior to the application of the tax.

The preferred system would be one that recovers regeneration costs incurred by the government in support of forest operations, while taxing a share of the underlying values generated by forest operations beyond the costs – including these public costs – of harvesting and managing the resource. This system would suggest two types of forest charges: a public cost recovery charge, which would be based on actual public expenditures in support of forest exploitation; and a cash flow tax in which the public cost recovery charge would be deductible as a cost by the companies. The same effect could be accomplished by a 100 per cent or relatively high rate of tax on the underlying value of the forest resource applicable to operators not financially responsible for regeneration. Once the full costs of regeneration have been recovered, the rate of tax would fall back to that charged other operators. In this framework, public expenditures on regeneration would be seen as investments to be recovered from forestry operators at the time of harvest.

While this approach would be appropriate if the only objective were to ensure that the underlying value of forest resources is isolated for tax purposes from the normal returns on capital employed in the forest industry, an exception to this rule might arise where the government has decided to subsidize regeneration explicitly for industrial policy or employment reasons. As noted, one of the bases for these public investments is that the public return from forest operations (including the benefits associated with employment in single-industry dependent areas) exceeds the private return. If subsidies for regeneration are required in order to produce the socially desired level of economic activity in the forest industry, it would defeat the purpose of these subsidies to tax them away.

Charges to Reflect Administrative Costs and the Costs of Holding Land Out of Alternative Uses

Whether the land is harvested or not, holding land out of other uses for forestry imposes a cost, which may be measured as the value of the forgone alternative uses. For example, when a forest is used for hunting or camping, the charge may take the form of a user fee. While many uses are not mutually exclusive, expansion of one use will generally reduce the potential for other uses. Increasing a recreational use of the forest by removing land from areas licensed for forest harvest, for example, would increase the revenues available from recreational uses, but would reduce the revenues available from harvest.

The trade-offs in maintaining forests for one use over another present a strong rationale for the area charges that currently supplement Crown dues in the Ontario stumpage fee system. Area charges could be seen as a charge on Crown land designated for forest harvest, but not producing a revenue stream. The charge would compensate for the revenue traded off in keeping forests out of recreational and other non-harvest uses.

TABLE 23.7
Ontario Area Charge Rates and Revenues

Fiscal year	Area charge ($/sq. km.)	Area charge revenue ($ millions)
1987/88	36.0	8.2
1988/89	45.0	9.6
1989/90	47.0	9.0
1990/91	49.0	9.0
1991/92	51.0	13.2
1992/93	51.0	—

Source: Ontario, Ministry of Natural Resources.

This framework suggests the need for revisions in Ontario's area charges. Area charges on productive forest lands under licence in Ontario generate a substantial amount of revenue, second only to Crown dues. Licensees currently pay $51 per square kilometre of productive licensed area (table 23.7).[7] Area charges apply to all productive forest lands under licence, regardless of whether these lands are actually in production. Lands not in production, but being held out of other uses for future harvesting, should continue to be subjected to these special area charges. Area charges might vary by region, with relatively high charges in regions with the strongest potential for non-harvest uses.

Since lands in production and lands recently harvested already generate a stream of income to the government through the sale of forest products, this framework would suggest that area charges should not apply. However, a reduced rate of area charge on land in production might be justified as a way to cover the government's cost of forest management and the administration of the stumpage system.

RECOMMENDATION 56

Ontario should revise the system of area charges for forestry to reflect the cost of holding forest land out of alternative uses such as recreation and to reflect costs of administration and forest maintenance.

[7] As an exception, salvage licensees and third-party licensees pay only $1 per square kilometre (Ontario Ministry of Natural Resources 1993a).

Part Nine
Issues in Consumption Taxation

24 Retail Sales Tax

The introduction of the Goods and Services Tax (GST) by the federal government in 1991 brought to the fore a number of significant issues in sales taxation in Canada. It focused attention on the fact that, since provincial sales taxes were introduced in the 1960s, Canada has maintained distinct sales tax systems at the federal and provincial levels. It highlighted the differences in economic impact between taxes like the GST, which are based on the value added at each stage in the production process, and taxes like the Ontario retail sales tax (RST), which are levied only at the retail level. It generated considerable discussion concerning the taxation of services, which are included in the base for the GST but are generally not included in the base for provincial retail sales taxes. And it raised the question of the appropriate role of consumption taxes in the provincial and federal revenue systems as compared with the progressive personal income tax.

Although the immediate controversy over the introduction of the GST has died down, these basic issues remain unresolved. In addition, two new issues have emerged since its introduction. First, the GST was touted by its designers as a way to address the problem of taxation of underground economic activity. However, evidence suggests that it is having the opposite effect by driving more economic activity underground. We discussed this issue in chapter 12. Second, the visibility of the GST has affected the options available to provincial ministers of finance in responding to their own budgetary problems. This point, in turn, raises issues of federal and provincial taxation responsibilities in our federal constitutional structure. We address these issues in chapter 37.

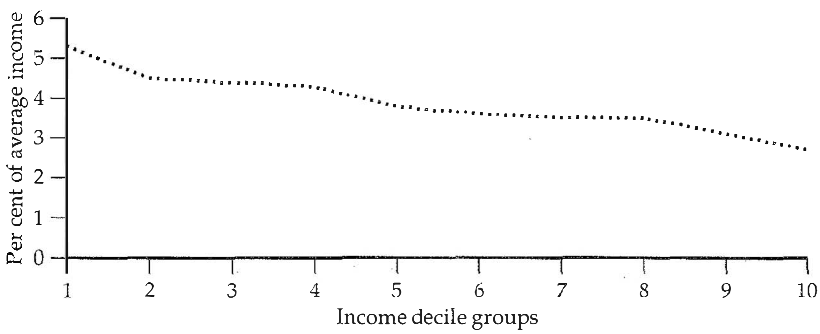
The focus of this chapter is on issues related to the design of the RST and the relationship between this provincial tax and the sales tax systems of the federal government and other provincial governments. Issues related to the role of sales taxation in Ontario's revenue system are dealt with in chapter 33. This chapter concludes with a consideration of special taxes on luxury items as a way to address the regressivity of the sales tax as a "stand alone" supplement to a wealth tax.

The RST, like all consumption taxes, is a regressive tax in that low-income recipients pay a greater proportion of income in this tax than do those with high incomes. Figure 24.1 shows that in 1991, RST paid as a share of average income decreased from 5.3 per cent of income for the 10 per cent of households with the lowest incomes to 2.7 per cent of income for the 10 per cent of households with the highest incomes. The measure of RST paid as a percentage of income includes both tax paid directly by consumers and tax paid indirectly because the input into a good or service has had tax applied to it at an earlier stage in the production process. This indirect taxation is estimated based on assumptions about how much of the tax is passed on to consumers in the form of higher prices and how much is borne by workers and by owners of the businesses. (For a full discussion of tax incidence, see chapter 9.)

The Ontario government relies on the RST for a little less than one-fifth of its revenue, making it a virtually indispensable component of the tax mix. In 1991–92 the RST generated 17 per cent of provincial government revenue and was the second largest source of revenue for the government. Because Ontario cannot give up this regressive tax, it is important to try to make it fairer.

To offset the burden of the RST and property tax on low-income taxpayers, the Ontario property and sales tax credits were introduced in 1973. In 1992 the sales tax portion of the credit was $100 for a single person. Exemptions have also traditionally been provided to reduce the regressivity of the RST. For example, food is exempt because expenditures on food make up a higher proportion of the incomes of lower-income individuals than of higher-income individuals. Despite these measures, the RST continues to be regressive. In the first part of this chapter, we argue that broadening the base of the RST to include many of those goods and services that are currently exempt would increase the fairness of the tax.

FIGURE 24.1
Incidence of the Retail Sales Tax, Ontario, 1991



Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

A second issue is whether the RST should continue to be collected on purchases by business that are inputs into the production process. Levying sales tax on business inputs results in the sales tax component of the input price being passed on to consumers of the final product. This "cascading" of the RST may result in higher prices for Ontario consumers and makes Ontario's exports less competitive. The second part of this chapter argues that business inputs should be exempt from a reformed retail sales tax.

The third part of the chapter describes the administrative advantages of a sales tax that applies at every stage of the production process and provides input credits (a multi-stage sales tax), as opposed to a tax levied only on final consumption, with exemptions for other purchases of goods and services. We determined that the best way to remove the sales tax from business inputs is to restructure the RST as a multi-stage tax.

After establishing the best design for Ontario's retail sales tax, we are also faced with the fact that Canada, unlike other industrialized countries, would still have separate, but now very similar, sales tax systems. The presence of the two sales tax systems operating in tandem raises questions about the cost – both to vendors and to governments – of operating the two systems, and about the advantages to Ontario of coordinating the province's RST with a national sales tax similar in structure to the federal Goods and Services Tax. We set out the conditions for coordination of Ontario's RST with such a national tax.

Broadening the Base of Ontario's Retail Sales Tax

Evaluating Current Exemptions

In 1988, two-thirds of RST revenue was generated from the application of the tax directly to final personal consumption expenditures; the remaining third came from the application of the tax to certain business inputs.[1] Through the effect of cascading, a portion of this one-third is also paid by consumers in the form of higher prices, with the remainder ultimately being borne by workers and the owners of businesses. For example, RST is not payable on real property that includes residential construction, but since building materials are subject to RST, there is tax embedded in the price of residential construction.

Because the RST does not apply to all expenditures, in 1988 the effective tax rate measured against personal expenditures was 3.6 per cent. Many categories of goods and services are exempt from the tax. The revenues forgone as a result of these exemptions are tax expenditures. Using broad-based final consumption as the benchmark, table 24.1 provides a comprehensive listing of the RST tax expenditures and estimates of the province's forgone revenue from these exemptions in 1991.

To ensure that the sales tax achieves a measure of horizontal equity (that the proportion of income that people with the same level of income pay in sales tax is roughly similar, regardless of what goods and services they choose to consume), the tax should apply to all goods and services. A broad-based application of the sales tax also reduces administrative complexity for the vendor. However, if an exemption for a good or service substantially reduces the regressivity of the sales tax or increases the equity of the tax between people in different situations, then justification exists for exempting that good or service, even though it adds complexity to the administration of the tax.

---

[1] FTC estimate based on 1988 data from Statistics Canada, Input Output Division.

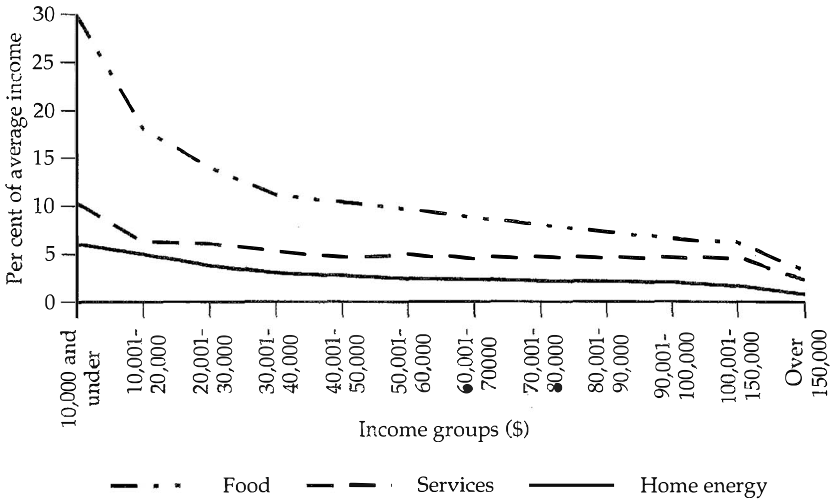
TABLE 24.1
Retail Sales Tax Expenditures – Estimates of Revenue Forgone in 1991

Goods and services	$ (millions)
Goods	
Energy	429
Motor fuels	170
Basic groceries	1188
Prepared food under $4	160
Reading material (newspapers and books; subscriptions to periodicals)	61
Prescription drugs and medical equipment	169
Children's clothing	50
Footwear under $30	35
Feminine hygiene products	11
Water charges	49
New housing	636
Rent and board	656
Transient accommodation	26
Vehicles using alternate fuels	4
Services	
Household	240
Medical and health	420
Transportation and related	362
Recreational, educational, and other	605
Personal	148
Financial	715
Legal, accounting, and other	58
Admission fees	30
Purchaser-specific	
Goods/services for people with disabilities	7

Source: Fair Tax Commission and Ontario, Ministry of Finance, Taxation Policy Branch.

Notes: Estimates are based on final consumption expenditures by households; for publicly provided goods, the estimates are based on costs less subsidies. Motor fuels and lubricants are subject to the Fuel and Gasoline Tax acts.

FIGURE 24.2
Expenditures on Food, Services, and Home Energy as a Share of Income, Ontario, 1991



Source: Fair Tax Commission estimates based on Family Expenditure Survey, 1986 (updated to 1991), Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

We examined the degree to which current exemptions from the RST reduce its regressivity. In our analysis, we determined the proportion of income that people in different income ranges spent on the exempt goods and services. If the proportion of income spent on an item is high relative to the proportion spent on other goods and services in low-income ranges and low in high-income ranges, then providing an exemption for that item would reduce the regressivity of the tax.

Figure 24.2 shows that in 1991, households in the lowest income group spent almost 30 per cent of their income on food for consumption in the home, while households in the highest income group spent just under 3.5 per cent of their income on food. Thus, if food were to be added to the base of the RST, the regressivity of the tax would increase sharply.

The large share of income spent on food by low-income families and the sharp reduction in the share of income spent on food as incomes rise is not repeated in the consumption patterns of other exempt goods and services. For example, consumption of home energy takes up a much smaller share of household income than does food. The lowest income group spends about 6 per cent of income on home-heating fuel; this drops off to about 1 per cent of income for the highest income group. While the share of income spent on home energy decreases as income increases, the pattern is only slightly more regressive than that of the RST generally. As a result, the exemption cannot be easily justified on the basis of reducing the regressivity of the tax, and complexity would be reduced if the exemption were discontinued.

A similar pattern emerges for certain currently exempt services. The services included in figure 24.2 are transportation services, various household services, laundry and dry-cleaning, and personal business services (exclusive of interest payments). Figure 24.2 shows that, although consumption of these services declines as a share of income between the lowest and next income range, it accounts thereafter for a fairly constant share of income until the highest income range. As a result, the taxation of services that are currently not included in the base would not increase the regressivity of the RST.

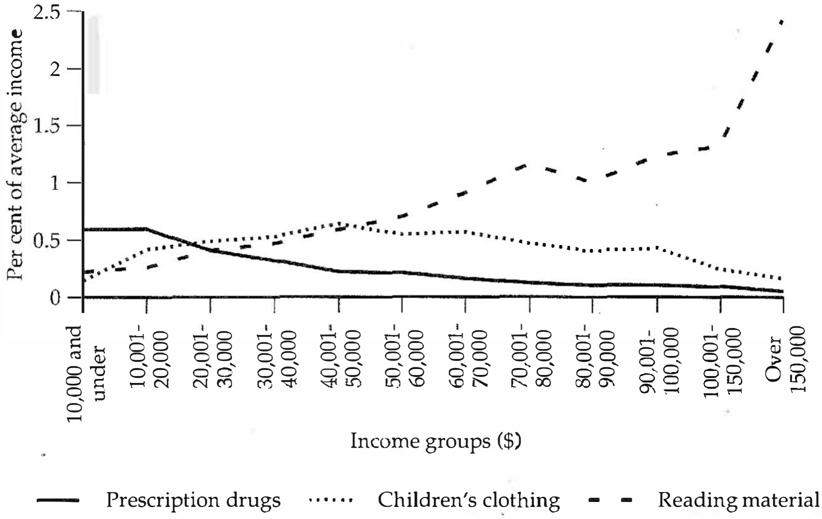
Figure 24.3 shows the share of income spent on a further set of products by income levels. These products include prescription drugs, children's clothing, and reading material.

Consumption of prescription drugs, on average, accounts for less than 1 per cent of income across all incomes ranges, although these expenditures decrease slightly as a share of income as income rises. Therefore, the inclusion of prescription drugs would not increase the regressivity of the RST. However, expenditures on prescription drugs are largely non-discretionary and would tend to make up a larger proportion of the consumption of persons with a chronic illness or a disability. As a result, providing an exemption for prescription drugs increases the equity of the sales tax between those with an illness or disability and those without.

The exemption for children's clothing dates back to the introduction of the RST in 1961. The exemption was intended to reduce the burden of the tax on low-income households (Ontario Treasury 1961, 25). However, consumption of children's clothing does not show a consistent pattern as a share of income across income categories. Figure 24.3 indicates that the share of income spent on children's clothing rises up to about 0.7 per cent of income in the $40,001–$50,000 income range and then drops as a share of income over the next seven income groups.

FIGURE 24.3

Expenditures on Prescription Drugs, Children's Clothing, and Reading Material, Ontario, 1991



Source: Fair Tax Commission estimates based on Family Expenditure Survey 1986 (updated to 1991), Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Figure 24.3 shows that the consumption of reading material as a share of income increases sharply as income rises. However, the policy justification for the exemption of selected reading material (books, newspapers, and subscriptions to periodicals) has not been the presumed regressivity of including these items in the base. Rather, the argument for the exemption is to encourage literacy and provide support for the Canadian publishing industry (Canadian Booksellers Association 1993).

There was strong representation made to the commission during its public hearings regarding the taxation of reading material in general and books in particular. Currently, reading material is taxed under the federal GST. Strong arguments were given for the non-taxation of all reading material because of the general benefits to society (National Book Committee 1993). Non-taxation is also proposed to support the publishing industry and to promote Canadian culture.

We considered the suggestion that reading materials be exempt from a reformed retail sales tax, but determined that an exemption for reading materials would be inappropriate for the following reasons:

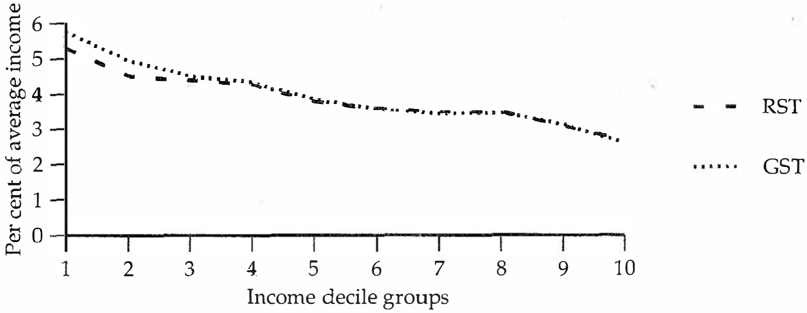
- Exempting reading materials reduces the fairness of the RST because consumption of reading materials increases as income increases (see figure 24.3).
- Exempting reading materials from sales tax provides a subsidy for all book publishers, Canadian and foreign. Since 53 per cent of books and 45 per cent of periodicals purchased in Canada are published in a foreign country, an exemption would be badly targeted as a subsidy (Statistics Canada 1993a, 11; Statistics Canada 1993j, 9).

To the extent that it is considered appropriate to provide financial support to the Canadian publishing industry, such support should be provided directly, rather than through a sales tax exemption for all reading material regardless of origin.

From this discussion we conclude that only the exemption for food increases the fairness of the RST. However, we recognize that a strong argument can be made to include food to reduce the complexity of the tax and to address the regressivity problem in the determination of refundable credits. There is no real fairness argument to be made to exclude a number of other exempt items; consequently, they should be added to the base of the RST, thus broadening the tax base. Next, it is important to determine whether this more broadly based sales tax, particularly one that includes a large number of services, has a less regressive pattern than the current RST. The comparison that follows uses the GST to approximate the impact of a broadly based RST. Figure 24.4 shows the distributional impact of collecting the revenue raised by the RST in 1991 on the more broadly based GST. The RST estimates include the tax directly collected on consumer expenditures and the tax on business inputs. The figure shows that both taxes have a regressive pattern and that the average effective tax rates are almost identical. Though the GST base does result in a slightly higher relative burden on the first three decile groups, a broader base does not noticeably change the fundamental regressivity of sales taxes.

Nevertheless, broadening the base of the RST has an impact on the fairness of this tax as it applies to individuals in the same income

FIGURE 24.4
Incidence of Collecting 1991 Ontario Sales Tax Revenue on the Goods and Services Tax Base

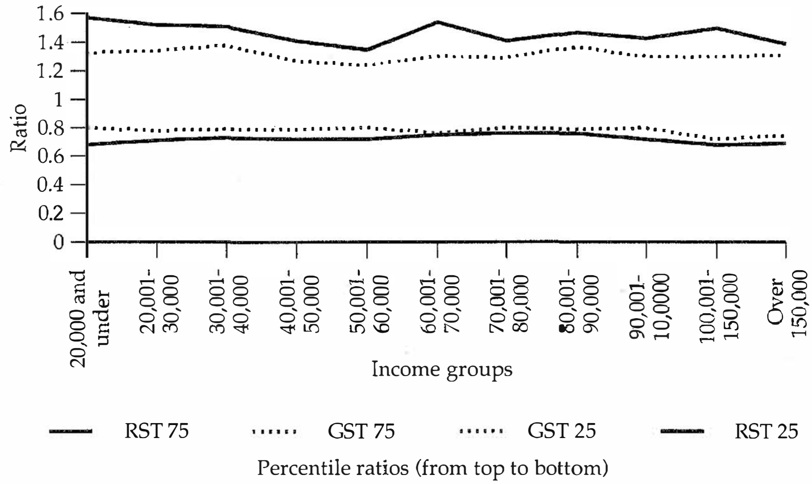


Source: Sheila Block and Richard Shillington, "Incidence of Taxes in Ontario in 1991," in *Taxation and the Distribution of Income*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming).

group. In other words, a broader base increases the horizontal equity of a sales tax. Once again, a comparison was made between the impact of the RST and the broader-based GST on income groups in order to assess the impact of a restructured RST on horizontal equity. Dispersion analysis was used to determine the horizontal equity of the retail sales tax; that is, the variation of the impact of the tax on individuals within income groups. To understand the effects of including services in the base of the RST, a comparison was made of the variation of impacts of Ontario's RST and those of the federal GST, which taxes services.

Figure 24.5 shows the relationship between the 25th and 75th percentiles and the median share (at 1 in the figure) for each income group. The distance between the 25th and 75th percentile lines measures the range of impacts of each tax on household incomes. The wider the gap, the greater the range of impacts of the tax. Since the gap between the 25th and the 75th percentiles is narrower for the GST than it is for the RST, the chart shows that the tax burdens for families with equivalent incomes are more similar for the GST than for the RST. Thus, a more broadly based tax like the GST is fairer than a more narrowly based tax like the RST when applied to individuals in the same income range.

FIGURE 24.5
Comparing the Impact of the Retail Sales Tax and the Goods and Services Tax within Income Groups, Ontario, 1991



Source: Fair Tax Commission estimate based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Note: Ratio on the Y axis is the ratio of the tax rate for the percentile to the tax rate for the median.

Since Ontario needs to maintain a retail sales tax for fiscal reasons, we conclude that in order to achieve increased fairness, the base of the tax should be as broad as possible. A broader base would result in a fairer application of the sales tax within income groups without appreciably affecting the distribution across income groups.

RECOMMENDATION 57

Ontario should broaden the base of the retail sales tax to include all goods and services with limited exemptions.

Business Inputs

In 1988, about one-third of RST revenue was collected from the taxation of goods that are inputs into the production of other goods or services (business inputs).[2] The changes to the base in the 1993 budget likely increased this share slightly. Because of the tax paid on business inputs, and despite the exemption for production equipment, purchases of machinery and equipment are subject to an effective tax rate of 3.6 per cent, about the same as that on consumer expenditures.[3] Although exports are exempt from tax, some tax is included in their price because of the tax on inputs into their production. As a result, the effective tax rate on exports is 0.2 per cent.

Some portion of the tax on business inputs is passed forward to consumers in the form of higher prices, although the amount of tax embedded in the price will vary according to the level of taxable inputs in the goods or services. As a result, the effective tax rate varies from product to product. Even the goods and services that are exempt from tax can have some tax embedded in their price. Because goods or services produced outside the jurisdiction are not subject to the tax on business inputs, imports have a competitive advantage over domestic goods to the extent that there is less tax embedded in their cost structures.

The taxation of business inputs not only increases consumer prices, but also reduces the ability of Ontario's goods and services to compete in export markets. For industries in which prices are set internationally, the cost increase resulting from the taxation of business inputs cannot be passed on by domestic producers. This impact is felt regardless of the type of taxable business input. The portion of the RST on business inputs that falls on investment goods – machinery and equipment, and residential and non-residential construction – also influences the level of investment in the economy. The sales tax on these goods increases their costs to investors. As a result, the level of investment in plant and equipment will be lower than it would have been in the absence of the tax on these particular

---

[2] FTC estimate based on data from Statistics Canada, Input Output Division.

[3] FTC estimate based on data from Statistics Canada, Input Output Division, and Ontario, Ministry of Finance, Provincial Economic Accounts.

business inputs. This trend, in turn, can result in a decrease in the productive capacity of the economy.

It is often argued that the entire amount of sales tax paid on business inputs has the same negative effect as the tax on capital investment. However, about 35 per cent of the tax on business inputs is on items of current expenditure (telephones, meals, office supplies, and repairs), not on investment goods. Furthermore, of the remaining 65 per cent, more than half applies to residential and non-residential construction, neither of which has as significant an impact on the productive capacity of the economy as investment in machinery and equipment. To estimate the economic impact of removing the RST on different kinds of investment goods, the RST/GST Working Group used a macro-econometric model of the Ontario economy. Simulations showed that removing the RST resulted in a 2 to 4 per cent increase in investment in machinery and equipment (above otherwise predicted levels in each year from 1995 to 2000) and a 1 to 3 per cent increase in investment in non-residential construction (Dungan n.d.).

To remove the effect of embedded tax in the price of goods and services in Ontario and to increase the productive capacity of the economy, business inputs should be removed from the base of the retail sales tax.

RECOMMENDATION 58

Ontario should exempt all business inputs from the retail sales tax.

Design of the Reformed RST: Single-stage or Multi-stage?

The recommended reforms to the RST raise the question of whether a multi-stage tax or a single-stage tax is a superior design for a fair and efficient consumption tax. Specifically, the question is which form of sales tax is more effective at eliminating tax on inputs and at allowing a broadening of the tax base to include services? Under a multi-stage system, all sales are subject to tax. Businesses then claim a credit for any tax paid on their purchases, effectively removing the sales tax from all business inputs. The relative ease of preventing cascading in this manner also makes it simpler to tax services under a multi-stage tax. Many services are used both by businesses and by consumers. Under the usual structure of a single-stage RST, there is no straightforward way to exclude those services that are inputs to a business activity because no "sale for resale" is involved.

Finally, cascading can be avoided at a lower administrative cost with a multi-stage tax than with a single-stage one (Due 1986, 16:6). To ensure that purchases on which the tax is credited are actually used for business purposes, only the purchaser needs to be audited, not the supplier. In addition, the supplier does not have to distinguish between sales for intermediate use and sales for final consumption. By comparison, under a single-stage tax like the RST, intermediate goods can be sold tax free only by issuing buyers with certificates or numbers that indicate use for business purposes. Preventing abuse then requires checking the seller's tax exempt sales and the buyer's use of the tax exempt purchase. Thus, the costs of ensuring compliance are lower for a multi-stage than a single-stage tax.

To prevent tax cascading – thereby making it possible to broaden the base of the tax to include services while minimizing administration and compliance costs – Ontario should replace its single-stage retail sales tax with a multi-stage tax, in which taxes are levied on all transactions involving taxable goods and services and taxes paid on inputs are offset against taxes due from sales.

RECOMMENDATION 59

Ontario should replace its current single-stage sales tax, levied only at the final point of sale at the retail level, with a multi-stage sales tax levied on all transactions with full credit for tax paid on business inputs.

Advantages of Tax Coordination

Thus far, we have recommended a series of changes to Ontario's retail sales tax that would broaden the base of the tax and make it a multi-stage tax, effectively eliminating the tax on business inputs. The design of the reformed RST would now be almost the same as that of the federal Goods and Services Tax. The most compelling reason for Ontario to harmonize its reformed RST with the GST is the cost to businesses of complying with two sales tax systems in the province. Among issues involving the RST, the cost to businesses of two sales tax systems was the one raised most often at the commission's public hearings.

Compliance Costs

The cost to individuals and businesses of complying with two sales tax systems arises from the separate administration and design of the two taxes, the different treatment of particular situations under the two systems, and the compounding of complexities in one sales tax because of the existence of another system.

Most business people who appeared at our public hearings were concerned about the added burden of complying with two separate taxes and what they saw as the unnecessary complexity of the current system. Most argued in favour of harmonizing the GST and the RST. In particular, auto industry representatives endorsed this view, arguing that harmonization would place Ontario in a more competitive position.

People living in border communities agreed with harmonizing the two taxes as a way to stem cross-border shopping. At present, the federal government collects GST at the border on certain items purchased in the United States by Canadians. If the taxes were harmonized, the federal government could also collect the RST, a move that could make cross-border prices less attractive to Canadian consumers.

Farmers, however, argued for increased exemptions from sales taxes and complained that the GST levied on their agricultural inputs is unfair because they have to wait too long for their refund cheques.

All retailers bear the costs associated with the separate administration and design of the two taxes, including the costs associated with dealing with separate administration and those associated with identifying the tax status of goods and services. The problems associated with identifying tax status is of particular concern to retailers. For GST purposes, a zero-rated good or service is not taxable, and input tax credits are received for all the tax paid on inputs. Exempt goods are not taxable, but taxes paid on inputs are not eligible for input tax credits. If a transaction is exempt for RST purposes, then it is not taxable. Thus, any given item may fall into one of the following categories:

- GST taxable and RST taxable
- GST taxable and RST exempt
- GST zero-rated/exempt and RST taxable
- GST zero-rated/exempt and RST exempt

Books and newspapers, for example, are taxable for GST purposes but exempt for RST purposes. Magazines sold by subscription are exempt for RST purposes and taxable for GST purposes, but magazines sold at retail are taxable for both RST and GST purposes. Footwear sold for less than $30 and children's clothing are exempt from RST, but are subject to GST. Retailers must identify the tax status of the various products and train staff to recognize the differences. Full coordination of the sales taxes with identical tax treatment of taxable goods and services and the same exemptions and zero-rating would reduce the number of categories from four to two and reduce the amount of time required for staff training and the time spent explaining the two tax systems to customers.

Tracking two taxes to ensure the proper amount is remitted is an ongoing cost to individuals and businesses. For the GST, the frequency of filing (monthly, quarterly, or annually) depends on the size of the business. For RST purposes, the rules are relatively straightforward: the return and tax are due on the 23rd of the month following the month in which the sales were made. (Small businesses can file less frequently, depending on the amount of tax remitted.) Filing for the two taxes involves not only different due dates, but also different forms and different information requirements. This doubling of filing requirements increases compliance costs. Because the two systems are different, at least two general ledger accounts must be established and monitored to ensure that the proper amounts of tax are being accumulated and remitted periodically. New businesses have additional set-up costs in addition to the ongoing costs. Established businesses face added complexities when reorganizing or selling their businesses, or otherwise changing their status.

In addition, business must bear the costs associated with audits by two sales tax administrations. The statutory audit period for both RST and GST purposes is generally four years. Audit visits can range from a few hours to several hundred hours. During audits, businesses are asked to provide different information and records and make staff available for interviews.

The costs associated with separate administration and design could be eliminated, but only through full sales tax coordination with a single administration. The implementation of a multi-stage sales tax with a broader base in Ontario would not reduce these costs. Quebec reformed its sales tax, starting in 1991, to expand the tax base and to introduce a system of input tax credits and a single administration for the combined federal and provincial tax in the province. However, there were enough differences between the Quebec sales tax (QST) and the GST that the complexity of compliance with the QST has increased (Wood et al. 1992).

Finally, the existence of two sales tax systems increases compliance costs on transactions where the complexity of one of the taxes is compounded by another tax on the same transaction. Contracts that include the sale and installation of tangible personal property or construction contracts involving fixtures and real property are examples of these types of transactions. Complexities are associated with taxing these transactions under the RST because of the distinction between tangible personal property (which is subject to tax) and fixtures (which are not). The application of GST on these transactions compounds the complexity.

Government Administrative Costs

Reducing the Ontario government's administrative costs is another argument for sales tax coordination. However, the administrative savings to the Ontario government that would result from full harmonization with joint administration are relatively small. The total cost of administering the RST in Ontario in 1991 was approximately $40 million (Ontario Ministry of Revenue estimate). The maximum cost savings from harmonization would be less than that because of the need for continuing policy review by both levels of government.

To achieve a broadened sales tax base while providing an exemption of business inputs and a reduction in compliance costs related to the taxation of retail sales for individuals and businesses, we favour changes that would result in only one sales tax administration in Ontario with a tax structurally similar to the GST. The adoption of a single tax structure would result in streamlined collection and reporting for businesses and would reduce consumer confusion over which goods and services are taxable and which are exempt. Such a change would not prevent Ontario from making rate changes, and the province would also retain the ability to impose selective excise taxes to achieve various policy objectives (such as the Tax for Fuel Conservation).

The effect on consumption of changing Ontario's RST to a tax similar in structure to the GST would be relatively minor. A study for the commission (Dungan n.d.) estimates that in the first year consumption would drop by 1 per cent relative to the expected level for that year, but that the drop would be reduced to two-tenths of a per cent after five years.

Constraints

Ontario's status as a subnational jurisdiction and the existence of different consumption tax systems in other provinces constrain the province's ability to take this action unilaterally. Specifically, an expansion of the number of goods and services subject to tax would provide an incentive for consumers of these goods and services to buy them in provinces where they are not taxable. Because services have traditionally not been taxed by the provinces, to start now would require new methods of identifying and taxing interprovincial trade in services (Vanasse 1992, 3). At present, there is considerable scope for tax planning to minimize any provincial taxes applied to services. Quebec's experience with two types of business services illustrates the difficulties associated with provincial taxation of services. Quebec's zero-rating of financial services reflects the constraints placed on a province trying to tax services that are not taxed in other provinces. Similarly, the tax treatment of interprovincial freight transportation is constrained by the lack of taxation of such services in other provinces, with the result that no interprovincial carriers collect the QST (Hill and Rushton 1993, 113). In light of the possibility of tax competition between the provinces, we are concerned about Ontario unilaterally harmonizing its RST with the federal GST.

In addition, harmonization by Ontario alone would not reduce compliance costs for firms operating in a number of different provinces. The greatest savings in compliance costs for firms operating nationally are realized if harmonization results in identical legislation and a single administration.

We are also concerned about the effect on compliance costs of provinces' reaching different "harmonization" agreements with

Ottawa. In 1991 Quebec's sales tax was "harmonized" with the GST. However, a number of goods and services are treated differently under the Quebec sales tax and the GST. For example, books are exempt under the QST and taxable under the GST; and financial services are exempt from the GST but zero-rated in Quebec, meaning that input credits can be collected. As a result of these differences in tax treatment, the reduction in compliance costs has not been as substantial as they would have been if harmonization had been total.

We therefore recommend that agreement be sought with all the provinces that levy a retail sales tax to coordinate their taxes with a federal level sales tax under a single administration. The agreement negotiated must be identical for each province.

If a national retail sales tax were established, Ontario would no longer be able to change the base of the sales tax unilaterally. Therefore, it is important that Ontario secure any desired changes to the tax base in the process of negotiating a national sales tax. The exemption for food would likely remain, and it would be sensible to harmonize the provincial tax to this exemption even if one does not accept the regressivity argument made earlier in this chapter. However, some limited changes may be feasible and would be advisable. One change that the commission recommends is in the treatment of prepared foods purchased in grocery and convenience stores. Currently, the GST is applied to prepared food purchased in restaurants, in cafeterias, and in home-delivery and take-out establishments, but not applied to grocery products or ready-to-serve meals purchased in grocery or convenience stores. This creates a major inequity for the food services industry: it must compete directly with ready-to-serve foods, frozen meals, and foods requiring only heat transfer, which are sold in grocery stores and are tax free. To equalize treatment, sales tax should be applied to prepared meals regardless of where they are purchased, as well as to products that require only limited heat transfer prior to consumption. According to the Ontario Restaurant Association and the Canadian Restaurant and Food Services Association (1992), the tax would apply to:

> Fresh, frozen or vacuum-packed dinners, entrées or other similar meals which have been partially or completely cooked, which require no further preparation other than heat transfer and which have been packaged as single servings, and fresh, frozen or vacuum-packed pizza which require no further preparation than heating.

We also suggest that the tax treatment of financial services be reconsidered. Currently, financial services are exempt from GST largely because of the complexity associated with trying to tax them. There is no fairness reason for exempting these services from a national sales tax, and exempting them provides an advantage to one sector of the economy compared with sectors that are taxable. We suggest that the federal and Ontario governments work together to explore the possibility of including financial services in the base of a national sales tax.

RECOMMENDATION 60

Given the existence of a comprehensive sales tax at the federal level, Ontario should harmonize its retail sales tax with a national sales tax modelled on the federal Goods and Services Tax. This would involve accepting the basic structure of the GST as a multi-stage sales tax or value-added tax, with the following provisions:

a) an exemption for health care services, financial services, education services, child care services, personal care services, legal aid, resale of homes, and residential rents; and
b) zero-rating for basic groceries, prescription drugs, medical services, transportation services, and public transit services.

In negotiating its participation in a national sales tax system, Ontario should:

- **examine approaches to making prepared foods purchased in convenience and grocery stores taxable; and**
- **explore the options for including financial services in the tax base.**

RECOMMENDATION 61

Ontario should require joint administration of the harmonized sales tax, which would provide for:

a) joint establishment of all aspects of sales tax policy, with the exception of rates;
b) establishment of tax rates by each government independently;
c) formal provincial involvement in the administration of the tax. This involvement would be accomplished through recognition of a clearly specified provincial role in the administration of the joint tax; provincial administration of the joint tax; or establishment of an independent federal/provincial agency for the administration of the joint tax.

Luxury Taxes

A luxury tax could be in the form of a special sales tax on selected luxury items or a higher rate of Ontario's retail sales tax on items that are purchased primarily by affluent households. In deciding whether or not Ontario should introduce such a luxury tax, we considered current experience with luxury taxes in Canada and the recent experience of the United States, where a luxury tax was introduced at the federal level in 1990 and abolished in the most recent federal budget.

Canadian Experience

The federal government levies a luxury tax in the form of a special excise tax on jewellery, including clocks and watches, as well as diamonds and other precious or semi-precious stones. Introduced in 1918 as part of a broad range of taxes on items considered to be non-essential or luxury goods, the tax is imposed on manufacturers and importers rather than at the retail level, and is levied at a rate of 10 per cent of the manufacturer's sale price or the duty-paid value of imported jewellery. Exemptions exist for items valued at less than \$3, for the first \$50 of the value of clocks and watches, and for all jewellery produced by manufacturers with total sales of \$50,000 or less.

The jewellery tax was recently evaluated by the federal Department of Finance (1993c), based on a study by Ernst & Young. In recent years, revenues from the tax have averaged about $50 million per year; elimination of all exemptions could raise this amount by up to $17 million (Canada Department of Finance 1993c, 10). Administrative costs are minimal, totalling only $235,000 for collections from domestic manufacturers and a small but unspecified amount for imported items, which are already subject to the GST. Overall, the Department of Finance estimates that collection and enforcement costs amount to no more than 1 per cent of revenue collected (Canada Department of Finance 1993c, 12).

Reliable figures on the costs of compliance and the economic impact of the tax are difficult to obtain. Although the Canadian Jewellers Association estimates taxpayer compliance costs at about $38 million in 1990, the Department of Finance considers the actual amount to be much lower. Similarly, although members of the jewellery industry suggest that elimination of the tax would increase jewellery sales in Canada by 30 to 60 per cent, these estimates are regarded as exaggerated by the Department of Finance. Further, though the tax likely has had some impact on the underground economy, it is difficult to assess the size of this sector accurately (the Department of Finance estimates annual underground sales to be between $181 million and $638 million), and difficult to determine the extent to which the luxury tax – as distinct from other taxes – is responsible for this result (Canada Department of Finance 1993c, 11).

US Experience

The US luxury excise tax was enacted by the Omnibus Budget Reconciliation Act of 1990 and became effective on 1 January 1991. Levied at 10 per cent of the amount by which the sales price exceeds specified threshold amounts, the tax was imposed on five categories of items: private boats costing more than $100,000, passenger vehicles (including light trucks and vans) costing over $30,000, private aircraft costing over $250,000, jewellery costing over $10,000, and furs costing over $10,000. In most cases, the tax was collected by retailers and submitted to the federal government on behalf of the taxpayer, though individuals importing and using items that would have been subject to tax if sold in the United States were directly responsible for paying the luxury excise tax on these items. In each case, taxpayers could deduct the luxury tax from taxable income when calculating federal income taxes.

The impact of the US luxury tax was reviewed in a February 1992 study by the General Accounting Office (GAO) of the United States Congress (1992). Gross revenues (before deducting reduced income tax revenues) amounted to $168.4 million in 1991, roughly 90 per cent of which ($151.5 million) was derived from the tax on passenger vehicles worth more than $30,000; most of the remainder was obtained from sales of jewellery ($9.2 million) and boats ($7.3 million) (United States GAO 1992, 33). As a result, luxury tax revenues accounted for slightly less than 0.02 per cent of total US tax revenues in 1991.[4]

Total administrative costs to collect the tax in 1991 were estimated at roughly $500,000 (less than 0.3 per cent of revenue raised), which compares favourably to collection costs for most other kinds of taxes (United States GAO 1992, 3). Further, these collection costs were expected to diminish after 1991, after one-time implementation costs had already been incurred. The General Accounting Office was unable to provide any figures for compliance costs imposed on retailers; nonetheless, in states which already had retail sales taxes, it speculated that additional costs would be minimal.

The GAO had more difficulty assessing the economic impact of the tax and determining who ultimately pays the tax. Although sales of all taxable items declined following the introduction of the tax, the GAO was unable to quantify the impact of the tax or to distinguish its impact from the effect of the recession, of increases in the "gas guzzler" tax on sales of luxury cars, and of product liability costs on airplane sales (United States GAO 1992, 2). The GAO was also unable to assess the impact of the tax on the price of taxable items; based on economic models, however, it concluded that the price of items subject to the tax likely increased when the tax first took effect, but by less than the full amount of the tax. Over the longer term, it predicted that prices would fall as consumers and producers shifted to untaxed substitutes, with a larger proportion of the tax ultimately paid by consumers.

---

[4] Calculations based on estimates of total US tax revenues for 1991 presented in OECD (1992c, 179).

Overall, assessments of the US luxury excise tax were largely unfavourable, while tax revenues were minimal. Perhaps not surprisingly, the US Congress voted to abolish the tax as part of the recent US federal budget.

Difficulties with Luxury Taxes

Based on Canadian and US experience, there are a number of difficulties in trying to use luxury taxes to enhance the progressivity of the tax system, particularly in a province like Ontario that is already vulnerable to cross-border shopping.

Identifying the luxuries themselves is the first difficulty. Since there is no universal definition for luxury items, both the products selected and the threshold levels established must, as the General Accounting Office notes, reflect "subjective decisions about which products are luxuries" (United States GAO 1992, 2). In fact, luxury taxes in Canada, the United States, and other countries have applied to perfumes, cosmetics, expensive clothing, luggage, home appliances, electronics, sporting goods, and cameras. Further, the use to which the item is put (business or personal) may determine whether it is characterized as a luxury. For example, the US luxury excise tax exempted boats and passenger vehicles used exclusively for business purposes and aircraft used predominantly (at least 80 per cent) for business purposes.

A second difficulty involves tax avoidance and evasion and possible increases in the administrative and compliance costs that must be incurred to collect the tax. To some extent, these problems are created by the introduction of thresholds and exemptions, which may be used to define luxury items in the first place. In both Canada and the United States, for example, one kind of avoidance strategy has involved improvements to non-taxable items (modifications to jewellery, or installing parts or accessories on boats, cars, or aircraft) that would have rendered the items taxable if made prior to the original purchase. Although the US Internal Revenue Service (IRS) introduced regulations to tax improvements such as these, this area was reported to be the most difficult part of the luxury excise tax for the IRS to audit and the most costly for businesses to comply with (United States GAO 1992, 36). Another avoidance strategy in Canada, which exempts small manufacturing companies regardless of whether they are members of a larger corporate group, involves the use of multiple corporate structures to qualify for the small manufacturer's exemption (potentially more than once) and to set up separate marketing and distribution operations that might otherwise fall within the tax base if conducted within the manufacturing company.

The problem of legal avoidance of a provincial luxury tax in Ontario, however, is likely to be exceeded by opportunities for illegal evasion. Current experience with cross-border shopping suggests that Ontario residents could easily purchase luxury items in other provinces or the United States (now that it has abolished its tax) and either register items such as boats and aircraft outside Ontario or fail to declare purchases such as jewellery when returning to Ontario. The enforcement costs necessary to address this kind of evasion might be prohibitive.

Finally, US experience casts doubt on the effectiveness of luxury taxes in enhancing progressivity in the tax system. Since the revenue raised by an excise tax imposed only on select "luxury" items is almost certain to be small, the extent to which the tax contributes to the overall progressivity of the tax system is also limited. If the tax were to raise the same percentage of total tax revenue in Ontario as in the United States, it would collect about $5 million. Further, since it is not known who ultimately pays luxury taxes, it is uncertain whether such a tax would actually enhance progressivity or whether the burden of the tax would be shifted to less affluent taxpayers. Indeed, given the opportunities for cross-border shopping in Ontario, it is possible that the ultimate burden of the tax would fall on producers of luxury items in Ontario and their employees.

RECOMMENDATION 62

Ontario should not increase retail sales tax rates on selected luxury items or introduce a distinct excise tax on luxury items.

Part Ten
The Natural Environment and Taxation

25 The Role of Taxes in Protecting the Environment

Aside from raising revenue to pay for public services, one of the major uses of the tax system is to provide incentives to individuals and corporations to change their behaviour. These incentives raise two types of questions that fall within our mandate: How effective are these incentives in achieving their objectives? And, what are the implications for tax fairness of using taxes extensively to influence behaviour?

As public awareness of environmental issues has increased over the past 25 years, Ontario governments have introduced a wide range of environmental protection policies involving regulations, subsidies, public information, and taxation. These policies have addressed, or have been described as addressing, environmental issues as diverse as recycling and reuse, solid waste disposal, water and air pollution, acid rain, global warming, ozone depletion, energy conservation, and the disposal of used automobile and truck tires.

Environmental considerations have emerged in Ontario's taxation policies in a number of different ways. In some instances, the environmental rationale for the tax is clear and the design of the tax is consistent with that rationale. For example, Ontario's tax on new cars, which is based on their fuel efficiency, is clearly identified with an environmental objective. In other instances, environmental considerations have been advanced as a justification for the introduction of a new tax or for an increase in an existing tax under circumstances in which the environmental protection rationale is much less clear. For example, the tire tax, which was introduced in

1989 and repealed in 1993, never bore any relationship to the costs of disposal of used tires. Similarly, successive Ontario ministers of finance have justified increases in gasoline and motor vehicle fuel taxes on environmental protection and energy conservation grounds without ever making any of the changes that would make these taxes more effective in achieving either of these objectives.

In chapter 11 we addressed the problems raised by taxes that create the impression they are levied for environmental purposes when, in fact, they are not. In this chapter we consider the role of taxes in relation both to policy instruments available to government for environmental protection and to specific environmental policy objectives.

Environmental problems arise from virtually every human activity. In some situations, regulation is the appropriate public policy response. In other situations, regulation is considered to be impractical or inappropriate, and taxation comes into consideration as one of the possible alternatives. Regulation tends to be most appropriate as a policy response where the number of individual activities giving rise to the environmental problem is relatively limited. For example, regulation is ideally suited to the control of emissions that produce acid rain because there are a few very large point sources involved. Similarly, regulation can be effective in reducing the environmental damage caused by automobiles if it is applied to manufacturers. Regulation, because it establishes the basis for direct control over the amount of environmental damage caused by the product or process, is also better suited to situations where there is a desire either to eliminate an environmentally damaging product or process altogether, or to limit its impact in a predetermined fashion.

In contrast, taxation is most appropriate where there are large numbers of individual sources of pollution and where the objective is to reduce, rather than eliminate, activities that cause environmental damage. For example, carbon emissions from the use of fossil fuels are the result of millions of individual decisions about consumption. Regulation of these millions of individual activities would be extremely difficult. Taxation, in contrast, can provide people with incentives to reduce their carbon emissions at a relatively low administrative cost. Similarly, it may be impractical to eliminate an activity entirely, or even to reduce it substantially in the short term, but it may still be appropriate to impose a tax to compensate society for environmental damage caused by the activity and to provide an incentive for change in the longer term.

Environmental taxation emerged as an issue in our public hearings in response to the recommendations of the Environment and Taxation Working Group. The working group endorsed environmental taxation as a complement to regulation. Although the working group's recommendations were generally well received, they generated critical comment from two perspectives. Some people concerned about environmental quality objected to the idea, implicit in environmental taxation, that the level of pollution considered acceptable would be determined by market forces, and they described environmental taxes as cheap licences to pollute. They considered regulation to be preferable because it stated what level of pollution was acceptable. However, representatives of some industries potentially affected by environmental taxes expressed a preference for regulation over taxation. Representatives of industries such as mining and agriculture argued that environmental taxes would simply increase costs, without achieving any meaningful environmental change.

We accept that each of these arguments may be valid under certain circumstances. Environmental taxation is not the appropriate policy response to every environmental problem. However, we believe that environmental taxes, appropriately designed and applied in the right circumstances, have an important role to play in coordination with other public policies for environmental protection.

Environmental taxes can apply either to inputs of substances used in production by industries or consumed by individuals, or to outputs or emissions of polluting substances into air or water or onto land. The case for environmental taxes is based on the assumption that consumers and producers are able to make choices about what they consume and how and what they produce, and that prices or costs are taken into account in making those choices. If a tax increases the price to the individual of choices that impose relatively more environmental damage, choices will tend to be made that impose less environmental damage.

Tax and other economic policy instruments have a number of potential advantages over regulation. First, economic instruments take into account the fact that different individuals and businesses may incur different costs in reducing pollution. The most efficient way to reduce overall levels of pollution is to reduce pollution to the greatest extent in those industries or for those activities in which reduction is least costly. A regulation requires pollution to be reduced uniformly, regardless of the costs of doing so for individual producers. A tax, in contrast, gives generators of pollution a choice. If the tax is set at the right level, industries or individuals facing lower costs for reducing pollution will tend to reduce pollution more than would be required by a regulation; industries and individuals who face higher costs will pay the tax and generate more pollution than would be permitted by a regulation.

In a regulatory system, there is no incentive to continue to reduce pollution once the regulatory standard has been met. Where a tax is applied, however, there is always an economic incentive to reduce pollution, even where performance exceeds generally accepted standards. By providing an incentive for further improvement to those who can reduce pollution at a relatively low cost, an environmental tax can achieve general pollution reduction objectives without requiring those who can reduce pollution only at very high cost to suffer economic hardship.

A tax regime recognizes the fact that the individual consumer or producer is in the best position to determine the lowest-cost way to reduce emissions. This means, in turn, that administrative costs for both the polluter and the government may be lower especially where the regulatory alternative would require approval of particular pollution abatement technologies.

Setting the rate of tax is an important issue in environmental taxation. The effectiveness of an environmental tax depends critically on setting a tax rate that will result in the desired reduction in environmentally damaging activity. If the tax rate is set too low, the tax may raise a lot of money for the government, but will not result in any change in environmental behaviour. If the tax rate is set too high, the tax may improve environmental quality, but at a greater than necessary cost to the economy. The dilemma faced by policy makers is illustrated by the results of a study for the commission on carbon taxes, which found that only a relatively high rate of tax on fossil fuels would likely result in an appreciable reduction in carbon emissions overall (Donner and Lazar n.d.). In part for this reason, we believe that environmental taxes can be most effective not as substitutes for regulatory and other policies, but as complements to these policies.

The potential impact of an environmental tax on competitiveness is an important consideration in assessing environmental tax policy options. Environmental taxes may affect competitiveness because they are generally not sensitive to profits and because their impact may be concentrated in one sector of the economy or in a relatively small number of sectors. For example, at our public hearings farmers expressed the concern that a tax on pesticides would drive up agricultural production costs in Ontario compared with those in other jurisdictions that ship produce into Ontario or compete with Ontario producers in export markets. A similar point was made in the study on carbon taxation. The study found that while a tax at a modest rate on carbon dioxide emissions would not increase costs dramatically in most sectors, it could increase costs significantly in the primary metals, smelting, cement, and pulp and paper sectors (Donner and Lazar n.d.).

These issues must be addressed directly in designing policies for environmental taxation. In some sectors and for some environmental problems, the best approach may be to exempt certain sectors from tax and to deal with the environmental problems in that sector through regulation. In some instances, complementary tax reductions in other areas of business taxation to avoid any increases in overall tax levels may be appropriate. In other situations, special grants might be considered either to offset cost increases resulting from an environmental tax directly or to accelerate the introduction of new production processes and technologies that cause less environmental damage. For example, the Environment and Taxation Working Group recommended that a carbon tax be introduced only in conjunction with other business tax reductions and/or special targeted grants programs.

Practical considerations of administration and constitutional authority are also important. Environmental taxes are generally considered to be most effective if they are levied at the point where the critical decisions that affect environmental quality are made. As a result, the most effective approach to environmental taxation from the perspective of both environmental policy and administrative convenience and cost is often to impose the tax on manufacturers or distributors of environmentally harmful substances. However, if such taxes are designed as indirect taxes, in that they are intended to be passed on to the consumer, they fall outside the constitutional jurisdiction of the provincial government. For some types of taxes, these problems can be addressed by applying the tax at the level of final consumption in conjunction with existing sales and excise taxes, but they may be less effective in achieving their environmental objectives as a result. Where there is no existing administrative mechanism through which a new environmental tax is levied, design features should reflect the production, distribution, and consumption patterns in the industry affected. The Environment and Taxation Working Group suggested that administrative structures for environmental taxes should be developed through task forces representing all the parties likely to be affected by each tax.

Some general standards should apply to environmental taxes, however. A tax that fails to vary with the quantity of pollution really does amount to a licence to pollute, and offers none of the advantages usually associated with taxes and other economic instruments for environmental protection. Environmental taxes should be designed to vary with emissions of taxable substances. Such taxes should also apply to all emissions of the taxable substance. If this is not the case, the system will produce a strong incentive to shift to untaxed forms of emission. Finally, the rate of tax must reflect the environmental costs and risks associated with the emission of the taxed substance. The minimal function of an environmental tax – compensating for the social costs of pollution – will not be achieved if the rate of tax is trivial relative to the social costs associated with emission of the taxed substance.

Because issues of environmental quality have been studied intensively in recent years, a great many substances have been identified by government agencies as particularly harmful to the environment and therefore as potential candidates for environmental taxation. Both the Ontario Ministry of Environment and Energy and Environment Canada have identified lists of substances causing environmental damage. Ontario should review those substances in the light of their tax potential as part of its policy response to the problems associated with their emission into the environment.

We believe appropriately designed environmental taxes have an important role to play in Ontario's mix of environmental policies. They are particularly well suited to situations where the public policy objective is to influence the decisions of large numbers of individual consumers, where regulation is impractical, or where the objective is in part to compensate society generally for the environmental costs imposed on it as a result of individual actions. It is also important, however, that the design of such taxes take into account legitimate concerns about competitive costs and administrative feasibility.

RECOMMENDATION 63

Ontario should increase its reliance on tax-related economic instruments directed towards pollution control. Ontario should establish pollution taxes on substances selected from generally recognized pollutants or lists of recognized pollutants, such as:

- **the Primary List of substances for ban or phase-out maintained by the Ontario Ministry of Environment and Energy;**
- **the Ministry of Environment and Energy Secondary List; or**
- **the National Pollutant Release Inventory.**

Such pollution taxes should apply to all discharges, whether into water (including sewers), land, or air. Such taxes should increase with the quantity of pollution and vary with the risks associated with the discharge of each substance.

In determining the appropriate mix of tax, regulation, and other instruments, Ontario should consider the extent to which the tax can be applied directly to the activities generating the pollution and the potential impact of each type of measure on industrial activity.

While it would be beyond our mandate to identify all the substances to which environmental taxes might apply, we have decided to focus on three areas: carbon dioxide emissions; rationalizing the use of transportation fuel taxes, road user charges, and the tax on fuel-inefficient vehicles; and ozone-depleting substances.

Carbon Taxes

Carbon dioxide emissions are a major factor in global warming, one of the world's major environmental issues. Climate change can have a dramatic and far-reaching impact. For example, the global-warming phenomenon may have implications for coastal flooding, energy use, forest growth patterns and productivity, availability of agricultural land and soil quality, and abundance and quality of water resources.

Emissions of gases that lead to climate change, known as "greenhouse gases," have received a great deal of attention in Canada and abroad. At the 1992 Environmental Summit in Brazil, Canada was one of more than 150 signatories to the "Framework Convention on Climate Change" document, which sets out a common framework within which countries are encouraged to pursue domestic policies to limit emission of greenhouse gases and establishes specific actions for greenhouse gas reductions.[1] Prior to this agreement, Canada's "Green Plan" proposed the goal of stabilizing national greenhouse gas emissions at 1990 levels by the year 2000. The Ontario Round Table on Environment and Economy went further and endorsed an 80 per cent reduction in global emissions by the year 2030 and a 20 per cent reduction by the year 2005.

Greenhouse gases are released when fossil fuels – natural gas, oil, coal, and wood – are burned to generate energy. The greenhouse gases include carbon dioxide, methane, and nitrous oxide. However, much of the discussion of greenhouse gas reductions has focused on carbon dioxide. It is estimated that carbon dioxide accounts for about 56 per cent of the past decade's increase in global warming potential. As a result, many environmental policy ideas have been geared towards a reduction in carbon dioxide emissions.

A carbon tax is one of many possible approaches to reducing carbon dioxide emissions. A carbon tax would be levied on fossil fuel energy inputs according to their carbon content. Fossil fuels with a relatively high carbon content, such as coal, would bear higher taxes per unit of energy content than fuels with a relatively low carbon content, such as natural gas. Under certain circumstances, the tax can provide an effective financial incentive to reduce use of fossil fuels and to switch from relatively high carbon fuels to relatively low carbon fuels.

The Environment and Taxation Working Group found that in studies of carbon taxation, estimates of economic impact, revenues,

---

[1] Much of the information in this section is derived from the Environment and Taxation Working Group (1992b).

and emission reductions vary widely. In one study, the federal Department of Finance found that a carbon tax designed to stabilize carbon dioxide emission at 1990 levels by the year 2000 would result in an approximately 0.2 per cent decline in real income, and that a carbon tax would be the most cost effective instrument for the achievement of the stabilization goal.[2] Another study of carbon tax options for Canada was carried out for Imperial Oil, Limited. This study, which is less favourable towards carbon taxes, argues that the tax would achieve only limited reductions in emissions at potentially great cost to the economy in terms of industrial competitiveness and inflationary pressures (Osten et al. 1991).

Despite the broad interest in carbon taxes, Sweden, Finland, and the Netherlands are the only countries that have actually introduced carbon taxes. Sweden originally imposed a relatively high rate of tax (approximately US$50 per tonne of carbon) and exempted major industrial sources of carbon dioxide, including iron and steel. More recently, Sweden reduced its tax rate substantially to approximately US$16 per tonne and broadened its base to include previously exempted industries. Finland and the Netherlands introduced carbon taxes in 1990. These taxes were introduced at lower levels than the Swedish tax, but they applied to all sectors. It is also worth noting that the European Community has considered carbon tax options.

Used as a complement to regulatory measures on emissions standards and energy efficiency, other taxes, and education, carbon taxation has a potentially important role to play in reaching Ontario's greenhouse gas reduction goals. Carbon taxes generally compare favourably with other environmental policy instruments. Studies demonstrate that carbon taxes are associated with lower economic costs than regulatory measures designed to achieve the same reduction in carbon dioxide emissions (Environment and Taxation Working Group 1992b). In addition, carbon taxes may help reduce other greenhouse gases, toxic pollutants, and ground-level ozone by promoting energy efficiency.

Carbon tax rates must be set to balance several policy objectives. Ideally, the tax should be set at rates that reflect the social cost of carbon dioxide emissions. Apart from the difficulties in measuring social costs, the main constraint in setting a tax that reflects these

[2] Cited in Environment Canada (1992, 16, 58).

costs is competitiveness. Given these constraints, the best solution is to set the tax at a level that sends a clear signal for carbon dioxide reduction, while not jeopardizing the competitiveness of Ontario's commercial and industrial sectors.

The commission sponsored a research project that examined the competitiveness implications of a carbon tax for Ontario (Donner and Lazar n.d.). The study, as well as the consultation carried out by the Environment and Taxation Working Group, suggests that there are really two competitiveness issues in introducing a carbon tax. One issue concerns appearances – the signal a unilateral carbon tax sends to business investors that a government's commitment to an environmental policy agenda may increase operating costs over time relative to those in other jurisdictions. The second issue is the actual impact of such a tax on Ontario's business operations compared with other jurisdictions.

The issue of appearances is difficult to pin down. Many other jurisdictions have much more stringent environmental regulations than Ontario and manage to survive economically. Furthermore, the argument that appearances have an impact on decisions independent of the substance of policy implies a level of irrationality in corporate decision making that is difficult to square with the sophistication of corporate activities in virtually every other area.

We are sensitive to the substantive competitiveness concerns raised by the introduction of a carbon tax in Ontario. A general comparison of energy costs between Canada and the United States indicates that costs in Canada may be lower than in the United States in electricity and natural gas, but higher in coal and industrial oil (International Energy Agency 1992). Thus, a carbon tax on energy inputs in Ontario would harm the competitive position of Ontario operations relative to US operations. However, Ontario can meet the objective of reducing carbon dioxide emissions by introducing a carbon tax at a moderate rate and decreasing other business taxes, introducing new or expanded grants to energy-intensive sectors or subsidies for the adoption of energy-efficient capital equipment, or some combination of these measures. In addition, a carbon tax regime should be sensitive to the particular impact of carbon taxes on important industries that are not in a position to alter their carbon consumption in response to tax/price changes in the short term. An approach such as this can result in clear tax incentives for carbon dioxide reduction without the negative economic impact often associated with carbon taxes.

Based on carbon taxes in other jurisdictions, a modest tax (approximately $25 per tonne carbon content) applied without any major exemptions would generate about $1 billion in revenues. It would raise the average monthly residential heating bill by approximately $2.85 and could increase gasoline prices by two to three cents per litre. The study conducted for the commission examined this level of carbon tax and found that, with the possible exception of a few energy intensive sectors, the tax would increase production costs by only 0.1–0.7 per cent (Donner and Lazar n.d., table 24).

An important policy question is how to treat the most carbon intensive industries, which have a limited capacity to respond to a tax in the short term. For example, the only carbon reduction options available to the steel industry involve significant investments in new technologies that have not been proven and could only be made in the long term. There are at least three possible reasons for regulating carbon dioxide emissions from these carbon intensive operations rather than taxing them. First, it can be argued that regulation through the establishment of limits on carbon emissions can improve certainty in reaching emission reduction targets for large sources. These limits can be set through emission quotas on a firm-by-firm basis, and might include a provision that allows firms to trade their quotas to limit total emissions rather than the emissions of individual firms. Second, if emission quotas are negotiated, the regulatory approach can be more sensitive to an operation's unique financial situation than a tax. For example, a system of regulated carbon dioxide quotas could be sensitive to the difficulties faced by resource companies due to falling resource prices on the world market, or the problems Ontario Hydro faces in increasing its power rates.

RECOMMENDATION 64

Ontario should introduce a tax on all fossil fuels consumed in the residential, commercial and industrial, and transportation sectors based on the carbon content of fossil fuel energy inputs. For the largest sources of carbon dioxide emissions, carbon dioxide emission limits should be negotiated and established through regulated limits. The tax should

apply to those sources only if they fail to meet agreed emission limits within the established timetable.

A separate issue is whether a carbon tax in the range of $25 per tonne carbon content will have any impact on fossil fuel consumption and, therefore, carbon dioxide emissions and environmental quality. The study conducted for the commission suggests that this level of tax would have only a marginal impact on decisions about fossil fuel use in Ontario. If combined with other regulatory and educational policies, however, the tax could play an important role in stimulating environmental change and investment in new capital equipment. The potential for change would also increase if revenues were spent to advance energy efficiency and environmental objectives.

Rationalizing Road Use Charges and Fuel Taxes

Taxes on motor vehicle fuels and vehicle registration fees have been justified as a kind of fee for the use of the public roads system. More recently, these taxes have been justified as measures to promote energy conservation and environmental protection. The fact that Ontario's motor vehicle fees and fuel and gasoline taxes are not well designed for either purpose has not prevented governments from rationalizing increases in fuel excise taxes both as payments for road use and as economic incentives for fuel conservation. When specific design features of the Ontario Gas Tax, the Ontario Fuel Tax, the Ontario Tax for Fuel Conservation, and Ontario vehicle registration fees are examined, it is difficult to find a consistent rationale for these charges. Rationalization of the system would require changes in existing taxes as well as the introduction of new taxes that serve stated objectives.

The distinct policy objectives of accounting for environmental costs and paying for road use require a number of different tax instruments. The importance of employing a range of tax and fee instruments for these purposes should not be understated. With fewer instruments, relatively high rates of tax are required to influence behaviour to support environmental goals and to raise revenue for transportation expenditures. Higher rates, in turn, generally lead to increased tax avoidance and the loss of revenue to other jurisdictions. If the Ontario Gas Tax, for example, were the sole instrument employed in the generation of revenues for transportation infrastructure and to compensate for environmental costs associated with vehicle use, many Ontario residents would purchase gasoline in the United States. In addition, tourists would find it more expensive to vacation in Ontario. By contrast, a moderate gas tax combined with road tolls, a redesigned vehicle licence system, and an environmental tax on fuel-inefficient vehicles might achieve the same objectives with less undesirable economic disruption.

Taxes on Transportation Fuel

In principle, a broad-based carbon tax should apply to transportation fuels in the same way as it applies to all other energy inputs in other sectors. The portion of carbon tax that applies in the transportation sector could be levied in conjunction with the current gasoline and fuel taxes, the retail sales tax, or through a separate carbon tax. One problem with using the gasoline and fuel taxes as the administrative vehicle for a carbon tax is that the base for these taxes is too narrow. Off-road uses, natural gas, and fuel purchased by marine vessels are exempt. These exemptions would undermine the effectiveness of a broad-based carbon tax. If the carbon tax in the transportation sector is administered through the gasoline and fuel tax system, these taxes should be revised to include off-road use, natural gas used in the transportation sector, and marine vessel fuel.

There are several reasons why the carbon tax on transportation fuel should be higher than the tax on other carbon-producing fuels. First, if the carbon tax is applied to transportation fuel at a level which is substantially lower than the current level of taxation through gas and fuel taxes, much of the ground previously gained in encouraging fuel conservation will be lost as fuel consumption increases. Second, the carbon tax inclusive price of fuel will only reflect the environmental cost of using the fuel and not the cost of road use, which is also a valid component of a tax on transportation fuel. Third, the impact of urban smog on the environment and human health suggests that the use of transportation fuels results in a greater degree of harm than their use in other sectors. This argument suggests that in the long term the tax on transportation fuels should be higher than the tax in other sectors.

For these reasons, we suggest that the current level of taxation on transportation fuels be maintained in the short term and that the level be brought into line with the tax on other carbon-producing energy sources after businesses have had a chance to adjust and a system of road use charges has been developed.

RECOMMENDATION 65

To maintain incentives for fuel conservation and to reflect the higher environmental costs associated with transportation use, Ontario should retain a rate of tax on transportation fuels higher than on energy consumed in other sectors.

Taxes on Fuel-Inefficient Vehicles

Environmental taxes should not be set at such high levels that consumption is simply shifted to other jurisdictions and the net result is a substantial loss in revenue. Differences in fuel tax levels between Ontario and neighbouring US states have resulted in less business activity in border towns and declines in tourism (figure 25.1). This may change somewhat with the US energy tax of 4.3 cents on all transportation fuel, except commercial airline fuel, which came into effect in October 1993.

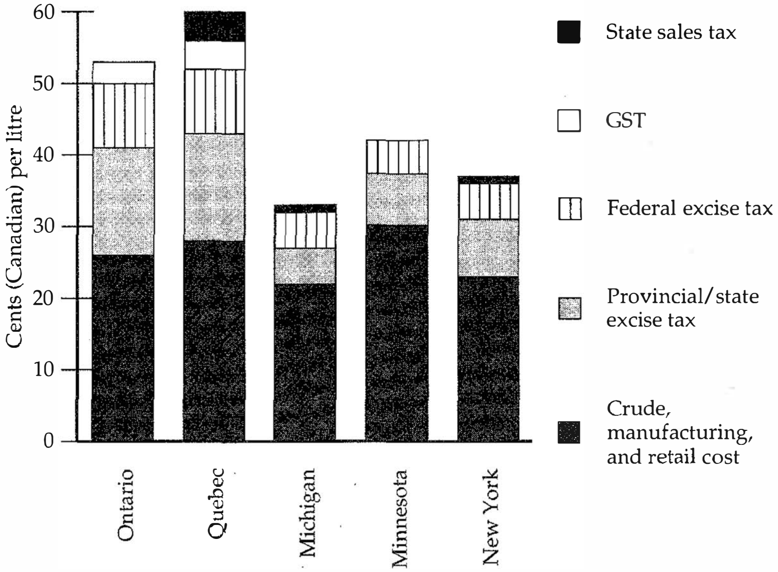
To ease the pressure on fuel taxes as the sole means of encouraging vehicle fuel conservation, taxes on fuel-inefficient vehicles have been applied in Ontario and other jurisdictions. The most prominent of these instruments is Ontario's Tax for Fuel Conservation, which provides a subsidy or rebate on the purchase of relatively efficient new vehicles and applies a tax on relatively inefficient new vehicles.

One of the gaps in the Tax for Fuel Conservation results from the fact that it does not apply to a large proportion of the vehicles sold in Ontario. The tax applies only to passenger cars and sport utility vehicles. Light trucks and vans are excluded from the tax/credit scheme, although they account for approximately 25 per cent of the vehicles sold in the province.[3]

---

[3] Sales figures based on 1992 estimates from Ontario Ministry of Environment and Energy, Policy Division, Economic Services Branch.

FIGURE 25.1
Comparative Prices of Gasoline, March 1993



Source: Ontario, Ministry of Finance, Tax Policy Branch.

Even where the tax does apply, the design of the tax undermines its potential value as an environmental measure. Current rates of tax as a percentage of the purchase price of the vehicle are probably too low to affect consumer choices to any significant extent. The rate structure contributes further to this ineffectiveness. Because about 90 per cent of passenger cars sold in Ontario currently fall in the fuel-efficiency range that attracts a $75 tax, for practical purposes the tax applies at a flat rate.

Insofar as the Tax for Fuel Conservation does change behaviour, there is concern that it may cause harm to the Ontario economy if a large proportion of vehicles produced in the province are less fuel efficient than imported vehicles. However, this concern is unjustified for two reasons. First, Ontario production is largely exported to the United States and thus is not subject to the tax. Second, the average vehicle manufactured in Ontario is actually relatively more fuel efficient than the average vehicle sold in Ontario (Millyard 1992), and thus is subject to less tax, on average, than imported vehicles.

The Tax for Fuel Conservation also generates opposition on the grounds that it creates the perception that environmental constraints in the transportation sector are more stringent in Ontario than in other jurisdictions. Car manufacturers often stress the importance of these perceptions in choosing locations for production, and threaten to relocate outside Ontario if the tax is expanded. Since more onerous environmental restrictions on motor vehicles exist in other jurisdictions, this argument does not carry much weight. Under the US Clean Air Act, for example, California sets tighter restrictions on vehicle emissions than any other jurisdiction in North America. The state of Maryland has recently introduced a special tax on fuel-inefficient vehicles. In light of these initiatives, it is difficult to sustain the argument that Ontario's Tax for Fuel Conservation is a special burden for vehicle manufacturers.

RECOMMENDATION 66

Ontario should extend the Tax for Fuel Conservation to light trucks and vans and then adjust the rates to provide a stronger incentive to purchase fuel-efficient vehicles.

Taxes to Support Roads

Government expenditures on our road system are significant; road users gain substantial benefits as individuals from that system. Spending typically involves outlays on infrastructure, such as road construction and maintenance, as well as expenditures related to proper and safe use, such as the enforcement of traffic laws and the administration of vehicle registration.

The primary purpose of a system of benefit taxes for road use is to strengthen the relationship between the tax paid and the benefit received by the road user, thereby generating economic benefits and improving fairness.

Traditionally, motor fuel taxes and vehicle registration fees have been viewed as the most appropriate changes, in a notional sense only, for road use in Ontario. While revenues from vehicle registration have increased to approximately $600 million in recent years, taxes on motor fuels are a more important source of provincial revenue. As figure 25.2 shows, revenues from motor fuel taxes have increased steadily over the last decade. In 1991–92 motor fuel taxes generated approximately $2 billion, or 5 per cent of total provincial revenue (Ontario *Public Accounts* 1991–92).

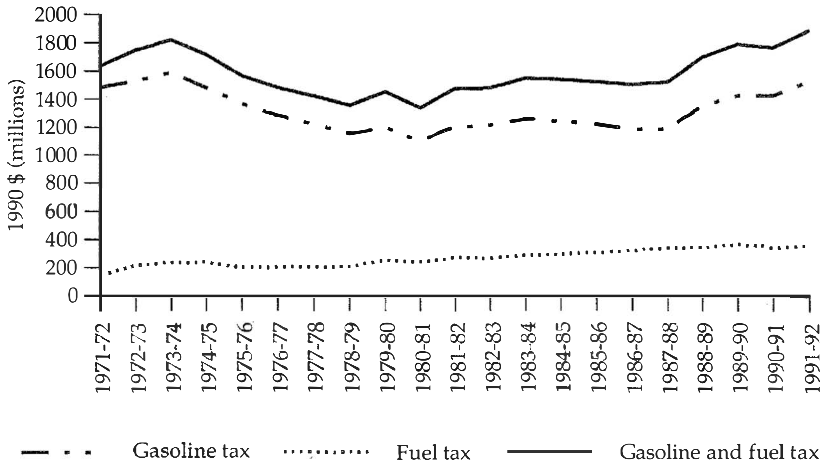
To determine whether users are paying the full cost of road use, revenues generated by fuel taxes and vehicle registration fees are often compared with road-related expenditures in the province. However, a broader comparison is appropriate since these levies are not earmarked for road-related costs and currently serve the functions of a provincial sales tax on transportation fuels, an energy tax on transportation fuels, an environmental tax on vehicle emissions, and a fee for road use. Of the $2.6 billion generated from transportation fuel taxes and vehicle registration fees in 1991–92, approximately $588 million can be seen as the portion that would be raised by the retail sales tax if it were levied on transportation energy.[4] The remaining $2 billion can be viewed as an excise tax both to encourage energy conservation, reflecting the environmental costs associated with transportation energy consumption, and to charge drivers for the use of roads and highways. Given that the province spent over $2 billion on roads in 1991–92 (Ontario *Public Accounts* 1991–92, 4-473), it is clear that the road-use portion of fuel taxes falls short of the costs of the road system.

The road system provides benefits to businesses and individuals other than the direct users of the infrastructure. Given the broad distribution of benefits among the Ontario public, there is no necessary fault in the current revenue shortfall. More serious are the economic and fairness problems created by the existing system's inability to reflect users' benefits accurately. The deterioration of transportation infrastructure varies with frequency of use and vehicle weight. The current system of charges can be viewed as accounting for frequency of use through motor fuel taxes, and for weight through vehicle registration fees. These instruments, however, lack design features that would enable them to reflect these costs more accurately.

---

[4] Fair Tax Commission calculation based on Ministry of Finance, *Ontario Budget 1993*, and Energy, Mines and Resources average gas and fuel prices in Toronto (mimeo from Canadian Oil Markets and Emergency Planning Division, Energy Sector, Energy, Mines and Resources).

FIGURE 25.2
Revenues from Motor Fuel Taxes, Ontario, 1971–72 to 1991–92 (1990 $)



Source: Ontario, *Public Accounts, 1971–72 to 1991–92*; Statistics Canada, *Consumer Prices and Price Indexes*, Cat. 62–010 (Ottawa, 1993), table 8.

In addition, because of wide variations in vehicle fuel efficiency, motor fuel taxes may fail as a proxy for road use. Owners of relatively efficient vehicles will pay less for road use than owners of relatively inefficient vehicles because they are consuming less fuel, and thus paying less tax, for every kilometre they drive. This might be justified on the basis that more efficient vehicles are also lighter and therefore less damaging to roads. For most passenger vehicles, however, differences in weight are only marginally significant in the determination of road wear.

An alternative to fuel taxes which would capture the cost of road use more accurately is a revised road use fee based on distance travelled and vehicle weight, and levied as part of the annual vehicle registration fee. Currently, passenger vehicle registration fees in Ontario are based on the region of registration only. Vehicle owners pay $90 per year in the Greater Toronto Area, $66 elsewhere in southern Ontario, and $0 in northern Ontario. To reflect road use, mileage-based registration fees could eventually replace the road use portion of transportation fuel taxes. The vehicle registration system could also be used to address the environmental problems caused by poorly maintained vehicles. A portion the registration fee could be tied to vehicle inspection results.

RECOMMENDATION 67

Ontario should establish a new system of vehicle registration based on mileage, vehicle inspection results, and other vehicle characteristics related to road use, such as weight. Fees raised from this system should replace a portion of the revenue currently raised from transportation fuel taxes. Until this system is implemented, transportation fuel taxes should remain at their current levels.

Commercial vehicle charges are more consistently structured to reflect benefits than passenger vehicle charges. Fees range from $109 for vehicles under 3500 kilograms, to $1689 for vehicles above 40,000 kilograms (Ontario Highway Traffic Act 1991, R212–R213).

Commercial vehicle registration fees should be based on distance travelled in Ontario as well as weight. Ontario should investigate ways of applying this system of charges to out-of-province vehicles so that Ontario companies are not disadvantaged. Truckers based in Ontario and out of the province already keep mileage log books for calculating fuel taxes. These logs might be used to determine kilometres travelled in Ontario and vehicle registration fees owed by all truckers regardless of origin.

Taxes on Ozone-depleting Substances

A number of substances used in Ontario have been linked to depletion of the Earth's ozone layer. These substances or families of substances include chlorofluorocarbons (CFCs), which have been used as blowing agents in rigid and flexible foam, and as refrigerants in refrigerators, freezers, air conditioners, and heat pumps; brominated compounds (halons), which have recently been used in fire extinguishers; methyl bromide, which has been used as an agricultural pesticide; and methyl chloroform and carbon tetrachloride, which have been used as solvents. Ozone depletion caused by these substances can lead to increased incidence of skin cancers and eye cataracts, suppression of the human immune system, damage to plant life, and damage to aquatic organisms.

By applying a tax on ozone-depleting substances, their price would increase, thus encouraging a reduction in their use and making substitutes economically more attractive. In 1989 the United States applied a system of special environmental excise taxes to CFCs, halons, methyl chloroform, and carbon tetrachloride. The tax rate increases with the ozone-depleting potential of the substance and is set to increase gradually over time. For various CFC products, rates in 1992 varied from about $1.00 to $1.70 per pound (US Department of Treasury, Internal Revenue Service 1991, 4). The tax also applies to imported products containing or manufactured with ozone-depleting substances when the product is first sold or used by its importer. At this time, no such tax applies in Ontario or anywhere else in Canada.

The purpose of introducing an environmental tax on ozone-depleting substances would be to reduce the use of these substances in the province. Thus, the tax should apply on the broadest possible base and should not exempt any of the major ozone-depleting substances used in Ontario unless administrative constraints are prohibitive.

The impact of such a tax on the use of specific substances would depend on the regulatory framework as well as the short-term availability of substitute products. In the case of CFCs, government established targets for the phase-out of the sale and production of CFCs have led to the search for alternatives in the production of foam products as well as in air conditioning and refrigeration. The two existing viable substitutes to CFCs are known as HCFCs and HFCs. Although HCFCs are thought to deplete ozone, they have only one-tenth to one-twentieth the ozone-depleting potential of CFCs. HFCs are believed to have no ozone-depleting impact.

Although the regulatory structure has been effectively used to eliminate the production of CFCs, there is still a role for the tax system in reducing their use. No CFCs are currently produced in Canada, but they are imported for use in the repair of old equipment, including refrigerators and air conditioning units. In addition, provincial regulations prohibiting the use of new ozone-depleting substances will likely result in the use of recycled CFCs and HCFCs in older vehicles.

Despite provincial regulations, there are two ways in which ozone-depleting substances can escape into the environment. First, while intentional venting of ozone-depleting refrigerants is prohibited under the regulations, equipment will continue to leak and require refilling. Second, the regulations do not apply to all ozone-depleting substances used in the province. Products not affected include halon, methyl bromide, methyl chloride, and carbon tetrachloride.

It is clear that regulation cannot eliminate the use of ozone-depleting substances. This suggests that a tax on recycled CFCs and HCFCs, combined with a tax on new CFCs and HCFCs as well as on ozone-depleting substances not covered by the regulations, could complement current and future regulations and potentially hasten the reduction of ozone-depleting substance use in Ontario.

The impact of the tax would differ among substances. In some cases, the tax would encourage short-term substitution of a less harmful substance. For example, the tax may accelerate substitution of HFC substances for CFCs in refrigeration equipment. Similarly, the tax could accelerate and broaden substitution from CFCs to non–ozone-depleting terpene-based solvents in the electronics industry. In other cases the tax would encourage substitution in the longer term, or short-term reduction without substitution. For example, though it may be difficult to find an effective substitute for halon in fire extinguishers in the short term, a tax could discourage its release into the environment through short-term reductions in unnecessary uses and by providing an incentive to search for a viable long-term alternative. Likewise, a tax on methyl bromide could provide an incentive to reduce pesticide application in the short term and to find a less harmful substitute in the long term.

There are at least two main issues to be addressed prior to the introduction of an ozone-depleting substance tax in Ontario. The first issue is the point of application for such a tax. Options include points of importation and production, point of purchase for final consumption, or some combination, depending on the substance. The decision on point of application will ultimately hinge on administrative ease and Ontario's constitutional authority to levy particular forms of tax.

The second issue is the timing for introduction of such a tax and the design of the tax in the context of current and emerging regulations. Given Canada's commitments to phase out production and consumption of a wider range of ozone-depleting substances under the most recent round of agreements between the major industrialized countries formalized in the Montreal Protocol, it is possible that many of the substances would be regulated out of use prior to, or shortly after, introduction of a tax.

RECOMMENDATION 68

Ontario should introduce an environmental tax on all ozone-depleting substances used in the province, whether new or recycled. The government should ensure that the tax closely complements the province's existing and emerging regulatory framework.

26 Environmental Charges for Water and Sewer Services and Solid Waste

The examples of environmental taxation reviewed in the preceding chapter all dealt with specific substances or activities causing environmental damage. Even where specific harmful substances are not a concern, however, the volume of emissions may give rise to environmental problems. The most obvious examples involve the generation and disposal of liquid and solid waste in the household, industrial, commercial, and institutional sectors of the economy. In addition, concerns about resource conservation may arise even where there is no specific environmental problem with waste disposal. These areas are also distinguished from the specific issues discussed in chapter 25 by the fact that, to varying degrees, the public sector is involved in the process. The public sector is largely responsible for water and sewer services. In the case of solid waste, the public sector is responsible for the disposal of most household waste and a portion of waste generated in the industrial, commercial, and institutional sectors.

The logic that supports increased reliance on environmental taxes to address specific pollution problems also suggests that the prices charged for water and for sewage and solid waste disposal can influence the amount of solid waste generated and water used. If water is made available free, or at a price that does not vary with the amount consumed, there is no incentive for the individual consumer to conserve water and therefore limit the volume of liquid waste generated. Similarly, if the cost to the individual of disposing of the solid waste he or she generates is independent of the amount generated, there is no economic incentive to reduce, reuse, or recycle to cut down on the amount of waste for disposal in landfill sites. This chapter explores the potential role of pricing policies for environmental services, in conjunction with other policies, in reducing the environmental problems caused by solid waste disposal and excessive water use.

Water and Sewer User Fees

A clean, secure water supply is a critical factor in maintaining the health of the Ontario economy. Water is not only vital to human life, but is also an important input both for industrial production and for the generation of electric power. Water treatment for consumption and disposal is also a significant area of public spending in Ontario. However, the system of pricing of water in Ontario does not adequately reflect either the importance of water to the Ontario economy or the public cost associated with water treatment. Although pricing systems vary among municipalities, in general they bear little or no relationship to levels of water consumption. This creates problems of tax fairness as well as of environmental quality and public sector economy. Because prices do not reflect the cost of water usage, those who consume large amounts of water are subsidized by those who consume less. In addition, both environmental and public sector costs associated with water treatment and liquid waste disposal are higher than they should be. The environmental and economic consequences of subsidized water consumption led the Ontario Round Table on Environment and Economy to conclude that Ontario's system of water charges should reflect the full social and environmental costs of water use. The current system falls far short of that objective. A reformed system of water and sewer user fees would improve fairness, encourage conservation, and improve water quality.

Ontarians rely on an abundant, clean water supply. Water is used for private residential purposes such as drinking and lawn care, as well as for public purposes such as fire-fighting and street cleaning. Water resources are also used as an input in commercial and industrial production and by utilities in generating electricity. Agriculture is an intensive consumer of water for irrigation. The breakdown of water uses in Ontario is presented in table 26.1.

TABLE 26.1
Water Withdrawal in Ontario, 1986

Sector	Intake – millions of cubic metres per year	Percentage of total intake
Agriculture	166	0.6
Mineral extraction	100	0.4
Manufacturing	3,763	14.7
Thermal power generation	19,967	78.0
Municipal	1,602	6.3
Total	25,598	100.0

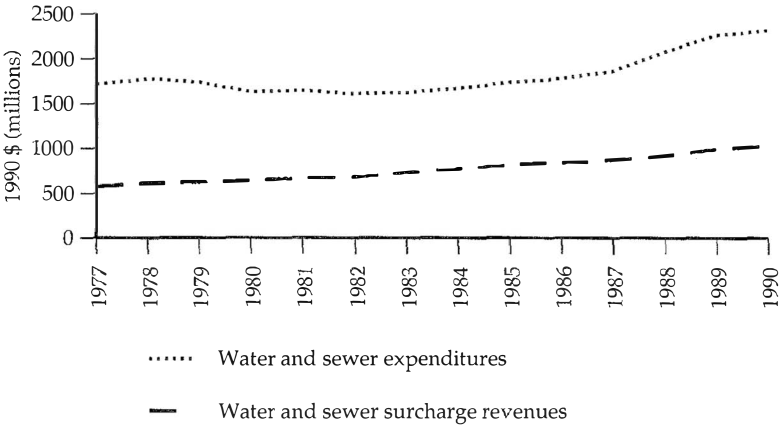
Source: Data provided by Environment Canada, Economics and Conservation Branch.

Ontarians pay for water-related services in part through water and sewer charges levied by municipalities, and in part through taxes paid at the provincial and municipal levels. The degree to which the cost of local water and sewer services is subsidized by taxpayers varies by municipality.

Ontario municipalities levy water and sewer charges as well as "extra-strength sewer surcharges." Water withdrawal charges apply to the consumption of water and may cover the extraction of the water from a natural source, treatment to make it suitable for human consumption, and distribution to final consumers. Sewer charges are generally based on water consumption and a formula related to building characteristics (primarily the number of toilets in the building), because metering of sewer discharges is impractical. The major exception is extra-strength sewer surcharges, which are levied on the discharge of particular substances into the sewer system and may cover treatment or environmental costs. These surcharges are applied in a limited number of municipalities to a limited range of substances (Ontario Ministry of Environment 1988).

Water and sewer revenues in Ontario over the past 12 years have increased in absolute terms, on a per capita basis, and as a percentage of total municipal revenue. Expenditures have also increased and continue to exceed user fee revenue (figure 26.1).

FIGURE 26.1
Municipal Water and Sewer Revenues and Expenditures, Ontario (1990 $)



Source: Fair Tax Commission calculations based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

Evaluation of Current Water and Sewer Charges in Ontario

The basis for current water and sewer pricing structures in Ontario seems to be simplicity and the equalization of costs among users, regardless of consumption. This leads to a situation where payments for water and sewer services often fail to reflect levels of water consumption. Currently, with little regard for relative consumption levels, residential water rates across the province vary from a low of about $5 per month to a high of about $75 (Marshall, Koenig & Associates 1991, 11). In effect, households subsidize each other's water use.

In 71 per cent of municipalities that levy water user fees, residential rates are the type that do not vary at all with consumption (a flat rate) or that decline with increased consumption (a declining block rate) (see figure 26.2). The declining block rate pricing structure generally includes a basic or fixed service charge per period combined with a volume charge that decreases in steps or blocks as the volume consumed increases (Marshall, Koenig & Associates 1991, 6). In the remaining 29 per cent of municipalities, the dominant rate structure is the constant unit rate – a rate that does not vary with the level of consumption. These figures have remained essentially unchanged since 1986. It should also be noted that many block rate structures strongly resemble flat rates since the minimum charge (first block) tends to cover a wide range of water volumes. The figures were similar for the commercial sector in 1986 (see figure 26.3).[1]

The provincial government also contributes to the cost of maintaining the water system in Ontario. This complicates the determination of who actually pays for water use. There is some degree of provincial subsidization through provincial involvement in the ownership of water and sewer infrastructure in municipalities. In addition, the provincial government and regional municipalities often charge local municipalities wholesale prices for water and sewer services. Local municipalities may or may not pass these costs on to users through user fees. As a result, water use is subsidized to varying degrees in different municipalities through provincial and municipal taxes. Water and sewer user fees designed to reflect costs would ensure that households pay for water-related services on the basis of the benefits they receive.

User fees are most effective where taxpayers have some flexibility in the extent of their water consumption and are informed as to how to alter their use in response to increased user fees. As a complement to user fees, Ontario should distribute easily accessible information on water conservation practices.

In principle, water and sewer rates should be set at levels that reflect the full cost of providing the service, including both transmission and distribution costs, as well as the environmental costs associated with water withdrawal and its subsequent discharge back into the natural environment.

A number of issues arise in measuring costs. First, both fixed and variable costs must be taken into account. Fixed costs may arise from spending on infrastructure and hook-up, while variable costs are incurred in pumping, water purification, and maintenance of machinery and equipment.

---

[1] These data are available in Marshall, Koenig & Associates (1991, 9) and Ontario Ministry of Environment (1991a, 18).

FIGURE 26.2
Municipal Residential Water and Sewer Rate Structures, Ontario, 1986

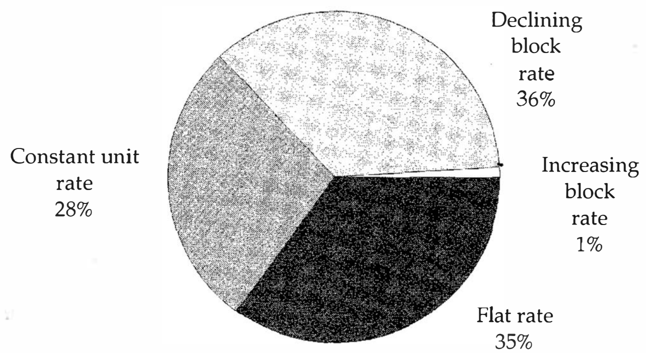
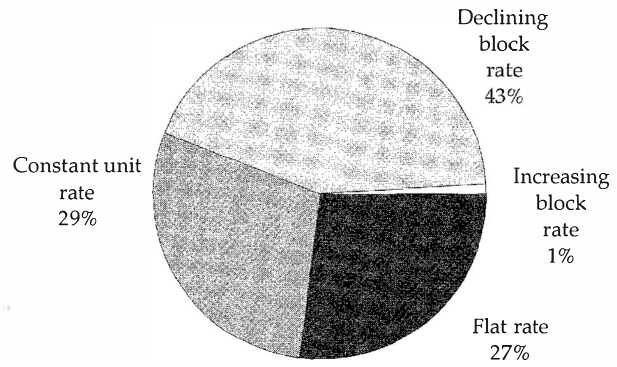


FIGURE 26.3
Municipal Non-residential Water Rate Structures, Ontario, 1986



Source: D.M. Tate, "Municipal Water Rates in Canada, 1986 – Current Practices and Prices," reproduced in Marshall, Koenig & Associates, "Background Study on the Pricing of Water and Sewer Services" (1991), tables 1 and 2.

Second, it is also difficult to calculate the environmental costs associated with water and sewer service. These are often difficult to measure in dollar terms. Environmental costs may also increase as overall use increases; for example, as sewer discharges increase, or as water temperature increases as a result of industrial and utility cooling processes.

If water and sewer rates were set to include all of these costs, there would be an increased incentive for consumers to reduce their consumption. However, given the measurement difficulties outlined above, rates can only approximate the environmental costs associated with water use.

There are serious problems with both the design and the level of current rates for sewer and water services. The common flat rate, declining block rate, and constant unit rate structures are not sufficiently sensitive to variations in unit costs of supply. Current rates also fail to recover the costs of providing the service. While full cost recovery is not necessarily an appropriate objective in setting rates, there is no evidence that local differences between revenues and costs are anything other than accidental. Moreover, these rate structures do not reflect environmental costs and thus do not provide an incentive for conservation and pollution reduction.

To account for fixed costs, variable costs, and environmental costs involved in resource use, charges might include a fixed amount to account for capital costs, and a variable charge to reflect the costs of water use and to provide some incentive for resource conservation. Other features such as seasonal pricing and pricing that increases during high-use periods (peak-load pricing) could improve the allocation of resources during high-demand periods.

Ensuring that water and sewer charges reflect the environmental costs of pollution is somewhat more complicated than providing incentives for conservation. These costs could be addressed either through expanded use of sewer surcharges in the water and sewer rate structure or through generally applicable pollution taxes.

The impact of moving closer to full-cost pricing from the current fee system for water would vary substantially among municipalities. A 1991 study for the Ministry of Municipal Affairs estimated the impact of implementing full-cost water and sewer rate structures in various municipalities (Marshall, Koenig & Associates 1991). Without considering environmental costs, the study indicated that household water cost increases could range from 11 per cent in Peel Region by 1994 to 70 per cent in the City of London by 1995. Sewer costs could increase in a range from 12 per cent in Peel to nearly 60 per cent in the Town of Carleton Place by 1994. These increases would be moderated if water consumption were to decline in response to higher prices. In addition, full-cost pricing would eliminate the need for the various provincial subsidies. While water and sewer rates might increase, provincial and municipal taxes would decline.

Since increases in some household water bills could be large, measures must be included to ensure that low-income households have access to an adequate level of service. One way to ensure access is to levy a flat or constant unit rate up to an average level of consumption, with increasing block rates for any additional units consumed. This approach would be consistent with the introduction of a fixed capital charge. Special "lifeline" rates for low-income consumers (which provide subsidized rates for basic consumption), increases in direct support payments, and income-tested exemptions are other possible approaches to ensuring broad access.

RECOMMENDATION 69

User fees should be applied for water and sewer services, based on levels of consumption and costs of providing the service. Such fees should apply to all sectors that consume these services.

Fees for water and sewer services should include a fixed amount to account for the costs of capital replacement, and a variable amount that reflects consumption.

To improve efficiency and to provide incentives for resource conservation, the user fee system should incorporate such features as peak-load pricing, seasonal pricing, and surcharges for hard-to-treat industrial, commercial, and institutional waste.

User fee systems should include such options as reduced, flat, or constant unit rates up to a minimum level of consumption, subsidized rates for basic service, and exemptions for low-income consumers to ensure that higher fees for sewer and water services do not bar low-income families from access to those services.

User Fees for Solid Waste Collection and Disposal

Solid waste collection and disposal is another service for which full-cost pricing would help to achieve greater tax fairness by ensuring that those who benefit from the service pay for it. User fees closer to full cost would reduce the need for municipalities to subsidize the service through property taxes, thereby shifting the cost from taxpayers generally to the specific beneficiaries. User fees of this kind would also provide an incentive for consumers to reduce their output of solid waste, thereby reducing pollution, conserving resources, and reducing the costs to municipalities and businesses of collection and disposal. In addition, the reduction of solid waste through user fees would support the Ministry of Environment and Energy's goal of diverting 50 per cent of solid waste from landfill sites by the year 2000. The understandable reluctance of many communities to host a landfill site for garbage from the Metropolitan Toronto area suggests that reducing the volume of solid waste should be a priority. The tax system can play an important role in achieving this goal.

Taxes raise the price of new materials relative to used materials, the price of garbage disposal, or the price of products and packaging that generate excess waste. Because producers are the primary decision makers in determining how products are packaged and because there are fewer producers than consumers, administrative costs are lower for taxes on producers that use excess packaging than for taxes on consumers. Unfortunately, a producer tax is subject to serious problems. First, it is likely beyond Ontario's constitutional authority to levy such a tax. To be effective as an environmental measure, it would have to apply to imports. And as a tax on producers that is intended to be passed on to consumers, it would clearly be an indirect tax. Second, unless some way could be found to exempt goods for export, it would create problems for exporters. Third, it would penalize consumers who avoid waste generation by returning packaging and products for reuse or recycling.

Packaging taxes applied at the consumer level can provide a signal for solid waste reduction while avoiding these complications involved in taxes at the producer level. Solid waste user fees make those who generate waste aware of the cost of municipal garbage collection and disposal and provide an incentive to reduce waste generated. Likewise, taxes on waste-generating products can help ensure that individuals pay when their behaviour imposes spillover costs on society. Further, a tax that serves as a refundable deposit can help encourage reuse and recycling of products and packaging that would otherwise be sent to landfill sites.

Governments provide for both collection and disposal of solid waste. Fees could apply to one or both of these stages in the waste management process. At the collection stage, residential, industrial, commercial, and institutional user fees might be based on volume or weight and type of waste. At present, user fees for waste collection are common only in the industrial, commercial, and institutional sector. In this sector, private contractors play a major role in the collection system, and the municipalities that collect this waste levy special fees for the service. In the residential sector, user fees have been levied only on an experimental or pilot project basis. Indeed, until recently the Municipal Act did not expressly provide local municipalities with authority to impose user fees for residential waste collection.

At the disposal stage, user or "tipping" fees could be based on volume or weight, or type of waste if sorted at collection. Debates over appropriate use and levels of tipping fees in Ontario are complicated by the fact that both the public and private sectors are involved in waste collection and disposal. For collection, private haulers are often contracted to service the industrial, commercial, and institutional sector, which generates approximately 60 per cent of municipal solid waste. Although there is some contracting out to private operators, municipalities usually provide collection services for the residential sector, which generates the other 40 per cent of municipal solid waste (Ministry of Municipal Affairs 1992, 7). For disposal, landfills can be owned and/or operated by either public or private interests. Charges that reflect environmental costs within this system of mixed ownership would have to include both user fees on households and taxes on private operators.

Tipping fees at landfill sites are normally based on the weight of waste materials. These fees have increased dramatically in recent years, particularly in the Toronto area, where fees roughly tripled between 1988 and 1992 from roughly $50 per tonne to $150 per tonne. In 1992, fees in Peel, Durham, and Halton regions were more than 10 times their 1982 levels.[2] Municipal revenues from these fees increased from approximately $31 million to $325 million over the period 1980 to 1990. Including private sites, total revenue from the operation of landfill sites is in the $600 million to $700 million range (Calvert 1991, 21).

From the perspective of tax fairness, there is no reason why user fees should not be applied for residential waste collection. The user clearly benefits most from solid waste collection and disposal. Further, there is no public policy reason why the use of this service should be subsidized. Solid waste disposal is also associated with a range of environmental costs. An expanded system of user fees in this area could serve as a charge for benefits received and as an assurance that households, institutions, and businesses face the full environmental costs involved in waste disposal.

User fees for solid waste disposal would also provide an economic incentive for waste reduction. While recycling technologies and the size of markets for secondary materials may limit potential for waste reduction, the composition of solid waste from all sectors indicates that these limits have not been reached in Ontario. Furthermore, changes in technology and market development will likely expand this potential in the future.

RECOMMENDATION 70

Ontario should expand the application of user fees for both residential and non-residential solid waste.

A framework for solid waste user fees should account separately for collection and disposal. Collection costs arise from administrative operations, capital investments in transportation and other equipment, and other operating expenditures including wages and fuel. Disposal costs are incurred in the construction and operation of dump sites. Other costs, which are more difficult to measure, include environmental costs and the cost of holding land out of other uses. In principle, pricing for solid waste collection and disposal should ac-

---

[2] Information obtained from treasurers and commissioners of finance, regional municipalities of Peel, Durham, and Halton.

count for this full range of costs and should ensure that these costs are passed back to the user.

The mix of public and private ownership of landfill sites and operation of collection services limits policy options. It would make no sense to require that public sector operators charge fees that account for social and environmental costs and provide incentives for waste reduction if the result would simply be to put private operators at a competitive advantage relative to public operators.

The potential for waste either to be transported to other jurisdictions for dumping or to be dumped illegally also constrains solid waste user fees. Tipping fee differentials between Ontario municipalities and various jurisdictions in the United States have already given rise to a solid waste exporting industry. The Municipality of Metropolitan Toronto, for example, has estimated that annual exports of solid waste to the United States have reached one million tonnes since local tipping fee rates increased beyond $100/tonne.[3]

At one level, one might argue that solid waste exports are not a problem. After all, the social and environmental costs are associated primarily with disposal, and we save those costs if the United States is willing to take our garbage. Apart from the somewhat questionable environmental ethic behind this view, however, it misses the point that one of the objectives of this policy is to provide incentives for waste reduction. If competition from solid waste exporters keeps fees down, the economic incentive to reduce is eliminated, and, unless all our waste is dumped in the United States, the waste disposal "savings" in the export market will be offset to some extent by higher levels of waste generated in Ontario and dumped here.

The government could address these problems by prescribing rates that reflect environmental costs and require that private haulers and landfill owners charge these rates. The resultant windfall profits could then be recovered through a special levy. For example, one way to avoid constraints on tipping fees is to levy a higher charge for collection to account directly for a wider range of costs. Costs associated with both collection and disposal generally increase with volume or weight and could be reflected in a single charge. In the residential sector, fees could be set by municipalities. In the industrial,

---

[3] Information supplied to FTC by Waste Management Department, Municipality of Metropolitan Toronto.

commercial, and institutional sector, private haulers could be required to charge similar fees to provide an incentive for waste reduction. This option has been implemented by various jurisdictions in the United States; for example, Hennepin County, Minnesota, which includes the City of Minneapolis–St. Paul and many of its suburbs.

Two other approaches might be taken. First, private operators could be subjected to a special tax designed to reflect social costs not captured in their fees. Second, the government could deal directly with the basic issue of industrial structure and assume public control over solid waste collection and disposal.

Solid Waste User Fees in the Residential Sector

Although Ontario has very limited experience with user fees for residential solid waste collection, there is substantial experience with user fee systems elsewhere in Canada and in the United States. For example, a user fee system was recently introduced in the Capital Regional District of British Columbia (Victoria). In the United States, solid waste user fee systems have been implemented in at least eight states, most of which contain major urban areas (CH2M Hill Engineering 1992; Ontario Ministry of Environment 1993a).

Solid waste user fees in the residential sector should reflect all costs of collection and disposal, as well as environmental costs. In North America, most residential fees for solid waste are based on volume. However, Seattle, Washington, experimented with a weight-based system in 1990. The project was reasonably inexpensive and highly successful in terms of effectiveness and public acceptance. Technologies for weight-based programs are rapidly becoming available.

Regardless of whether fees are based on weight or volume, decisions must be made with regard to rate structures. Major urban centres in California, Oregon, Minnesota, Washington, and New York, as well as Victoria, British Columbia, levy fees that increase with volume generated. The city of Salem, Oregon, has implemented perhaps the steepest rate structure. It requires that charges per can of garbage increase as the number of cans increase. Other systems provide a more moderate incentive for waste reduction.

The clear incentives for reduction provided by solid waste user fees have been found extremely effective in the diversion of solid waste from landfill. It is not uncommon for cities with such schemes to experience diversion rates of up to 40 per cent (CH2M Hill Engineering 1992, 2-2). Although these accomplishments are also attributable to other policies, most regions find that substantial reductions result directly from application of the user fee. One notable example is Seattle, where diversion has reached approximately 25 per cent and the city has identified the variable can rate as its most effective program in the promotion of recycling (CH2M Hill Engineering 1992, 2-16).

RECOMMENDATION 71

User fee rates for solid waste in the residential sector should reflect all costs associated with the collection and disposal of solid waste, including the environmental costs generated by waste collection and disposal.

Fees should vary with the amount of waste generated. Where possible, fees for residential solid waste should increase with weight.

To ensure broad access to solid waste collection and disposal services, user fee structures should provide for reduced rates for basic service, and special reduced rates for low-income consumers.

Public Information

One of the primary objectives of a solid waste user fee system is to change behaviour to promote economic efficiency and to protect the environment. This requires that households be able to make informed choices as to how to reduce solid waste. Waste reduction is possible only if viable substitutes for disposal are available and information on waste diversion methods is accessible to consumers. In Ontario, alternative disposal methods are available, but there are indications that people are not making use of them. For example, studies of waste composition in 1989 and 1990 indicate that recyclable newspaper made up approximately 17 per cent of the residential solid waste stream; food and beverage containers constituted approximately 9 per cent; and organic material suitable for composting, such as food and yard waste, 32 per cent.[4] Estimates of the extent of recycling vary substantially, from municipality to municipality and from product to product, but generally do not exceed 50 per cent for newspapers and 20–30 per cent for glass, metal, and plastic food and beverage containers. This reflects the limited success of alternatives to disposal, such as the blue box program and backyard composting. While composting has increased in recent years, owing in part to the efforts of the provincial government, better information is required on sound, successful composting methods in urban areas for these methods to reach their full potential. In addition, consumers should also be provided with accessible information on the importance of waste reduction and the merits of simple techniques for reducing waste, such as the purchase of reusable products and packaging.

Implementation Issues

Costs of administration, compliance, and enforcement will depend largely on the type of program introduced. The systems in Victoria and in Tompkins County, New York, involve the use of special tags or tickets indicating payment in advance for additional cans of waste. Similarly, customers in Seattle subscribe to a particular level of disposal and are provided special wheeled toters to match. These types of systems could be introduced at relatively low cost, especially if consumers are required to purchase their own cans. To avoid the cost of standardized cans altogether, an alternative is to use special stickers or ties on trash bags to indicate pre-payment.

Although a weight-based system would involve substantial start-up costs in the purchase and installation of specialized equipment, charges based on weight would achieve better results from an environmental perspective, and, in the longer term, simplify the process.[5] A tag system encourages households to reduce the volume of

---

[4] These statistics vary substantially between municipalities.

[5] The Seattle weight-based pilot project found costs to retrofit trucks for waste collection were less than $8000 per truck, but would have been lower for full-scale implementation. Labour costs may or may not increase depending on the technology. See Hill Engineering 1992, 3-3.

trash, even though weight is the more important factor in determining collection and disposal cost. In addition, volume systems still require rough limits on weight, if for no other reason than to protect the health and safety of collectors, and thus call for some discretion on the part of the collector to determine whether this limit has been exceeded.

Multiple unit residential buildings pose administrative problems for sold waste user fees, regardless of the type of program. Most jurisdictions with a residential user fee program levy volume-based charges for an entire building. While this approach avoids the obvious practical problems posed by multiple unit buildings, it offers no incentive for waste reduction to individual residents. Because waste disposal costs are paid centrally and are passed on to residents as a group, the waste reduction efforts of individual residents will not result in any appreciable savings unless others reduce their waste as well. Seattle permits all units in a building to subscribe to its variable can service on a building-wide basis as an alternative to imposing one rate on the entire building. This approach has potential as an option in Ontario, especially for relatively small multi-unit buildings.

Illegal dumping has also been cited as a barrier to the introduction of solid waste user fees. Experience in other jurisdictions, however, suggests that these concerns may be exaggerated. In a survey of 12 counties across eight states in the United States, none of the user fee programs resulted in significant illegal dumping (CH2M Hill Engineering 1992, 2-2). Nonetheless, these matters should be addressed specifically in any fee system introduced in Ontario. Actions to minimize dumping activities might include stricter enforcement and visible penalties. Better information about programs and the availability of reduction and recycling alternatives will also support a fee system by strengthening the option of avoiding user fees through reduced waste generation.

Solid Waste User Fees in the Industrial, Commercial, and Institutional Sector

The same principles would apply to solid waste user fees in the industrial, commercial, and institutional (ICI) sector. The primary objective of any system should be to ensure that the user pays the full cost of disposal, including social and environmental costs. To a certain extent, this objective is already met in the ICI sector since private haulers generally charge customers at the pick-up point. Presumably services are priced to account for collection and hauling as well as disposal.

The main question in the ICI sector is whether the full social costs of waste generation are reflected in prices charged by haulers. The answer will depend on a number of factors, including tipping fee rates charged by municipalities and the public/private mix in the provision of the service. With tipping fees constrained by the absence of strong regulations against waste export, it may be more promising to focus on collection in establishing full-cost pricing in this sector. The significant role of private operators means that full-cost pricing in the ICI sector can only be achieved through a combination of municipal fees and taxes on private waste collection designed to reflect social costs that would not otherwise be included in the prices charged by private operators.

As another option, municipalities could set tipping fee rates to reflect full costs if the provincial government introduced a disposal tax on waste generators in the ICI sector. To curb cross-border transport of waste, the tax could be set equal to the difference between full-cost tipping fees in Ontario and fees in the United States. Ontario tipping fees would then be creditable against this tax, but fees paid in the United States would not. Revenues generated by the tax would flow back to municipalities. Under this system, the government could reduce the flow of Ontario garbage to the United States while also providing a general incentive for waste reduction.

RECOMMENDATION 72

Ontario should establish a regulatory and fee framework to ensure that prices charged for solid waste collection and disposal in the industrial, commercial, and institutional sector provide incentives for waste reduction.

Other aspects of solid waste user fees, as set out for the residential sector, also apply in the ICI sector. In particular, charges should increase with weight, the government should ensure the availability of viable options for the reduction of solid waste, and information on waste reduction techniques should be easily accessible.

Taxes on Packaging and Deposit Refunds

Solid waste user fees are intended to provide an incentive for waste reduction by increasing the cost of disposal of solid waste. A similar incentive can be provided by increasing the cost of acquisition of packaging and products that end up in landfill sites.

Environmental taxes on packaging can serve two main functions. First, they can provide an incentive for consumers to purchase products that generate less waste. Second, if the taxes take the form of refundable deposits, they can encourage the return of reusable and recyclable products or packages.

Environmental taxes on goods which have a clear value in reuse and for which there is a consistent basis for determining a tax level related to environmental costs have a clear role in encouraging the diversion of waste from landfill sites. Both newspapers and magazines (21 per cent of the waste stream) and food and beverage containers (9 per cent) meet these criteria. While there is no precedent for environmental taxes on newspapers and magazines at the consumer level, many jurisdictions apply environmental taxes to food and beverage containers.

Food and Beverage Containers

Environmental taxes on food and beverage containers should encourage resource conservation and waste reduction by allowing for variable refunds on containers returned for reuse and recycling. A tax/refund system would include a tax that varies with waste generated and a refund that is higher for material that can be reused than for material that can only be recycled.

Tax/refunds should apply to most glass, rigid plastic, and metal food and beverage containers sold in Ontario. Most jurisdictions have limited the application of their refundable and non-refundable packaging taxes to beverage containers. It is difficult to justify this narrow focus because the environmental impact of a container is independent of its original contents. However, considerations other than environmental impact, such as availability of substitutes in consumption and markets for secondary materials, may ultimately justify limiting the range of products subject to taxation. If there is no widely available container substitute in consumption and no market for secondary container materials, as in the case of milk cartons, for example, little or no behaviour change will result from application of a tax.

On the other hand, if there is a substitute available for a particular container, the market for this container's secondary materials should be irrelevant to the taxation decision. Glass beverage containers that are recyclable or reusable, for example, are often good substitutes for non-recyclable plastic beverage containers. Even if no market exists for the reuse or recycling of plastic materials from certain beverage containers, a tax would have an impact on behaviour if price increases on these containers relative to glass make them relatively less attractive to consumers.

Another case where an environmental tax may be applicable arises where there is no widely available substitute for the container, yet a well-established market exists for the recycled container. This category of container can be exemplified by glass jars, such as jam jars. An environmental tax on glass jars, partially refunded on return, would help increase recovery and recycling rates.

RECOMMENDATION 73

Ontario should introduce a broad-based system of environmental excise taxes on food and beverage containers. These taxes should be fully refundable for containers returned for reuse and partially refunded for containers returned for recycling.

Concerns about potential employment impact invariably generate opposition to packaging taxes. There is no evidence, however, that shifts towards reusable and recyclable containers would result in net job losses in Ontario. In fact, there is some evidence that the labour needs of container redemption systems can result in net job gains (Vallante and Vopni 1991, 33). While this information may be of some comfort to economists, it is not particularly helpful to the individual worker displaced as a result of an environmental change. The only way to address this individual impact is to insist that adjustment measures are included as part of any environmental reform that has a potential impact on employment.

The most important technical issue to be addressed in developing deposit/return/refund systems concerns the institutional framework for administering the system. An institutional basis must be developed for collection of the tax, return of refunds, and operation of container collection facilities. In some jurisdictions, such as Quebec and Saskatchewan, point of sale refund systems have been successful. In others, such as Alberta and Washington, central community depot systems have been successful (British Columbia Department of Environment 1990).

Another option might involve a combination of at-source separation and, where that is impractical, municipal collection and the use of central depots. Funding for a municipally based collection and refund system could be generated from environmental tax revenues and non-refundable deposits. From an environmental perspective, this system may be superior to a system of central depot collection facilities because it would reduce fuel consumption in the transportation of containers by individual households.

Part Eleven
Financing Local Government in Ontario

27 Issues in Property Tax and Local Government Finance

Local government finance issues were raised more often in the commission's public consultation process than all other tax issues combined. We received hundreds of letters from individuals and groups concerning property assessment and the financing of education. Most of the community task forces sponsored by the commission found local finance to be the main public issue of tax fairness. Similarly, during our public hearings, we engaged in frequent discussions with individuals and organizations interested specifically in property tax and the financing of education.

The issues ranged from technical problems with the property assessment system to the broadest questions of public policy. Out of those many individual submissions, some clear messages emerged:

- The system of local government finance is so complex and arcane that it is incomprehensible to most Ontario residents.
- Those few who know the system well accept as a given that virtually every component of Ontario's system of local government finance is in a state of crisis or near crisis.
- Most residents believe that Ontario is far too dependent on property taxes for the funding of education.
- Many Ontario residents feel that the current system for funding education discriminates unfairly against students who attend schools with limited access to local sources of funding.
- Many residents and most municipal leaders question the extent of Ontario's reliance on property taxes for funding social services.

- The system of property assessment and local taxation is extremely confusing and perpetuates a number of obvious inequities.
- Assessment reform, even when it is introduced in small measures and as a local option, creates its own practical and fairness problems.

Our research and analysis confirm these views and point directly to the need for substantial and dramatic change.

For the most part, the issues that have emerged in our contact with the public and in our own investigation are not new. Many of the same issues were addressed in the report of the last commission to take a comprehensive look at the Ontario tax system – the Ontario Committee on Taxation (Smith Committee) – which reported in 1967. The assessment system was in chaos then; it is in chaos now. The extent to which property tax was relied upon for financing education was a concern then, as it is now.

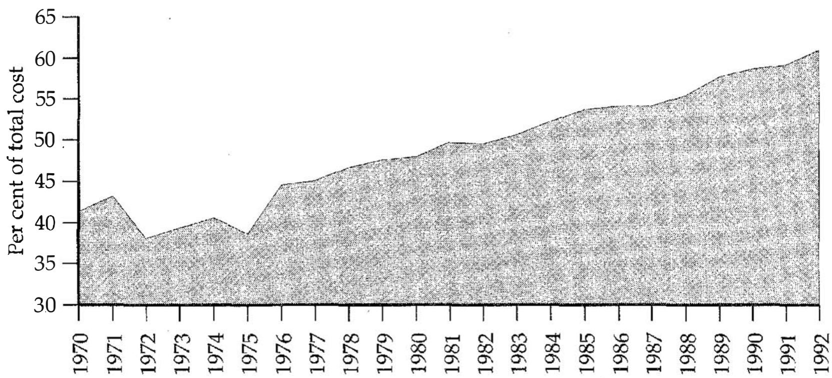
Efforts at reform have failed. While the provincial government took over the property assessment function from local governments in response to the Smith Committee's recommendation, it did not implement assessment reform. The system today is different, but it is no more uniform and no easier for the taxpayer to understand than it was before.

Education Funding

The issue of funding education from property taxes dominated discussions of local government finance in our public consultation program. Virtually every aspect of the education funding system was questioned:

- Ontario's growing reliance on property taxes as a source of funding for education;
- variations in the burden of local taxes required to support education in different parts of the province;
- variations in tax revenue available at the local level in different parts of Ontario and between separate and public school boards; and
- the impact of these variations on the quality of education available to students in different parts of the province.

FIGURE 27.1
Education Funding – Ontario's Growing Property Tax Dependence: Percentage of Elementary and Secondary Education Cost Funded from Property Taxes, Ontario, 1970-92



Source: Fair Tax Commission calculation based on Ontario, Ministry of Education administrative data.

On most of these issues, our research showed clearly that these concerns are well founded.

Over the past 20 years, Ontario has become increasingly dependent on property taxes as a source of funding for education. From a low of less than 40 per cent of funding in the mid 1970s, property taxes have risen steadily, accounting for over 60 per cent of revenue for education in Ontario in 1992 (see figure 27.1).

Provincial grants now account for about 38 per cent of school board revenue, and other sources about 2 per cent. In contrast, municipalities have a much more diverse revenue base and are much less dependent on property taxes for their funding. In 1991, 39 per cent of municipal operating revenue came from property taxes and 30 per cent from provincial grants; the other 31 per cent of municipal revenue came from a variety of local sources.

Ontario's heavy and growing reliance on property taxes for education funding has generated an increasingly heated debate in recent years. At the public hearings, people told us that services such as education, which are of general benefit to society, should be funded from taxes based on ability to pay. They identify the property tax as a tax related to property, and they don't see why it should be a source of funding for services such as education or social assistance, which have nothing to do with property.

Seniors and others on fixed incomes expressed their concerns about Ontario's growing reliance on property taxes for education funding because of the impact on their property tax bills of what they saw as the spiralling costs of education and the potential effect of market value assessment. Tenants expressed the same fear of the unknown.

One problem is that the property tax base is distributed very unevenly across the province. School boards that operate in jurisdictions with access to large tax bases relative to the size of the student population they serve are able to raise revenue more easily than boards that operate in jurisdictions without access to large tax bases. Students, teachers, and school board representatives at the public hearings consistently raised the issue of student equity: Why should some students be deprived of services because they happen to live in an assessment-poor school district? There is no question that there are significant disparities among school boards in the size of the property tax base to which they have access, although the measurement of that base in a way that permits comparison among school boards is a difficult exercise in and of itself.

To compare the hundreds of different assessment and tax systems at the local level in Ontario, local assessment figures must be adjusted to a common standard. This process – assessment equalization – is complex. It involves estimating for each municipality in Ontario the average relationship between assessment and market value for each of the broad types of property. The resulting percentages are used to create equalization factors. When these factors are applied to assessment totals in local areas, they produce estimates of current market value assessment for each class of property. For example, a property valued at $10,000 on a local assessment roll and assessed at 10 per cent of its market value would have an equalized assessment of $100,000.

There are enormous disparities in equalized assessment per pupil among the 114 school boards that operate both elementary and secondary schools on a permanent basis. Table 27.1 shows the range of variation in the public and separate school systems in equalized residential assessment, while table 27.2 provides the same picture for equalized commercial and industrial assessment. The numbers

TABLE 27.1
Equalized Residential Assessment per Student, Ontario, 1991

Public boards	Assessment ($)	Separate boards	Assessment ($)
Highest 5		Highest 5	
Haliburton County B of E	281,319	Ottawa RCSSB	161,396
Muskoka B of E	257,709	Metropolitan Toronto Separate School Board	129,230
Ottawa B of E	231,077	York Region RCSSB	124,460
West Parry Sound B of E	230,433	Halton RCSSB	105,536
York Region B of E	217,806	Ottawa-Carleton French (catholique), Cslf	105,002
Lowest 5		Lowest 5	
Lake Superior B of E	49,131	Cochrane Iroquois Falls/ Black River Matheson RCSSB	38,464
Geraldton B of E	52,427	Timiskaming District RCSSB	43,406
Nipigon Red Rock B of E	54,464	Hearst District RCSSB	49,577
Atikokan B of E	56,226	Kapuskasing District RCSSB	50,521
Cochrane Iroquois Falls/ Black River Matheson B of E	57,197	Kenora District RCSSB	51,082

Source: Ontario, Ministry of Education administrative data.

Abbreviations: B of E = Board of Education; Cslf = Conseil scolaire de langue française/French-Language School Board; RCSSB = Roman Catholic Separate School Board.

Notes: Equalized assessment per student based on total elementary and secondary average day school enrolment. Ranking excludes elementary-only boards.

indicate clearly that there are wide disparities in residential and in commercial and industrial assessment bases both between the public and separate systems and within each system.

TABLE 27.2
Equalized Commercial and Industrial Assessment per Student, Ontario, 1991

Public boards	Assessment ($)	Separate boards	Assessment ($)
Highest 5		Highest 5	
Kapuskasing B of E	260,031	Ottawa RCSSB	84,869
Metropolitan Toronto School Board	258,865	Metropolitan Toronto Separate School Board	56,608
Hearst B of E	220,611	Lakehead District RCSSB	44,818
Ottawa B of E	219,364	Kapuskasing District RCSSB	39,716
Michipicoten B of E	206,318	Welland County RCSSB	34,758
Lowest 5		Lowest 5	
Central Algoma B of E	15,102	Haldimand-Norfolk County RCSSB	10,121
Ottawa-Carleton (publique), Cslf	15,761	Bruce-Grey County RCSSB	11,937
Bruce County B of E	23,318	Peterborough Victoria Northumberland and Newcastle RCSSB	12,279
East Parry Sound B of E	24,117	Huron-Perth County RCSSB	12,582
Manitoulin B of E	26,767	Simcoe County RCSSB	13,174

Source: Ontario, Ministry of Education administrative data.

Abbreviations: B of E = Board of Education; Cslf = Conseil scolaire de langue française/French-Language School Board; RCSSB = Roman Catholic Separate School Board.

Notes: Equalized assessment per student based on total elementary and secondary average day school enrolment. Ranking excludes elementary-only boards.

There are also wide variations in equalized assessment per pupil between public and separate school boards that serve the same community (see table 27.3). The provincial grants system is supposed to compensate for differences in per pupil assessment bases, but it is only partly effective. A distinction is drawn between recognized expenditures, for which the province provides equalization grants, and other expenditures, for which the province does not. The objective of the grants is to equalize the impact on taxpayers of local spending up to the recognized level.

TABLE 27.3
Equalized Assessment per Student, Selected Ontario Public and Separate School Boards, 1991

	Residential ($)		Commercial and industrial ($)	
Community	Public	Separate	Public	Separate
Metro Toronto	211,217	129,230	258,865	56,608
London	117,142	83,575	80,214	20,835
Sudbury	83,721	62,434	91,924	25,509
Hearst	94,496	49,577	220,611	32,934
Renfrew	90,643	63,229	61,769	16,481
Brant	101,173	71,887	66,737	17,642
Lambton	119,265	74,555	92,055	19,790

Source: Ontario, Ministry of Education administrative data.

Notes: Equalized assessment per student based on total elementary and secondary average day school enrolment. Ranking excludes elementary-only boards.

One problem with the provincial grants system is its narrow definition of expenditures. In 1993 recognized expenditures make up only about 74 per cent of total expenditures by school boards. Another problem is that the grants do not produce equal effective tax rates even for recognized expenditures.

It is difficult to compare the impact of local taxes on taxpayers in different jurisdictions in Ontario. Because the tax paid on a given property is determined by multiplying the local tax rate by the assessment of the property, it is not possible to compare tax rates without reference to the relevant assessment. Because assessment systems differ so much from municipality to municipality, it is impossible to tell by looking at the tax rates alone whether the tax rate is "high" or "low." To make a valid comparison of tax rates, assessments have to be adjusted to a common standard. The most obvious common standard is market value, the assessment basis mandated in Ontario under the Assessment Act. Adjusting assessments in this way makes it possible to calculate effective tax rates – taxes as a percentage of market value – which can be compared among municipalities with different underlying assessment systems.

As an example, consider two municipalities, one with a tax rate of 20 per cent and assessment at 10 per cent of market value, the other with a tax rate of 3 per cent and assessment at 100 per cent of market value. The municipality with the 3 per cent tax rate actually has a higher effective tax rate than the municipality with the 20 per cent tax rate. In the first municipality, a property with a value of $100,000 would be assessed at $10,000 (10 per cent of value) and would pay $2000 in tax (20 per cent of $10,000). In the second municipality, a property with a value of $100,000 would be assessed at $100,000 and would pay $3000 in tax (3 per cent of $100,000). The municipality with the 20 per cent tax rate actually has a lower tax rate, on an equalized basis, than the municipality with the 3 per cent tax rate.

The idea behind the system of equalization grants for education is that taxpayers in different parts of the province should pay the same rate of tax for the provincially recognized portion of education spending. This implies that effective tax rates for recognized spending should be equal among all boards in the province, both for residential taxpayers and for commercial and industrial taxpayers. Our analysis reveals that effective tax rates are not equal. In the following figures and tables we present data in two forms: graphically, summarizing the data for all municipalities; and in tabular form for a sample of 40 municipalities of varying sizes and in different regions of the province. Although the graphs provide a general picture, the tables present more concrete detail for a limited number of representative municipalities. This pattern is followed in presenting municipal data throughout this report.

Figure 27.2 reveals substantial variation in effective tax rates on residential properties for recognized educational spending in Ontario. It shows that, despite the expenditure of approximately $5 billion on a grants program intended to equalize local taxation required to fund recognized expenditures, there is in fact a very wide variation in effective rates of tax around the provincial average of 0.48 per cent of equalized market value assessment.[1]

Figure 27.3 shows a similar variation in the effective tax rates on non-residential (commercial and industrial property, including the business occupancy tax) properties for recognized educational expenditures. Here, the variations around the provincial average of 0.67 per cent are even greater.

[1] The provincial average is calculated by dividing total residential property taxes for recognized expenditures by total equalized assessment. This calculation produces an average for all municipalities weighted by total equalized assessment in the municipality. Because the graph gives equal weight to each municipality, regardless of its size, the apparent average in figures 27.2 and 27.3 differs from the weighted average.

FIGURE 27.2
Distribution of Residential Effective Rate of Tax for Recognized Expenditures in Education by Municipalities, Ontario, 1991

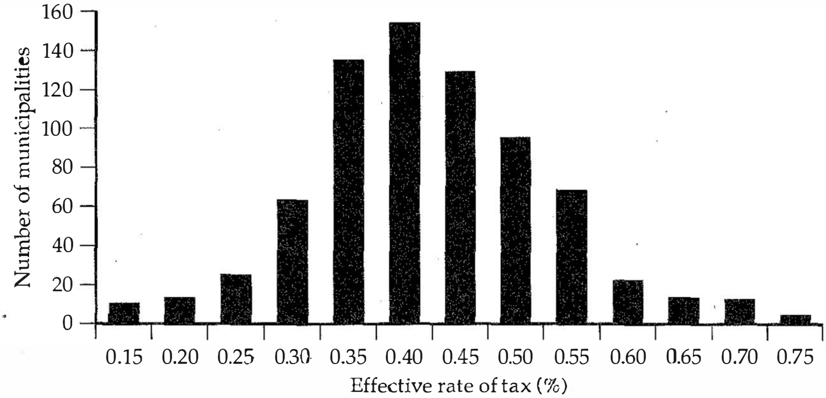
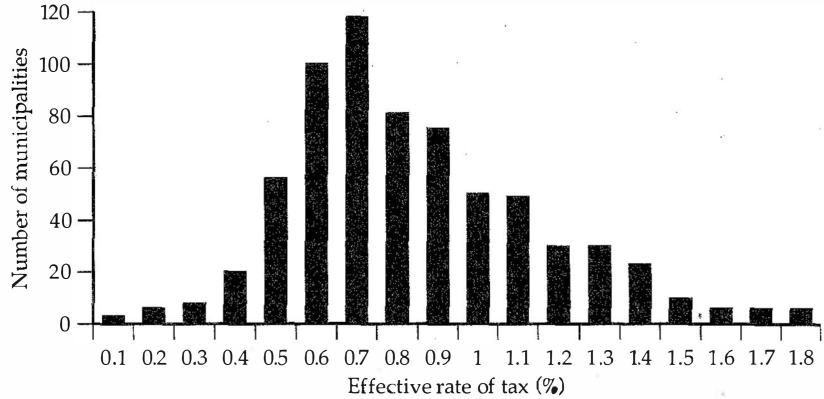


FIGURE 27.3
Distribution of Non-Residential Effective Rate of Tax for Recognized Expenditures in Education by Municipalities, Ontario, 1991



Source: Fair Tax Commission calculation based on Ontario, Ministry of Education administrative data and Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

TABLE 27.4
Effective Tax Rates for Recognized Education Expenditures
Selected Ontario Municipalities, 1991

Municipality	Residential	Non-residential
Cities	(%)	
Barrie	0.41	0.61
Burlington	0.41	0.55
Cambridge	0.42	0.60
Chatham	0.59	1.03
Cornwall	0.48	1.05
Etobicoke	0.35	0.76
Guelph	0.40	0.74
Hamilton	0.37	0.76
Kingston	0.45	0.65
London	0.45	0.60
Mississauga	0.45	0.52
Nepean	0.52	0.64
North Bay	0.43	0.85
North York	0.33	0.76
Oshawa	0.36	0.79
Ottawa	0.54	0.60
Owen Sound	0.35	0.91
Peterborough	0.40	0.78
Sault Ste Marie	0.51	0.81
Scarborough	0.34	0.79
Sudbury	0.60	0.76
Thunder Bay	0.46	0.98
Timmins	0.48	0.90
Toronto	0.29	0.71
Windsor	0.52	0.84
Towns		
Halton Hills	0.38	0.58
Markham	0.38	0.50
Milton	0.40	0.61
New Liskeard	0.49	1.28
Oakville	0.37	0.53
Orangeville	0.19	0.27
Pickering	0.40	0.60
Picton	0.43	0.57
Townships		
Augusta	0.41	1.50
Horton	0.43	0.62
McKellar	0.37	0.87
Mersea	0.67	0.92
Montague	0.49	0.91
Nakina	n/a	n/a
Stephen	0.56	0.60
Provincial average	0.48	0.67

Source: Fair Tax Commission calculation based on Ontario, Ministry of Education administrative data and Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

Note: Effective tax rates for commercial and industrial property take into account business occupancy tax and business assessment.

In the 40-municipality sample (table 27.4), effective tax rates on residential property for recognized expenditures in 1991 ranged from a low of 0.19 per cent in Orangeville to 0.67 per cent in Mersea Township. On non-residential property, effective tax rates for recognized expenditures ranged from 0.27 per cent in Orangeville to 1.50 per cent in Augusta Township.

The current system of equalization grants fails to equalize tax rates among taxpayers in similar situations because it is based on a weighted sum of residential assessment and commercial and industrial assessment. If residential assessment and commercial and industrial assessment were distributed across the province in the same way and if the relationships between effective tax rates on commercial and industrial property were the same in every jurisdiction, the weighted average approach to equalization would work. Unfortunately, neither of these conditions is met.

Ignoring the figures for township muncipalities, for which the residential category includes farm properties and recreational property used by non-residents, education property taxes for recognized spending in 1991 ranged from $7.23 per $1000 of household income in New Liskeard to $16.19 per $1000 of household income in Markham.

No system of equalization based on property assessment can be expected to produce a fair distribution of either the costs or the benefits of public education in Ontario. The fundamental flaw in the use of assessment in the distribution of education costs among local areas is that assessment is not a good indicator of the collective ability to pay taxes. As a result, as a percentage of household income, residential property taxes for recognized education spending vary significantly across the province. They would continue to vary even if differences in tax rates on equalized assessment were eliminated.

Figure 27.4 shows the variation in residential property taxes used to support recognized education spending at the board level relative to household income.

TABLE 27.5
Residential Property Taxes for Recognized Expenditures in Education per $1 000 of Household Income, Selected Ontario Municipalities, 1991

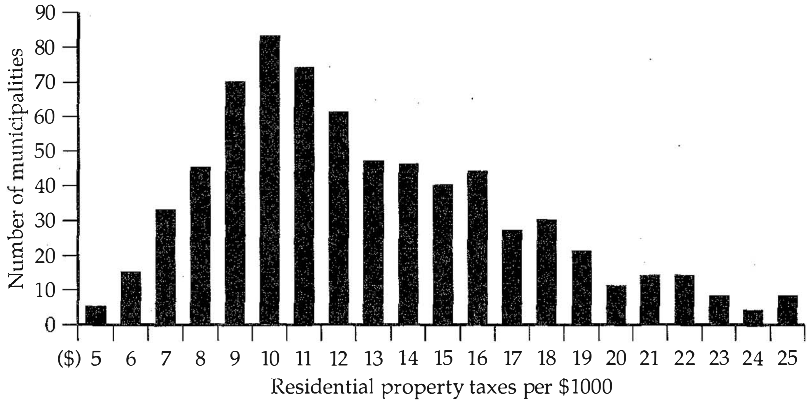
Municipality	Tax ($)	Municipality	Tax ($)
Cities		Thunder Bay	8.02
Barrie	13.09	Timmins	8.72
Burlington	12.48	Toronto	14.44
Cambridge	10.46	Windsor	10.91
Chatham	8.80	Towns	
Cornwall	9.19	Halton Hills	12.69
Etobicoke	14.25	Markham	16.19
Guelph	11.11	Milton	13.21
Hamilton	10.32	New Liskeard	7.23
Kingston	11.63	Oakville	12.51
London	10.66	Orangeville	11.58
Mississauga	15.61	Pickering	13.23
Nepean	11.05	Picton	8.92
North Bay	9.20	Townships [a]	
North York	14.27	Augusta	8.46
Oshawa	10.33	Horton	10.95
Ottawa	12.43	McKellar	35.27
Owen Sound	9.15	Mersea	21.28
Peterborough	10.94	Montague	9.62
Sault Ste Marie	10.50	Nakina	n/a
Scarborough	12.98	Stephen	18.39
Sudbury	9.53		

Source: Ontario, Ministry of Education administrative data; Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS); Statistics Canada, 1991 Census of Canada, 2B Profile for Census Divisions and Census Sub-divisions.

a. Figures for township municipalities are distorted by the fact that taxes on agricultural and recreational property are reported as residential taxes, thus affecting the figures for property taxes relative to income.

The residential tax burden associated with recognized education spending – in theory related to comparable education services across the province – varies widely at the local level. Although many Ontario households are located in municipalities in which the average tax burden is close to the provincial average of 1.15 per cent of household income, many others are located in municipalities in

FIGURE 27.4
Distribution of Residential Property Taxes for Recognized Expenditures in Education per $1000 of Household Income, Ontario, 1991



Sources: Ontario, Ministry of Education, administrative data; Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS); Statistics Canada, 1991 Census of Canada, 2B Profile for Census Divisions and Census Sub-divisions.

which the impact on household income is substantially above or below this average.

The inadequacy of the current system of equalization grants is exacerbated by its restriction to recognized expenditures. Recognized expenditures have declined as a share of total expenditures since the early 1970s. As recognized expenditures decline as a percentage of total expenditures, a larger share of the burden of funding education expenditures has shifted to local taxpayers.

Given the narrow definition of recognized expenditures, the current system of equalized grants is not equipped to produce a fair distribution of spending on pupils across the province. Recognized spending in 1993 is, on average, only about 74 per cent of total spending on education at the board level in Ontario. Because local boards are totally dependent on their local assessment base to make up any difference between recognized and actual spending, boards with limited local resources have to choose between imposing higher than average taxes to maintain spending levels and reducing program spending to keep taxes in line. Because the overall level of funding recognized for provincial support is inadequate, local school boards are forced by the funding system to make a trade-off between pupil and taxpayer equity; this trade-off is perceived as unfair by the public.

Social Services Funding

Property taxes are also used to fund social services provided through municipal governments. Although there is concern about the fairness of funding these programs from property taxes, the magnitude of the problem is not nearly as great as it is for education. In 1991, expenditures on health and social services accounted for 28 per cent of total municipal operating expenditures. Their funding, however, was heavily subsidized by provincial grants. Only 4.9 per cent of total property taxes across the province were used for these services.

Social assistance (general welfare) expenditures are divided between the provincial and municipal governments. The cost of providing the local share of social assistance varies among municipalities, depending on local employment and other factors that affect the welfare case-load. The tax resources available to fund the local share of program costs also vary from municipality to municipality.

Social assistance programs are normally administered by county, regional, district, or metropolitan governments, known as upper-tier municipalities. In some parts of Ontario, however, social assistance is the responsibility of the lower-tier or local municipalities (cities, towns, villages, townships, and boroughs) that make up the county area. In addition, in cities and towns that are not part of the county government system (known as separated cities and towns), social assistance programs are delivered by the separated city or town.

This variation creates a problem in tax fairness. Despite the fact that social assistance is a provincial program and is intended to be broadly comparable across the province, the burden of residential property taxes for social assistance benefits varies widely across Ontario. Table 27.6 shows that residential taxes to support social assistance benefits in 1991 vary in a sample of 40 municipalities from \$0.31 per \$1000 in household income in New Liskeard to \$3.82 per \$1000 of household income in Orangeville.

Similar concerns arise in varying degrees from an analysis of other social service and health programs provided by municipalities where costs are shared with the provincial government.

TABLE 27.6
Residential Property Taxes for Social Assistance Benefits per $1000 of Household Income, Selected Ontario Municipalities, 1991

Municipality	Tax ($)	Municipality	Tax ($)
Cities		Thunder Bay	0.86
Barrie	1.09	Timmins	1.26
Burlington	0.42	Toronto	1.22
Cambridge	0.94	Windsor	1.62
Chatham	1.30	Towns	
Cornwall	1.58	Halton Hills	0.47
Etobicoke	1.60	Markham	0.53
Guelph	1.03	Milton	0.39
Hamilton	1.45	New Liskeard	0.31
Kingston	2.04	Oakville	0.42
London	1.73	Orangeville	3.82
Mississauga	0.69	Pickering	1.68
Nepean	1.80	Picton	0.35
North Bay	1.08	Townships [a]	
North York	1.75	Augusta	0.33
Oshawa	1.01	Horton	0.84
Ottawa	2.13	McKellar	1.23
Owen Sound	0.33	Mersea	1.66
Peterborough	1.86	Montague	0.67
Sault Ste Marie	1.98	Nakina	1.53
Scarborough	1.66	Stephen	0.53
Sudbury	1.64		

Source: Fair Tax Commission calculation based on Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS), and Statistics Canada, 1991 Census of Canada, 2B Profile for Census Divisions and Census Sub-divisions.

a. Figures for township municipalities are distorted by the fact that taxes on agricultural and recreational property are reported as residential taxes, thus distorting the figures for property taxes relative to income.

TABLE 27.7
Assessment as a Percentage of Market Value, Selected Ontario Municipalities, 1991

Municipality	Single family residential (1–2 units)	Multi-residential (7+ units)	Commercial	Industrial
	%			
Cities				
Barrie	42	44	59	59
Burlington	4	9	4	6
Cambridge	4	11	6	6
Chatham	5	8	9	11
Cornwall	5	8	8	11
Etobicoke	2	8	4	7
Guelph	9	21	13	20
Hamilton	3	8	6	8
Kingston	4	6	5	6
London	4	9	5	8
Mississauga	13	22	13	17
Nepean	2	4	2	3
North Bay	3	9	6	11
North York	2	8	5	4
Oshawa	5	10	6	15
Ottawa	4	9	5	n/a
Owen Sound	8	19	18	26
Peterborough	4	5	6	9
Sault Ste Marie	9	14	12	15
Scarborough	2	8	5	5
Sudbury	13	26	18	20
Thunder Bay	4	10	6	8
Timmins	5	10	9	10
Toronto	1	6	5	5
Windsor	9	17	11	18

(Table 27.7 is continued on the following page)

Assessment and Market Value

Nearly 25 years after the province took over the property assessment function from municipalities, the system is still disorganized. Few people actually understand how their assessments and taxes are calculated. Because of inconsistencies in assessment systems among municipalities, it is almost impossible for people to compare the rates at which they are taxed.

Table 27.7 concluded

Municipality	Single family residential (1–2 units)	Multi-residential (7+ units)	Commercial	Industrial
		%		
Towns				
Halton Hills	3	5	3	5
Markham	10	18	11	12
Milton	2	7	3	4
New Liskeard	4	6	10	10
Oakville	3	7	3	5
Orangeville	2	5	2	4
Pickering	11	19	16	15
Picton	46	61	65	76
Townships				
Augusta	3	n/a	5	12
Horton	3	n/a	4	n/a
McKellar	41	n/a	88	91
Mersea	3	4	3	5
Montague	2	n/a	5	5
Nakina	10	8	7	7
Stephen	50	53	62	71

Source: Fair Tax Commission calculation based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

According to the Assessment Act, all real property must be assessed at its market value. In most municipalities, however, property is assessed at a percentage of market value. This percentage varies from municipality to municipality, depending on the base year used when the municipality was reassessed.

Within each single municipality, this percentage also varies for different property classes. In one municipality, a house may be assessed at 5 per cent of its market value while an apartment building is assessed at 8 or 9 per cent. In a neighbouring municipality, the houses and apartment buildings may be assessed, respectively, at 3 and 7 per cent of their estimated market values and these values may be based on another year.

The extent of these variations between municipalities and between classes of property in the same municipality is illustrated in table

27.7, which looks at assessment as a percentage of market value in selected municipalities.

Although the assessment and taxation system takes the differences in base years into account when the tax rate is set, property owners paying taxes to the same school board and region or county will find it difficult to compare the basis on which they pay those taxes. For example, a house in community A may be assessed at $5000 because the municipality has not been reassessed for many years. A similar house in neighbouring community B might be assessed at $25,000 because B was recently reassessed using values from a more recent base year. The assessments cannot be compared without knowing how assessment/market value percentages compare for a common base year. And even this comparison doesn't tell the whole story when it comes to comparing tax burdens. The amount of tax paid will depend not only on the assessment on the individual property, but also on the assessment of other classes of property in the two municipalities. For example, in two economically similar communities, non-residential property might be assessed at different percentages of value. Residential taxes will be lower in municipalities where non-residential property is relatively overassessed, and higher in municipalities where non-residential property is relatively underassessed.

As a result, similar properties may be assessed and taxed very differently in different parts of the province. For example, automobile plants in Oakville, Brampton, and Oshawa bear different tax burdens even though each is a similar plant with essentially the same access to local services, making the same type of product for the same market. In Oshawa, where the General Motors assembly plants are located, industrial properties are assessed for local tax purposes at 15.3 per cent of their value and pay an effective rate of tax (including business occupancy tax) of 1.95 per cent. In Brampton, where the Chrysler plant is located, industrial assessment is at 16.2 per cent of value. The effective rate of tax is 0.65 per cent. In Oakville, where one of Ford's plants is located, industrial property is assessed at 5.3 per cent of value. The effective tax rate is 0.81 per cent.

Assessment differences also lie at the root of issues in local government finance that initially appear unrelated to assessment. For example, residential property taxes for education are extremely high in Peel and York regions compared with residential taxes for education in Metropolitan Toronto. While at first glance it would appear that the difference can be explained by differences in the size of the commercial and industrial assessment base between Metropolitan Toronto and the surrounding area, it turns out that differences in assessment contribute significantly to the problem. In Peel and York, commercial property is taxed at about the same rate as single family residential property on an equalized assessment base. On the same adjusted basis in Metropolitan Toronto, commercial and industrial property is taxed at roughly twice the rate of residential property. Depending on one's perspective, either commercial and industrial taxpayers in Metropolitan Toronto are subsidizing single family residential taxpayers, or single family residential taxpayers in Peel and York are subsidizing commercial and industrial taxpayers. In fact, compared with the provincial average relationship between single family residential and commercial properties, each of these perspectives is about half right.

The end result of this mixture of assessment systems and base years is a system that preserves virtually as many different local taxation policies as there are municipalities. These different policies exist behind the facade of a relationship that links tax rates on different classes of property. The Municipal Act, the Education Act, and the Ontario Unconditional Grants Act require that the rate of tax on residential property be 85 per cent of the rate of tax on non-residential (commercial and industrial) property. Implicit in this requirement is an expectation that all residential property will be taxed at the same rate and that all commercial and industrial property will likewise be taxed at the same rate. In practice, neither the relationship between residential and non-residential taxation nor the relationships among tax rates within each sector comes close to matching the standards set in legislation.

The report of the Property Tax Working Group (1992, 33–40) revealed a wide variation across municipalities in these relationships among effective tax rates. The data for a sample of 40 municipalities presented in table 27.8 make the same point. Relationships among effective tax rates on different classes of property are extremely diverse across municipalities for both residential and non-residential properties.

For residential properties, these differences occur both within the single family residential sector and between the residential single family and multiple unit sectors. Effective tax rates on single family residential properties ranged from 27 to 131 per cent of the commercial rates in the sample considered. The provincial average effective tax rate of residential property relative to commercial property in 1991 was 49 per cent. By contrast, multi-residential (more than seven units) properties are taxed in a range of 49 per cent to 224 per cent of commercial rates. The provincial average in 1991 was 138 per cent.

Industrial properties show similar inequities. The effective tax rate for industrial properties should be the same as for commercial properties. In practice, though, the study showed it ranges from 84 per cent to 253 per cent, with the majority of municipalities taxing industry at well over 100 per cent of the commercial rate. The provincial average was 112 per cent.

Figures 27.5, 27.6, and 27.7 illustrate how effective tax rates on residential, multi-residential, and industrial property, respectively, vary relative to commercial property. For each type of property, the distribution of effective tax rates relative to the effective tax rate on commercial property is compared with the legally mandated relationship.

From a tax policy standpoint, the situation presented by this chaotic system is virtually impenetrable for the average taxpayer and is the source of much anger and frustration. The apparent tax policy – residential tax rates at 85 per cent of commercial and industrial tax rates – exists only as words on the pages of the Education Act, the Municipal Act, and the Ontario Unconditional Grants Act. The actual tax rate relationships are buried in significant differences in assessment practices that have never been acknowledged directly in any previous efforts at property tax reform. Local tax policy is determined by the Ministry of Finance, which decides what classes of property will be recognized as separate classes in class-by-class reassessments. By deciding what classes will be recognized, the ministry effectively decides which historical differences in tax policies will be preserved and which will be eliminated.

Although many of these issues are related to the fact that assessment systems are not consistent among municipalities, the basic problem goes beyond these differences. The system of market value assessment contains significant flaws that distort the assessment results it produces.

TABLE 27.8
Effective Tax Rate in Class as a Percentage of Commercial Tax Rate
Selected Ontario Municipalities, 1991

Municipality	Single family residential (1–2 units)	Multi-residential (7+ units)	Industrial
Cities			
Barrie	60	63	100
Burlington	83	202	163
Cambridge	58	146	100
Chatham	48	77	118
Cornwall	47	87	135
Etobicoke	42	162	168
Guelph	56	135	153
Hamilton	44	104	124
Kingston	68	121	131
London	71	151	157
Mississauga	85	142	126
Nepean	8[illegible]	161	140
North Bay	49	134	182
North York	32	125	84
Oshawa	65	138	238
Ottawa	72	153	n/a
Owen Sound	39	89	141
Peterborough	54	77	154
Sault Ste Marie	65	99	126
Scarborough	35	122	93
Sudbury	61	121	112
Thunder Bay	46	127	123
Timmins	52	97	114
Toronto	27	115	105
Windsor	66	124	157
Towns			
Halton Hills	70	137	164
Markham	85	157	105
Milton	58	166	121
New Liskeard	36	49	96
Oakville	84	187	165
Orangeville	83.	224	183
Pickering	60	104	97
Picton	61	80	118
Townships			
Augusta	60	n/a	253
Horton	56	n/a	n/a
McKellar	40	n/a	103
Mersea	75	110	167
Montague	43	n/a	111
Nakina	131	97	102
Stephen	67	71	114

Source: Fair Tax Commission calculation based on Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

FIGURE 27.5
Distribution of Effective Tax Rates, Residential (1–6 Units) Compared with Commercial, Ontario, 1991

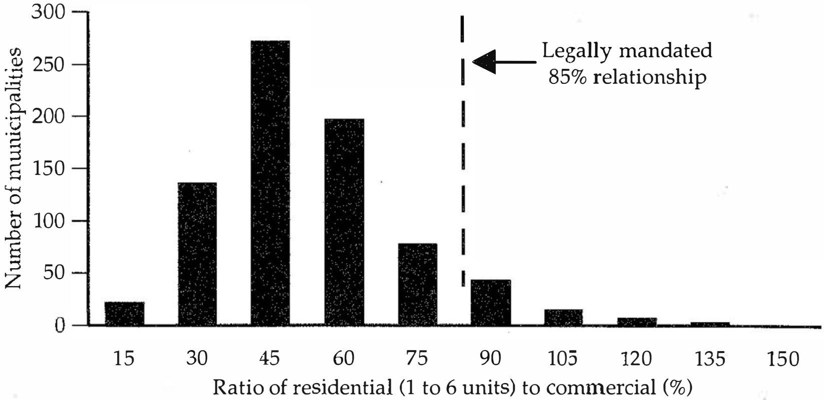
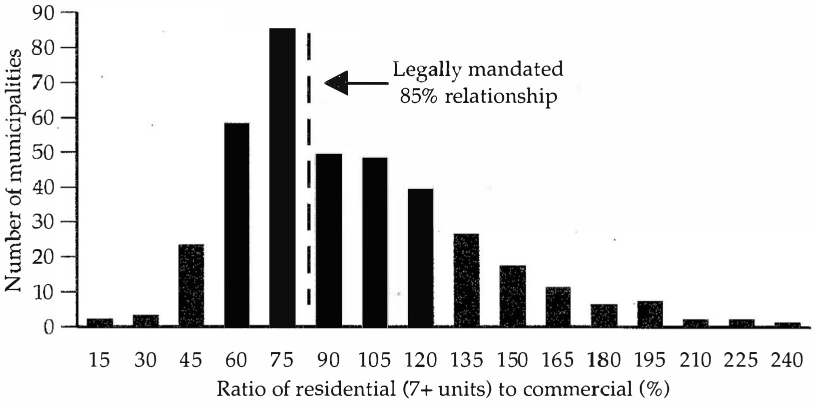
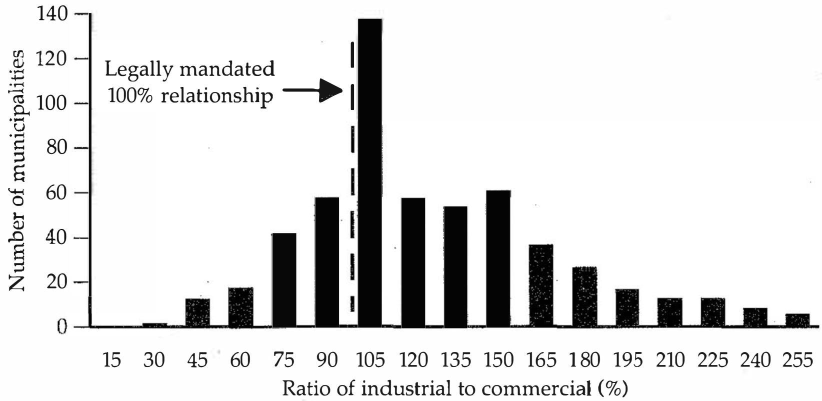


FIGURE 27.6
Distribution of Effective Tax Rates, Residential (7+ Units) Compared with Commercial, Ontario, 1991



Source: Fair Tax Commission calculation based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

FIGURE 27.7
Distribution of Effective Tax Rates, Industrial Class Compared with Commercial, Ontario, 1991



Source: Fair Tax Commission calculation based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

Properties in different classes have their market values calculated by different methods. There are three commonly used methods to determine the market value of property: the cost approach, the direct comparison approach, and the income approach. Each of these approaches measures something different.

- The cost approach involves estimating the value of the land as if it were vacant and then adding the cost of replacing any buildings on it, less an allowance for depreciation based on the age and condition of the building. This is the approach used to value most large industrial properties and some large commercial properties. Values are based on replacement cost without reference to whether replacement would be economically viable under current market conditions.
- The direct comparison approach estimates market value by comparing one property with similar properties that have recently sold. Adjustments are made for differences in the properties. This approach is used for single family residential properties and for some smaller commercial properties. Values arrived at using this

method will include whatever speculative value market transactions reflect in prices.

- The income approach values properties by the net rental income they can generate. Large commercial properties and multi-residential properties are valued by this method. The income approach attempts to measure the value of the income stream on a property. It reflects what a tenant in the property would pay to use the property as is, thus ignoring most speculative elements of value. It is normally based on such factors as how much money a tenant pays to use the property, what the average rate of return on investment is for properties of a similar type, and how much a buyer might be willing to pay for an income stream based on current rents.

Each of these methods takes into account elements from the other two methods, but the weight assigned to them is largely a matter for the personal judgment and experience of the assessor, as well as the circumstances under which the valuation is being prepared. Has there been an appeal on the property? Is there a general reassessment of the municipality taking place? Has there been some change to the property? Has the neighbouring property been appealed? Was there a court decision on that property which changed its value? Each of these circumstances can produce a different valuation and assessment on any given property, making it difficult for affected taxpayers to understand the basis for assessment.

Each of the three methods of estimating market value is a valid, recognized approach to property appraisal. But each measures something different and can result in varying estimates of value. To value different classes of property with such different methods, collect all the results into one system, and call it market value is misleading and inaccurate.

The use of different methods for different types of property introduces an element of randomness into the assessment results. Houses are assessed based on sales of similar properties in the immediate neighbourhood. Farm properties are assessed based on sales, but only on farmer to farmer sales (that is, based only on farms sold to buyers intending to farm the land, not to speculate with it, develop it, or put trailer parks on it). Large commercial and multi-residential buildings are assessed on the income they currently produce. By contrast, most smaller commercial properties are assessed on the basis of sales data that reflect development potential. Industrial properties are generally valued either on an estimated rental value or on a calculation of how much it would cost to replace the building on a similar piece of property. Anchor tenants in large retail malls are also often assessed on a cost basis. Retailers and other business people with commercial properties told us time and time again that the inequities inherent in the current system were a constant source of perplexity and frustration.

In addition to these theoretical concerns, the current approach to assessment raises a number of practical questions. The Ontario government has been responsible for property assessment since 1970. Since that time the resources allocated to assessment have decreased as a proportion of total provincial expenditures and the assessment bases in many municipalities have not been kept up to date. For example, new buildings, renovations, and changes in occupancy and in the use of a property are not always promptly reflected in the assessment roll. Municipalities lose millions of dollars in tax revenues because of the delays in assessing these properties. Commercial assessments are being challenged regularly and reduced by appeal tribunals because they are not up to date, or were not calculated accurately or defended effectively before the tribunal by the assessor. (It is the statutory responsibility of the regional assessment commissioner to defend the assessment base.) These successful appeals also cost municipalities and, indirectly, other taxpayers millions of dollars in lost tax revenue.

The Ministry of Finance has responded to reduced funding and staff levels by streamlining the assessment process. For residential properties, it relies increasingly on mass appraisal techniques and self-assessment by property owners. Mass appraisal involves the valuation of similar properties, such as houses in subdivisions or in blocks of similar houses, without individual inspections. While this method is more efficient, it does not take into account upgrades in the finish of the house or extras added after the house was completed. Although overall this streamlining may not cost the municipalities much in lost tax revenue, it does irritate taxpayers to discover that houses that command significantly higher market values than their own have been assigned the same assessment. After all, the assessment system is supposed to be based on market value.

The ministry has also attempted to reduce costs through a program of self-assessment, a relatively new activity. A form is generated from the Assessment Division's database that lists typical house characteristics. This form is sent to the property owner, who is asked to confirm the information or update it. People are warned that the forms will be audited and that there are penalties for being untruthful. Because experience in other tax programs shows that taxpayers on the whole comply voluntarily with such requests, the assumption is made that the forms will be returned with the correct information.

Information about the characteristics of the property is compared with information about similar properties nearby that have recently sold, and an estimated market value is established for each property. In areas that have not been reassessed in many years, such as the City of Toronto, these estimated market values are weighted to generate an assessment that would reflect the property's estimated value in the municipality's base year (in Toronto's case, 1940). There is a wide margin for personal interpretation or error in these retrospective calculations. Further, when the assessments of older houses in places such as Toronto are appealed, the market value of neighbouring similar properties is weighted, reduced to a square-foot rate, and applied to the area of the property under appeal. Although this approach is actually quite sensible and efficient, it is not recognized officially by the ministry as standard assessment practice and does not appear in any description to taxpayers of the process by which their share of local taxes is determined.

The current system of measuring values in different ways is indefensible. A similar situation with respect to any other tax would not be tolerated. Imagine an income tax system in which income from employment is measured in Japanese yen, dividend income in US dollars, interest income in Canadian dollars, and income from self-employment in German marks. Tax is determined by adding up all these numbers and applying a single tax rate. And neighbouring provinces use different currencies to measure the same things. Totally irrational. But for income from employment, dividend income, interest income, and income from self-employment read single residences, multiple residences, commercial property, and industrial property. For yen, US dollars, Canadian dollars, and German marks read seemingly random percentages of value. For provinces read municipalities. And you've got the property tax system.

Comprehension of the Property Tax System

The assessment system in this province is inconsistent and virtually incomprehensible to all but assessment officials and professional tax agents. In our public hearings, we heard repeatedly from frustrated, angry, and dissatisfied taxpayers who received assessment notices they didn't understand; who were given explanations of figures that didn't make any sense; who participated in an appeal process in which the points at issue were never clear, and the real issues never discussed; and who, in the end, felt that the process itself was biased against them.

From the taxpayer's perspective, the local government finance system is nothing short of impenetrable. The role of assessment in relation to tax is mysterious. In most areas, three distinct levels of government – lower-tier municipal, upper-tier municipal, and school boards – determine portions of the tax rate. Local politicians regularly blame the provincial government and each other for tax increases. The provincial government regularly accuses local politicians of fiscal irresponsibility. The assessment process generates numbers that are difficult to rationalize or relate to everyday experience. Local government finance is characterized by archaic language – mill rate instead of tax rate, for example.

The Assessment Act itself is difficult to understand – it relates to the world of the 1890s, not that of the 1990s. The act has been amended in a patchwork manner over the last 90 years to solve individual and unique assessment and taxation issues. While it has been reviewed by a number of commissions, some recommending comprehensive change, the act has never been the subject of a thorough legislative overhaul. In many respects it has not changed since it was rewritten in 1904. As a result, the Assessment Act is difficult to apply in today's society. The appeal process is also an anachronism. The Assessment Review Board evolved from the Court of Revision, the earliest mechanism for assessment appeal.The main responsibility of the Court of Revision was to resolve assessment complaints. There was no requirement that persons who sat on the Court of Revision be knowledgeable concerning property valuation, although they were presumed to have been selected for their common-sense approach to the issues.

The Assessment Review Board was set up in 1970 with the same responsibilities and characteristics as the Court of Revision. The Ontario Municipal Board considers appeals from Assessment Review Board decisions and is the final decision-making body on questions of fact. Questions of law are resolved by the courts. Since the Assessment Review Board is not a court of record, appeals from its decisions on assessment complaints to the Ontario Municipal Board result in a rehearing of the entire matter. In many complex cases, the parties to a complaint simply ask the Assessment Review Board to confirm the original assessment in order to speed up progress towards final determination by the Ontario Municipal Board.

The issues addressed by assessment complaints can range from changes in a taxpayer's designation of school support to complex valuation problems involving tens of millions of dollars in assessment and millions of dollars in property taxes. As a first-level complaints body, the Assessment Review Board must strike a delicate balance between the need for a technical capacity to deal with complex issues and the need to maintain an atmosphere in which non-expert complainants can present their cases fairly and effectively. The current system does not reflect an appropriate balance.

Taxpayers perceive the Assessment Review Board as lacking important knowledge and understanding of the system and as being unable to resolve crucial issues. Often Ministry of Finance officials are the only people present at hearings with an understanding of the system. Appellants are left with the impression that adjudicators defer to the expertise of the officials, making the process inefficient and undermining its credibility with taxpayer participants.

It would be tempting to attribute taxpayer concerns with the assessment system to lack of communication, to process defects, and to the fact that the system has not been reformed. It is certainly true that the local government finance system is complex and not well understood by the public; that the legislation that governs the process is archaic in its language and obscure in its meaning; that the appeals process leaves a lot to be desired; that the failure of successive governments to reform the system has layered complexity on top of complexity. But it would be misleading to suggest that the problems experienced by taxpayers with the assessment system can be resolved by redrafting the Assessment Act, making the assessment appeal process more professional, writing better pamphlets explaining the role of assessment in the local government finance system, and getting on with the job of implementing market value assessment. The root of the problem is in the goal of the assessment system itself.

While it sounds simple, measurement of the market value of an individual property is a complex process that is subject to the individual judgment of the property assessor. Measuring the market value of every property in a municipality on a consistent basis is a very tall order indeed. Much of the complexity in the assessment system is inevitable, given the decision Ontario has made to base local property taxation on a concept as difficult and elusive as market value. Much of the complexity in the broader system of local government finance is driven by the need to adapt other aspects of the system to the market value assessment base.

The Dysfunctional Provincial-Local Financial Relationship

Municipalities in Ontario exist constitutionally as "creatures of the province." This means that the roles, powers, responsibilities, and structure of municipal government are determined by the provincial government. In practice, a quasi-constitutional relationship has evolved which effectively recognizes local government as a third order of government and provides for a significant degree of stability in the provincial-municipal relationship and in the roles played by local governments.

That relationship is complicated, however, by three key characteristics.

- First, the programs and fiscal responsibilities of the provincial and local levels of government are intertwined and overlap in virtually every area of local government activity. This entangled relationship has been widely criticized for creating duplication and blurring lines of political accountability.
- Second, despite their access to local revenue sources, local governments are fiscally dependent on the provincial government. Municipalities received 30 per cent of their funding from the provincial government in 1991. The extent of provincial funding for locally delivered programs means that municipal governments are vulnerable to the effects of provincial policies. Changes in provincial spending priorities can have a direct impact on the policy choices open to municipal governments. General provincial fiscal policies have an equally direct impact on the capacity of municipal governments to plan and deliver services. Increases in provincial grants such as those of the early 1970s significantly ex-

panded the ability of municipalities to deliver services locally. Cutbacks, through the process described by municipal governments as "downloading," have the opposite effect.

- Third, although municipal governments have been able in recent years to broaden their revenue bases, they are still almost totally dependent on three related taxes – the residential property tax, the commercial and industrial property tax, and the business occupancy tax – as their sources of general revenue.

The importance of provincial grants in municipal finance, combined with the dependency of municipal governments on property taxes, creates an invisible but direct relationship between provincial fiscal policies and the levels of these taxes. When provincial grants go down, there is upward pressure on property taxes. If property taxes were relatively minor taxes in the overall provincial/municipal fiscal system, this relationship might be of little interest from the perspective of taxation policy. However, property taxes are anything but minor taxes. Property-based business taxes (the commercial and industrial property tax and the business occupancy tax) are by far the largest single source of revenue from business under Ontario's jurisdiction. The residential property tax is the second-largest tax borne by individuals in the province. As a result, policies that influence the level and distribution of these local taxes are important elements of provincial tax policy.

During the past 30 years, the services provided to the public by both the provincial and local levels of government expanded rapidly to meet the changing needs and expectations of Ontario residents. Today, services such as policing, social services, transit, and waste management are essential to the quality of life in the province. However, services at the local level are delivered within a complex web of interrelated and overlapping responsibilities shared by the provincial and municipal governments. For example, municipalities now deal with 15 different provincial ministries to secure funding to support their responsibilities for program delivery. More than 100 different conditional grants programs exert a significant influence on municipal spending priorities.

Over the years, various study groups have looked into the provincial-local financial relationship and have focused primarily on concerns related to accountability and efficiency. The most recent of

TABLE 27.9
Distribution of Lower-Tier Municipalities by Size, Ontario, 1991

Population	Number of municipalities
1000 and under	208
1001–2500	247
2501–5000	145
5001–10,000	85
10,001–25,000	59
25,001–100,000	39
100,001–250,000	9
Over 250,000	8

Source: Fair Tax Commission calculation based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

these groups, the Advisory Committee to the Minister of Municipal Affairs on the Provincial-Municipal Financial Relationship (Hopcroft Committee), recommended that steps be taken to "disentangle" the provincial-municipal relationship (Hopcroft Committee 1991).

Participants in our public hearings highlighted the problems of duplication and waste that result when responsibilities are not clearly defined and activities overlap. Both school board and municipal leaders complained bitterly about cutbacks in provincial cost sharing that effectively downloaded the responsibility for funding important services onto local government and therefore onto property tax payers. From members of the general public, however, local government itself came in for its share of criticism. The overlapping responsibilities of the two levels of municipal government were often cited as examples of waste and duplication that contribute to high property tax levels. There is also widespread frustration with an education system whose governance structure is complicated by two, three, or even four elected school boards operating in parallel in the same geographical area.

TABLE 27.10
Distribution of School Boards by Total Enrolment, Ontario, 1990

Number of students enrolled	Number of boards
0–999	15
1000–1999	9
2000–2999	11
3000–3999	10
4000–4999	4
5000–9999	23
10,000–14,999	17
15,000–19,999	15
20,000–24,999	5
25,000–49,999	9
50,000–74,999	2
75,000–99,999	2
100,000–149,999	0
150,000–199,999	0
200,000–250,000	1

Source: Ontario, Ministry of Education administrative data.

One of the major problems with the various reform exercises that have attempted to address these funding and jurisdictional problems is that they have been based on the assumption that there is a "typical" local government around which proposals for reform can be built. Nothing could be further from the truth. At the end of 1991, 832 municipal governments in Ontario served a population of 10 million people. These municipalities vary significantly in population, responsibilities, administrative resources, and ability to raise revenue.

Ontario's municipal sector is characterized by many very small, sparsely populated municipalities and a few very large municipalities, with more than half the population concentrated in the area surrounding Metro Toronto. Table 27.9 shows how municipalities in Ontario are distributed by size. Almost 75 per cent of all lower-tier municipalities in Ontario have a population of fewer than 5000 people, and only 2 per cent have populations of more than 100,000. From another perspective, 15 per cent of all lower-tier municipalities contain 80 per cent of Ontario households (Hopcroft Committee

1991, 8). These large variations mean that no single answer will normally be adequate to deal with the problems faced by differing municipalities. Different solutions must be developed for the different categories of municipalities.

Similar issues arise with respect to school boards. Ontario's public elementary and secondary education system provides instruction to approximately 1.8 million students, operates nearly 5000 schools, and employs approximately 120,000 teachers. As table 27.10 shows, a substantial proportion of boards serve relatively small student populations. Thirty-five of the 123 larger boards represented have enrolments of 3000 or less.

Infrastructure Funding

Paying for the infrastructure needed to support urban growth has been a major issue in recent years. The Federation of Canadian Municipalities has drawn attention to the deterioration of the physical infrastructure of urban areas in Canada as federal funds have been withdrawn and provincial governments have had to deal with increasingly difficult financial circumstances. As federal and provincial capital funds dried up, municipalities looked to the development process itself as a source of funds for road, water, and other services through the imposition of lot levies and the negotiation of agreements with developers as a condition of zoning or subdivision approval. In 1989 the Development Charges Act formalized municipal authority to levy development charges and, for the first time, established the right of school boards to levy their own development charges.

The funding of infrastructure in growing areas through the imposition of special charges, which are passed on to new residents in the form of higher prices for housing and for commercial and industrial space, has raised both legal and public policy issues. The constitutional validity of the Development Charges Act has been challenged in the courts, and the funding of new infrastructure from special charges borne by residents has been attacked as bad housing policy because of its impact on housing prices. This approach to funding also raises issues of tax fairness that were brought to our attention during our public consultation process. Questions were raised about the fairness of requiring one group of taxpayers to pay a special fee for services which, for other taxpayers, are funded from general taxes paid by everyone – including those paying the special levies – and about the fairness of requiring one generation of taxpayers to pay the full cost of infrastructure developments that will be of benefit to future generations.

Interrelated Problems Demand a Coherent Solution

A system of local government finance must answer a number of basic questions:

- What services should be provided by local government and funded from its local tax base?
- How should the costs of local government be allocated among individual residents of each local jurisdiction?
- How should the costs of local government be allocated among businesses in each local jurisdiction?
- How should the costs of local government be allocated between individual taxpayers and business taxpayers?
- How should the costs of services provided by upper-tier (county, regional, and metropolitan) jurisdictions be allocated among the lower-tier (local) municipalities that make up the jurisdiction?
- How should the provincial government allocate funds to assist in the financing of local services among municipalities and school boards generally? (Bossons et al. n.d.)

With the exception of the first question, which deals with the mandate of local governments, the official answer to all these questions in Ontario since the provincial take-over of assessment in 1970 has been based on a presumption that all properties in the province would be reassessed at full market value with a common base year. In this system, taking the pre-existing fiscal responsibilities of local government as given, the costs of local government services would be allocated among all local taxpayers in proportion to the market value of their property. In addition to resolving the basic problem of assessment – the measurement of the tax base for local government – market value reassessment was also intended to form the basis for the remainder of the system of local government finance.

In this scenario, market value assessment would determine the local tax mix between residential and commercial/industrial taxpayers. A single rate of tax would be applied to all property assessed at market value, and the mix of tax revenue for each local government between residential and commercial/industrial property would be determined by the total market value of each type of property.

Using market value assessment as a measure of the local taxpayer's ability to pay and of the capacity of a local municipality to shoulder a portion of the upper-tier burden, market value assessments would also determine apportionment of upper-tier costs among lower-tier jurisdictions. Jurisdictions with relatively large amounts of commercial and industrial assessment would pay relatively more as would jurisdictions with relatively higher-value residential properties.

Market value assessment would also be used as an indicator of the community's ability to pay in determining how provincial grants to support local services would be allocated. Local governments with relatively large market value assessment bases would receive less provincial support; local governments with relatively small assessment bases would receive more provincial support.

Previous Attempts at Assessment Reform

Following its assumption of responsibility for assessment in 1970, the provincial government made a number of attempts to follow through on the original purpose for the take-over and to introduce a uniform assessment system across the province. In the early 1970s the Assessment Act actually specified an effective date for a new assessment system. As details of the potential impact of a uniform system of assessment and taxation for all types of property became clear, however, significant opposition to the proposed change emerged. One of the major problems with the proposal concerned its impact on the shares of local taxes raised from residential and non-residential property, and, within the residential sector, from multiple unit property and single family property. Non-residential property and multiple unit residential property had traditionally been overassessed relative to single family property.

In proposing a new system incorporating a common assessment and tax system for all types of property, the government was effectively proposing a substantial tax shift against single family residential property and in favour of non-residential property and multiple unit residential property. When political opposition to this shift became too strong, the government appointed a commission to review the concerns raised about uniform market value reassessment and to recommend a response to the government. The Commission on the Reform of Property Taxation in Ontario (Blair Commission) recommended that the provincial government continue with its plans for market value reassessment. To offset the province-wide tax shift that would otherwise take place, however, Blair proposed that single family residential property be reassessed at a lower percentage of its market value than multiple unit residential and non-residential property. This would make it possible to maintain the implicit policy of assessing single family residential property at lower rates than other types of property, but at the same rates across the province.

The Blair Commission's report led, in turn, to the most comprehensive attempt at reform, announced in January 1978 by Treasurer Darcy McKeough. The details presented in that announcement are interesting for a number of reasons. First, the statement presents a catalogue of problems with the assessment system that would apply as well today as it did in 1978. Second, the proposals advanced show a determination to produce a single answer to all the problems. Third, the eventual failure of these proposals illustrates the difficulty of finding a workable approach to reform of the system of local government finance, if the scope of reform is limited to the assessment system.

The statement catalogued inequities in the distribution of provincial grants, the apportionment of costs of upper-tier municipalities and school boards among local municipalities, the distribution of tax burdens among different classes of properties, the relative tax burdens of similar properties, the tax treatment of government properties, and the system for exemption of particular properties from local taxation (McKeough 1978, 4). As a solution to these problems, it proposed a uniform province-wide system of assessment and taxation based on the market value of real property. The statement also suggested that a reformed assessment system should be used as the basis for resolving a host of other tax and provincial grants policy problems.

While McKeough's proposals offset the impact of reassessment on the distribution of tax burdens among classes or types of property at the provincial level, they ignored the variations in assessment systems and practices in existence at the local level by proposing that rates of assessment be uniform across the province. When it became clear that the 1978 reforms were unworkable, the provincial government essentially abandoned its goals of a single uniform assessment system for all properties and a uniform taxation policy for all local governments. As an alternative, it shifted the decision on reassessment to the municipal level, and offered partial reform options that preserved existing differences in taxation policy at the local level.

Class-based reassessments, conducted under section 58 of the Assessment Act (formerly section 63), equalize assessments within classes of property (such as single-family residential, multi-unit residential, commercial, and industrial). In class-based reassessments, all properties in a class are reassessed at the same percentage of their estimated market value in a specific year. Within the class, some assessments increase; some decrease. But the point of the class-based reassessment is that the class as a whole pays the same amount of tax after the reassessment as it did before. This approach has been favoured by many municipalities because it avoids tax shifts among classes, but for that reason it perpetuates inequities in the distribution of the tax burden particularly between tenants and homeowners and between commercial and industrial property owners.

Although uniform reassessment for all classes of property on the same basis across Ontario has vanished as a provincial objective, it is still available as a local and upper-tier option. In so-called full market value reassessment (section 63 of the act, formerly section 70) each property is reassessed at its estimated market value in the chosen base year without concern for the protection of class tax burdens. Because this system causes tax shifts among classes, especially when first implemented, it is usually adopted only by municipalities with a limited commercial/industrial tax base – generally rural and farm municipalities with stable property values.

More recently, in a number of areas, all municipalities within a county or region have been reassessed at the same time and on the same basis. Most of these upper-tier–wide reassessments have been class-by-class reasssessments under section 58 of the Assessment Act. This has been done to try to address differences in assessment between local municipalities in the same upper-tier jurisdiction.

In official explanations of the reassessment programs, a great deal of emphasis is placed on the number of municipalities that has been reassessed since 1970. The numbers sound impressive: 730 municipalities, or 87 per cent, reassessed. In fact, however, only 20 per cent of municipalities have been reassessed at full market value; 67 per cent have been reassessed on a class-by-class basis only. And a total of 29 per cent of all municipalities are now operating on assessment bases that are at least 15 years old.

When population is factored into the summary, the rural bias in the reassessment success story is evident. The 13 per cent of municipalities that have not been reassessed at all make up 34 per cent of the population. More than 45 per cent of the population lives in municipalities whose assessment base is 15 or more years out of date. Only 6 per cent of the population lives in municipalities that have been reassessed at full market value (FTC calculations based on Ontario Ministry of Finance, Assessment Division, 1993).

While these reassessments have addressed some of the problems at the local level, they have failed totally to address the more general problems that formed the basis for the provincial take-over of assessment in the first place.

Inconsistencies remain for a number of reasons. There has been a lack of political will to risk the changes needed to address the inequities and inconsistencies that have grown over the past 20 years. This reluctance has translated into a decreasing budget for the Assessment Division that has meant fewer staff, less resources for the staff to work with, and a loss of credibility with the taxpayers.

The lack of the political will to implement province-wide reform is partly a consequence of the substantial shifts in tax burden that such reform would create. Although differences in local assessment practices are often described as accidents of history with no rational explanation, they may in fact reflect differences in local taxation policy that developed over time and were hidden in the local assessment system in order to preserve the appearance of compliance with provincial standards. As a result, dismissing these differences as accidents and attempting to wipe them out by imposing a uniform system across the province has the effect of eliminating long-standing variations in taxation policy at the local level. The elimination of these hidden differences in taxation policy in assessment reform, without at the same time reforming the role of the property tax, would have the effect of creating substantial increases in tax burdens for some classes of property at the local level. Ultimately, the prospect of such tax increases doomed reform initiatives in the 1970s to failure.

Although market value assessment has not been implemented generally in Ontario, it is used to determine the share of the costs of upper-tier governments to be borne by taxpayers in each of the local municipalities that make up the upper-tier government. It is also the basis for provincial grants for education and other programs. Equalization factors determined by comparing estimated market values with assessments on sample properties are used to adjust local aggregate assessment figures to reflect current market values.

A reformed assessment system is clearly needed in Ontario. However, apart from conceptual problems with the use of market value as an assessment base, market value itself has proven to be difficult to estimate consistently in practice. In addition, it is not obvious that such a reformed system need necessarily be used to determine the local tax mix, the local shares of upper-tier costs, and the allocation of provincial equalization grants among local governments. There are significant problems associated with its use for these other purposes, suggesting these functions should be uncoupled from assessment.

The problems faced by Ontario's system of local government finance are interrelated and cannot effectively be addressed in isolation from one another. But there is no one solution for all these problems. In fact, the issues are far too complex for a one-dimensional policy response to be effective. Our approach to the issues of local tax mix and local government finance flows from two basic points of departure.

First, the residential property tax and the commercial and industrial property tax should be considered as two different taxes. Each has a different impact on people and on the economy. There is no reason in principle why the two tax bases should be measured in exactly the same way and taxed at the same rate, and no reason in principle why the mix of local taxes between residential taxes and commercial and industrial taxes should be determined on the basis of the total assessed value of the property in each class.

Second, the issues of local apportionment and provincial equalization can be resolved independently of the assessment system. While it is obviously possible to determine apportionment and equalization payments based on assessment, there is no reason why they must be. Whether assessment is used as the basis for apportionment or equalization depends on how well assessment performs against other methods in achieving public policy goals.

The appropriate direction for reform depends critically on the particular framework of tax fairness in which the issues are analysed.

28 Paying for Services: Property Taxes in a Fair Tax System

In chapter 27 we identified significant problems with the current system of local government finance in Ontario. Virtually every aspect of the system was described as being in a state of crisis or near crisis. Our analysis of the data confirmed these concerns. Given the wide range of important issues to address, it would be tempting to plunge right in and begin considering specific options for reform of the system. As our analysis suggests, however, that would be a mistake. The extent to which issues in local government finance are interrelated requires a systematic policy response from a carefully considered and consistent conceptual framework.

Because of the importance of the property tax in local government finance, the fundamental question that must be addressed is, under what circumstances and in what context can property taxes be considered fair? The way we answer that question has important implications for the design of virtually every aspect of Ontario's system of local government finance.

The Property Tax and Tax Fairness

There are two ways in which property taxes might be considered to be fair. If there were a systematic relationship between property taxes paid and the ability to pay of taxpayers, property taxes would be seen as fair according to the ability-to-pay principle of tax fairness. Alternatively, if there were a systematic relationship between the amount of tax paid by an individual taxpayer and the benefits received by that taxpayer from services funded from the tax, property taxes would be seen as fair on the benefit principle of tax fairness.

Evaluating property taxes and ability to pay is relatively straightforward. It simply requires an assessment of the relationship between property taxes and various potential measures of taxpayers' ability to pay. It is somewhat more complex to determine the relationship between property taxes and benefits received because it depends on what services are being funded from property taxes. If property taxes are used as the source of funding for services that should not be funded from benefit-related taxes, property taxes used to fund those services would not be seen as fair on a benefit approach to fairness.

In the analysis that follows, we test property taxes against these basic principles of fairness and reach clear conclusions that have profound implications for Ontario's system of local government finance. We find that:

- There is no systematic relationship between residential property taxes and ability to pay as measured either by income or by net wealth. On average, regardless of how ability to pay is measured, property taxes are regressive. When comparing individual taxpayers, the relationship between property tax and ability to pay is weak.
- More than half of the property tax bill in Ontario supports services such as education, social assistance, and services for children. None of these services should be funded from benefit-related taxes.
- A further portion of the property tax bill in Ontario supports services such as sewer and water services and solid waste collection and disposal for which direct benefits taxes or user fees are the most appropriate source of funding.

From these findings, we conclude that:

- The residential property tax cannot be seen as an ability-to-pay–related tax and should be viewed as a benefit tax for services of local benefit.
- The non-residential property tax may be viewed either as a benefit tax for services of local benefit or as a general tax on business. As a local benefit tax, it is subject to the same considerations as the

residential property tax. As a tax on business activity in Ontario, it must be judged in comparison with other taxes on business such as capital taxes and corporate income taxes.

- Education, social assistance, and assistance to children should not be funded from property taxes. Instead, these services should be funded from provincial general revenue sources.
- Sewer and water services and solid waste collection and disposal should be funded primarily from user charges.

In this chapter, we set out the research on property taxes and local services that supports these arguments and draw specific conclusions about the funding of education, social assistance, services for children, and environmental services. This analysis has direct implications for the role of residential property taxes in particular in the mix of taxes used to support public services in Ontario. It also has implications for the basis to be used for property assessment, for local tax policy, for provincial grants policies, and for the overall functioning of the system of municipal finance. These implications are analysed, with conclusions drawn in chapters 29, 30, and 31.

Residential Property Taxes and Ability to Pay

A number of arguments are traditionally advanced to support the idea that residential property taxes are related to ability to pay. One suggests the value of the residential property occupied by a household is related to the income of the household – the higher the income, the higher the value of the residential property. In this approach, the value of the property of the household acts as a proxy for its ability to pay, measured by its income. A second argument suggests the value of residential property is an indicator of the ability to pay of the household, as measured by its wealth. In this approach, the gross value of the property occupied by the household is taken as a proxy for the net wealth of the household, and the property tax is viewed as a type of wealth tax. A third argument views the residential property tax as compensating for the fact that the personal income tax does not include in income the imputed income (in the form of rent-free housing) received by owner-occupiers. In this approach, the gross value of residential property is seen as a proxy for the net benefit derived by taxpayers from owner-occupied housing. A fourth argument suggests the residential tax generally as a way to tax increases in the value of real property that would otherwise escape capital gains taxation.

The first argument presents a fairly straightforward proposition concerning the relationship between the value of residential property occupied and income. This analysis is conducted not to determine how well the property tax resembles the income tax, but to test the proposition that the property tax can be characterized as a tax related to ability to pay.

Each of the other arguments, however, is subject to serious conceptual problems. If the property tax really were a way to tax wealth, it would have to apply only to owner-occupiers and would have to be based on the net value of property after allowing for mortgage debt. While there may be some debate as to how much of the property tax is shifted from landlords to tenants, it is beyond question that some of the property tax is shifted. Housing does not represent wealth to a tenant. In addition, in the wealth tax approach, it is clearly net wealth that should be subject to tax, not gross wealth. The fact that the property tax is paid by tenants as well as owners, and that it makes no allowance for mortgage debt, clearly undermines this line of argument. Finally, it would be difficult to justify designing a wealth tax that included only one asset in the base unless it was an extremely good proxy for total wealth. Our analysis, presented below, shows clearly that the market value of a principal residence is not at all a good proxy for net wealth.

The same problems arise in considering the property tax as a way to tax the imputed income from housing. First, if it is a tax on imputed income from housing, it should not apply to tenants. There is no imputed income from rental housing. The net income from rental housing is already taxed in the hands of the landlord. Second, there is no conceptual basis for a proxy relationship between the imputed income from owner-occupied residential property and the market value of the property. The only relationship for which there might be a conceptual basis is between imputed income and the value of the property after allowing for mortgage debt. Interest on mortgage debt is not part of the imputed income from the property; a value that does not account for mortgage debt cannot serve as a proxy for imputed income. Again, the fact that the property tax applies to tenants as well as to owner-occupiers and makes no allowance for mortgage debt undermines the argument.

The argument that property taxes are really a way to compensate for the fact that capital gains on principal residences are not taxed in the income tax system is subject to the same criticism; if that were the role of the property tax, it would not apply to tenants at all, since they clearly cannot benefit from any capital gain on the property they occupy. This argument runs into a second problem as well. If the property tax were really a capital gains tax, the appropriate measure of the tax base would be the increase in the value of the property, not the current gross value of the property. In a market value property tax system, increases in property taxes from valuation to valuation might reflect capital gains (although not necessarily capital gains received by the owner paying the increased tax), but there would be no reason to expect the total value of the property to bear any systematic relationship to periodic increases in value. In any case, the more straightforward and effective way to tax capital gains on owner-occupied residential property would be to alter the treatment of these gains in the income tax.

Residential Property Tax and Income

We conducted these studies of the relationship between property taxes and income and between the market value assessment of residential property and income. The first study used a model based on province-wide data to measure the overall relationship between property taxes and income. The second used data on incomes and property values in individual municipalities to measure the relationship between assessed value and household income. The third used data on family income and assets from Statistics Canada's 1984 wealth survey (Statistics Canada 1986).

The province-wide study used the Social Policy Simulation Database and Model (SPSD/M) developed by Statistics Canada as a tool for public policy analysis. It looked at the relationship between property taxes and family income. The study results confirmed the general findings of most other studies – that residential property taxes are regressive. Lower-income families pay a higher proportion of their incomes in property tax than higher-income families. The Fair Tax Commission study found that the regressive pattern was particularly pronounced in the lower and middle income ranges, $50,000 and below. It also found that when the provincial property tax credit (administered through the income tax system) is taken into account, households in the $20,000–$30,000 range still pay proportionally more property tax than higher-income households.[1]

For the purposes of the study, it was assumed that property taxes on residential rental accommodation are ultimately paid by tenants through their rents. Given the fact that property tax increases have been passed through into rents under rent review and rent control in Ontario for nearly 20 years, that would appear to be a reasonable assumption. A number of different assumptions about the shifting of taxes in rental property were tested. Generally speaking, the greater the extent to which taxes were assumed to be shifted to tenants, the more regressive the pattern appeared to be.

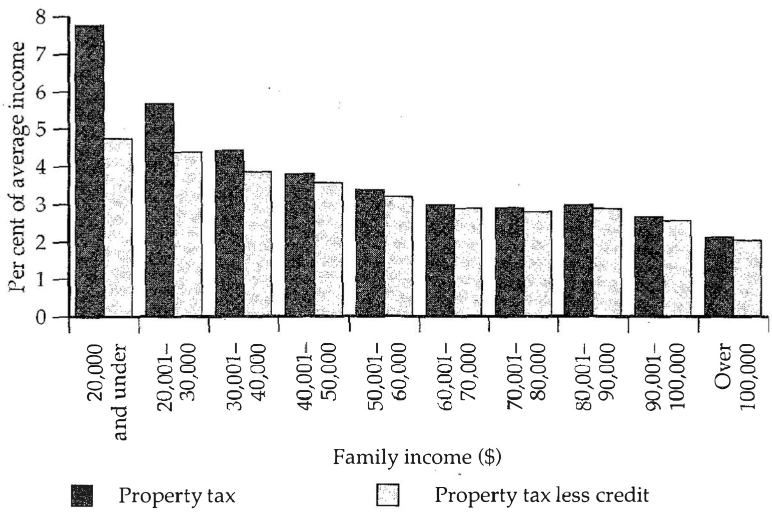
Figure 28.1 shows the overall results of this study. It presents the average percentage of household income paid in property taxes by households according to their income. Two different results are presented. One shows the impact of property tax as a percentage of income (the dark bars) without taking into account the property tax credit administered through the income tax system. The other shows the effect of property tax credits on the incidence of the property tax. Households with incomes in the $20,000–$30,000 range paid out roughly 5.7 per cent of their income in property tax. Households in the $60,000–$70,000 range paid 3 per cent of their income in property tax. The property tax credit reduced that average impact by 1.5 per cent – to 4.2 per cent – for households in the $20,000–$30,000 income range. In the $60,000–$70,000 income range, the credit had relatively little impact.

These results speak to the relationship between average property taxes and average incomes in different income ranges as a measure of the vertical equity (appropriately unequal treatment of unequals) of the property tax. The study also looked at how the impact of property tax on household income varies among households in the same income range as a measure of the horizontal equity characteristics (equal treatment of equals) of the tax.

---

[1] The analysis summarized in figure 28.1 assumes that property taxes are fully passed through by landlords to residential tenants. An alternative assumption of a 50:50 split between landlords and tenants shows a similar overall pattern that is somewhat less regressive at lower household income levels.

FIGURE 28.1
Estimated Effect of the Property Tax Credit in Offsetting the Property Tax Paid by Ontario Households in 1991



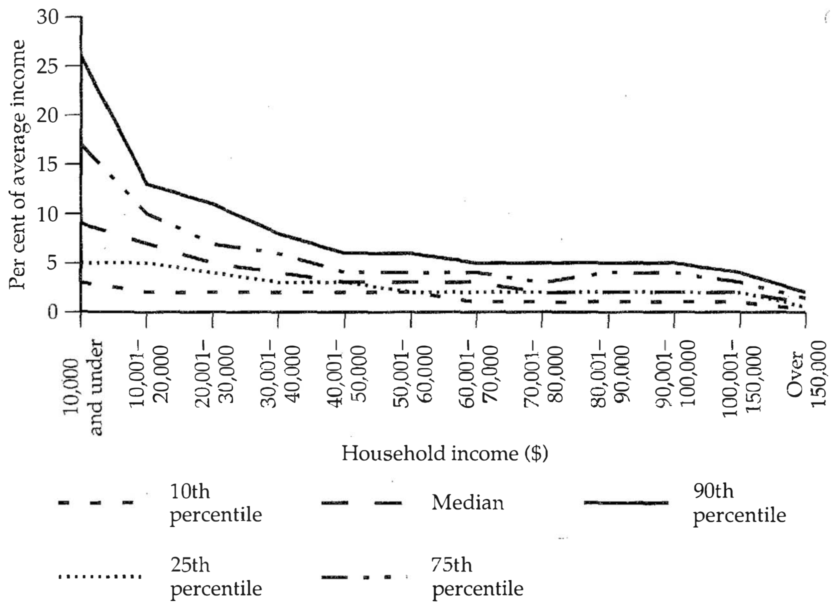
Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M); 1988 data adjusted to 1991 values.

Note: In this example, it is assumed that property tax levied on multi-residential buildings is passed on to tenants. See also note to figure 16.1.

The study found substantial variability in property tax as a percentage of household income among households in the same income range. These results are summarized in figures 28.2 and 28.3.

Figure 28.2 shows the percentage of household income accounted for by property taxes in Ontario for each household income range. The vertical axis shows property tax as a percentage of household income. The horizontal axis shows ranges of household income. The lines plotted on the chart show the impact of the property tax on the median or average household in the province in 1991. (The lines above and below the average illustrate the range in impact of variations in property taxes in each income range.)

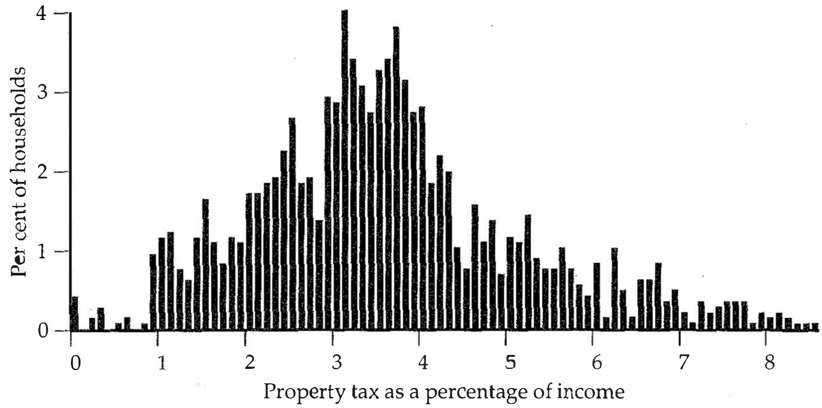
FIGURE 28.2
Dispersion of Property Tax Impact on Household Incomes, All Ontario Residents, 1991



Source: Fair Tax Commission estimate based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M); 1988 data adjusted to 1991 values.

The middle line, shown on the legend as the median, shows the impact on the average household in the income range. In the $40,000–$50,000 range, half the households pay more than the median of 3.5 per cent of their income on property taxes and half pay less than 3.5 per cent. The bottom line in the chart is the 10th percentile. For 10 per cent of households in each income range, the impact of property taxes on income is lower than the percentage indicated by the 10th percentile line. For example, in the $40,000–$50,000 income range, one-tenth of households pay less than 1.75 per cent of their income. The second line from the bottom is the 25th percentile. In each income range, 25 per cent of households pay less in property tax as a percentage of income than the percentage shown by the 25th percentile. In the $40,000–$50,000 range, one-quarter of

FIGURE 28.3
Distribution of Property Tax Impact, Ontario Households with Incomes of $40,000–$50,000



Source: Fair Tax Commission estimate based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M); 1988 data adjusted to 1991 values.

households pay less than 2.5 per cent of their income on property taxes. The fourth line from the bottom of the chart is the 75th percentile. In each income range, 75 per cent of the households pay less in property tax as a percentage of income than the percentage indicated by the 75th percentile line. In the $40,000–$50,000 income range, three-quarters of the households pay less than 4.5 per cent of their income in property taxes, and one-quarter of households pay more than 4.5 per cent. The top line in the chart is the 90th percentile. Ninety per cent of households in each income range pay a lower percentage of their income in property tax than that indicated by 90th percentile. For example, in the $40,000–$50,000 income range, 90 per cent of households pay less than 6 per cent of their income on property taxes; 10 per cent pay more.

Figure 28.3 presents the same information described in the text following figure 28.2, but in another form. It is a cross-section of figure 28.2, showing the distribution of the impact of property taxes for households in the $40,000–$50,000 income range.

Figures 28.2 and 28.3 illustrate two key points. First, the range of residential property taxes as a percentage of household income in each income range is very broad. Looking again at the $40,000–$50,000 income range, the figure shows that half of all households with income in this range pay between 2.5 per cent and 4.5 per cent of their income in property tax. However, one-quarter pay more than 4.5 per cent; one-quarter pay less than 2.5 per cent. This diversity illustrates very clearly a problem of horizontal equity – the principle that taxpayers in a comparable economic situation should pay a comparable tax – with property tax. Households in similar financial circumstances pay very different amounts of property tax. Second, figure 28.2 shows plainly the familiar regressive profile of the residential property tax. Property taxes are shown as declining as a percentage of household income over the entire income range. Although the range of variation narrows in absolute terms as income increases, it remains essentially the same, in relative terms, over all income ranges.

Studies such as these, which use data from general statistical surveys, must be interpreted with care. First, either the property tax data or the income data or both usually come from surveys relying on self-reporting of these amounts by survey respondents. This method creates the potential for error that might distort the results. Second, because these studies are based on data that cover a number of local jurisdictions, they cannot allow for differences in assessment systems, provincial grants, local tax mix, and the overall size of the local public sector. Third, these types of studies are not based on actual property tax data for rental properties. It is generally assumed that property taxes make up a constant proportion of rents, and that calculated figure is what is used as the measure of property taxes on rental property. Data from Ontario's rent control program suggest this proportion varies both with the age of the building and among municipalities.

To address these problems, we conducted our own study of the relationship between property values and household income, using data that permit the analysis to be done at the level of the individual municipality and that make possible an analysis of the relationship between a number of property characteristics measured in the assessment database and household income.

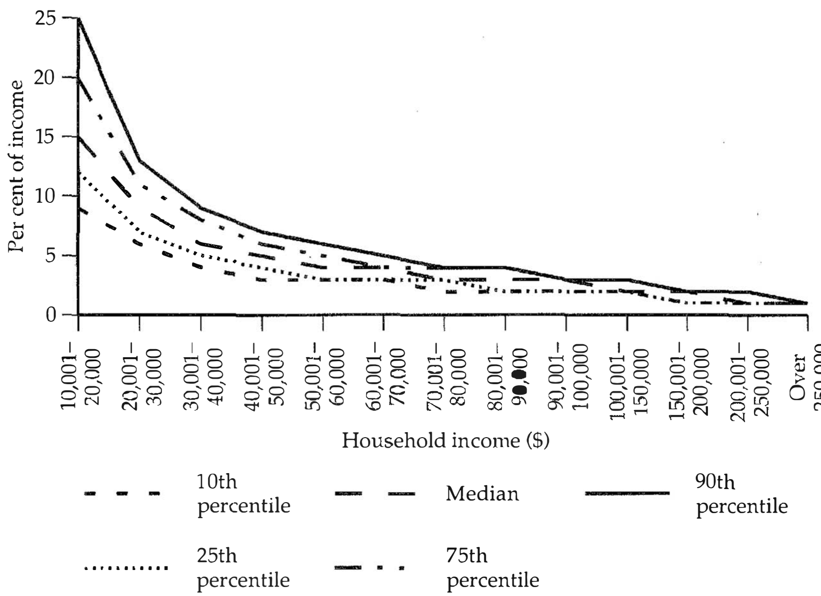
This study design addresses, in part, one further criticism of the kind of general tax incidence analysis done for the Fair Tax Commission. In typical studies of this type, the pattern of distribution of tax impacts is largely predetermined by the assumptions made in advance about how the burden of the tax is distributed. This relationship between assumptions and results is a common weakness in traditional studies (Kitchen 1992, 55–57). In our studies, the impact of this problem is reduced because the nature of the database allows the analysis to be done separately for different types of properties, for owner-occupied properties and rental properties and for different types of households. It is therefore not necessary to include in the same component of the analysis properties for which different assumptions about who ultimately bears the tax would be appropriate. As a result, while the absolute level of tax for each category of property analysed will vary depending on how it is assumed the burden of the tax is distributed, the distribution within each category will be independent of those assumptions.

Final results of this study are available in a publication of the Fair Tax Commission's research program (Bossons n.d.). The study drew data from three sources: individual income tax records from Revenue Canada for all income tax filers in Ontario; assessment and enumeration data for each residential property in the province from the Assessment Division of the Ontario Ministry of Finance; and, for communities not operating on an updated market value assessment system, the most recent market value estimates from Ministry of Finance reassessment studies. Both the income tax and some of the assessment data used in this study are confidential. The data are accessible only on a restricted basis to authorized employees of the Ministry of Finance. We were permitted to conduct the study described here and to report its results in a way that maintains the confidentiality of the underlying data.

The first step in the study was to create household income data from the income tax database. These households were then matched to individual property assessments and estimated market value records from the Assessment Division of the Ministry of Finance to create a database that linked household income and a variety of information maintained by the Assessment Division, including various physical measurements of the property occupied by the household as well as its assessment and current estimated market value.

The summary information presented in this report is drawn from an analysis of this combined database.

FIGURE 28.4
Dispersion of Property Tax Impact, Pickering Homeowners, 1990



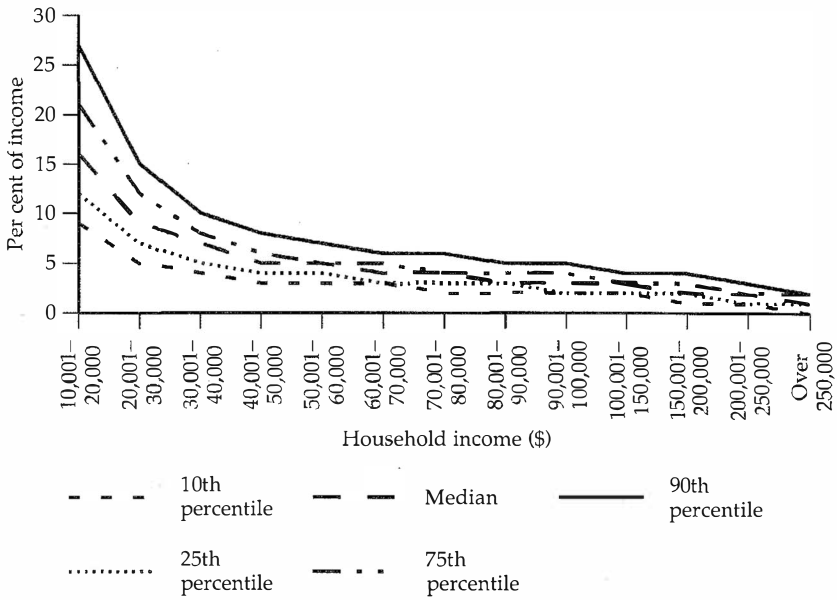
Source: Fair Tax Commission Income Tax and Assessment Record Matching Project.

Two communities were studied in the first phase of this project: the Town of Pickering in the Regional Municipality of Durham and the City of Etobicoke in Metropolitan Toronto. These studies used income tax records to generate household income data and then linked these household data to assessment and property tax data.

The findings for the two areas were similar. Overall, the pattern in each case was regressive: property taxes declined as a percentage of household income as that income increased. As was the case for Ontario as a whole, however, within income ranges the assessed value of property and the impact of property taxes on household income varied widely. These variations are illustrated in the figures below.

Figures 28.4 and 28.5 are in the same format as figure 28.2. They illustrate both the overall pattern in the relationship between property taxes and household income and the spread in impact within income ranges.

FIGURE 28.5
Dispersion of Market Value–based Property Tax Impact, Etobicoke Homeowners, 1990



Source: Fair Tax Commission Income Tax and Assessment Record Matching Project.

The statistical relationships among income and various household characteristics were measured directly. The results are summarized in table 28.1 In general, they show that there is an extremely weak relationship between household income and any characteristic of the residential property occupied by the household.

For the households analysed in Pickering and Etobicoke, there is virtually no relationship between any measure of the size or value of a residential property and total household income of all occupants. In Pickering, only 3 per cent of the variation in market values is explained by variation in household income. In Etobicoke, the association between household income and property values is slightly stronger, but even there only 7.5 per cent of the variation in property market values is explained by variations in income. In both municipalities, a poll tax (a flat tax per adult member of the household) would have been almost as well related to ability to pay as a market value–based property tax.

TABLE 28.1
Percentage of Variation in Various Housing and Household Characteristics Explained by Differences in Household Income (%)

Factor	Town of Pickering	Etobicoke
Market value assessment	3.0	7.5
Number of adults in the household filing income tax returns	5.8	4.1
Gross floor area of house	2.0	4.8

Source: Fair Tax Commission Income Tax and Assessment Record Matching Project.

Note: Samples are confined to single family residences (detached, semi-detached, and row houses). Sample size: Pickering, 8952 households; Etobicoke, 26,816. "Household income" is total income from income tax returns of all filers in household.

Major factors affecting market value assessment are displayed in table 28.2. In both municipalities, the most important of these factors is the total floor space in the house. The property tax is much closer to a tax on gross floor area than to a tax on ability to pay as measured by total household income.

These studies demonstrate that there is only a very weak relationship between the assessed value of residential properties and household income. Averages for each income range reveal a strongly regressive pattern. The data also show that effective tax rates for individual households range widely around these averages. The variations within those ranges are so substantial that, at the individual household level, there is essentially no statistical relationship between income and the assessed value of residential property occupied. The relationship between the market value assessment of owner-occupied residential property and household income is essentially random.

The most obvious hypothesis to explain this finding suggests there may be a relationship between life cycle and the value of housing relative to income. The premise on which this argument is based is that younger families just getting into the housing market and at the beginning of their earnings cycle occupy property with a higher value relative to their income than middle-aged people in their peak

TABLE 28.2
Percentage of Variation in Market Value Assessment Explained by Different Factors

Factor	Town of Pickering	Etobicoke
Household incomes	3.0	7.5
Number of adults in the household filing income tax returns	0.01	1.4
Gross floor area of house	79.2	39.3

Source: Fair Tax Commission Income Tax and Assessment Record Matching Project.

earning years. Similarly, older people may continue to occupy their family homes after they retire and their incomes decline. From this premise, it is argued that these life cycle differences are masking a positive relationship between income and residential property values. To test this hypothesis, the commission study measured the relationship between income and the assessed value of property separately for various age ranges of the highest-income member of the household. The study found no underlying relationship between the assessed value of housing occupied by households whose highest income earners were in the same age range. The same weak relationship was found within each age range.

Our third study of the relationship between income and the value of a family's principal residence also addressed this issue, taking advantage of the fact that Statistics Canada's wealth survey allows the data to be grouped by family type and by type of community. In this analysis, we found a weak relationship between family income and property value, although one that is somewhat stronger than the preliminary results of the individual municipality study for the commission would suggest. For homeowner families in urban areas with a population of over 100,000, 14 per cent of the variation in housing value is explained by variations in family income. In smaller communities, only 3 per cent of the variation in housing value was explained by familiy income variations. The results of this analysis are summarized in table 28.3.

TABLE 28.3
Family Income and Value of Principal Residence, 1984
Percentage of Variation in Value of Principal Residence Explained by Variations in Family Income, Homeowner Families

Type of family	Urban areas, population over 100,000	Small cities, towns, and rural areas
	%	
All homeowner families	13.8	3.1
Two-adult families with children under age 16	16.4	11.3
Other two-adult families	11.5	0.1
Unattached individuals	12.0	0.0
Other family types (primarily single parent families with children)	4.0	1.1

Source: Fair Tax Commission calculation based on Statistics Canada, Household Surveys Division, 1984 Survey of Consumer Finances, Ontario sub-sample, microdata file.

The relationship between value of principal residence and family income is strongest for two-adult families with children under age 16 in large urban areas. Just over 10 per cent of the variation in the value of principal residence is explained by family income for two-adult families with children outside large urban area and for two-adult families living in large urban areas. Outside these three groups, the relationship is almost non-existent. This analysis suggests a stronger relationship between income and value of principal residence across the province in 1984 than the preliminary results of the commission study (for Pickering and Etobicoke) suggest. Given the volatility of the housing market in the Toronto area, the results from the 1984 wealth survey may be more representative of property value and family income relationships in the longer term and in Ontario as a whole than are the results in the Toronto area for Pickering (1984 market values) and Etobicoke (1988 values).

The conclusion emerging from our analysis of these data is that the property tax performs poorly as a tax based on ability to pay, as measured by household income. This conclusion would appear to hold whether the measurement base for property assessment is market value (as estimated by provincial assessors) or the physical character of the structure occupied by the household.

The common-sense description of this finding is that incomes vary substantially within neighbourhoods in which the homes are similar. As a result, while it is true that the incomes of households in neighbourhoods with higher-value residential properties tend on average to be higher than incomes in neighbourhoods with lower-value residential properties, the variation in household incomes within neighbourhoods is so great that it swamps the variation on average between neighbourhoods. The horizontal inequity (unequal treatment of equals) of the property tax is so great that, statistically, it overwhelms whatever vertical equity (unequal treatment of unequals) may exist in the tax.

Residential Property Tax and Wealth

An alternative argument put forward for the property tax as a tax related to ability to pay is that it plays an important role in a fair tax system as a tax on a form of wealth. It is argued that because other forms of wealth are not taxed, the property tax is to some minimal extent offsetting a gap in the tax system (Kitchen 1987, 963). The conceptual problems with property value as a wealth tax base aside, the property tax on owner-occupied property might be seen as a legitimate base for a wealth tax if the value of the residential property occupied by a household serves as a reasonable proxy for the net wealth of the household.

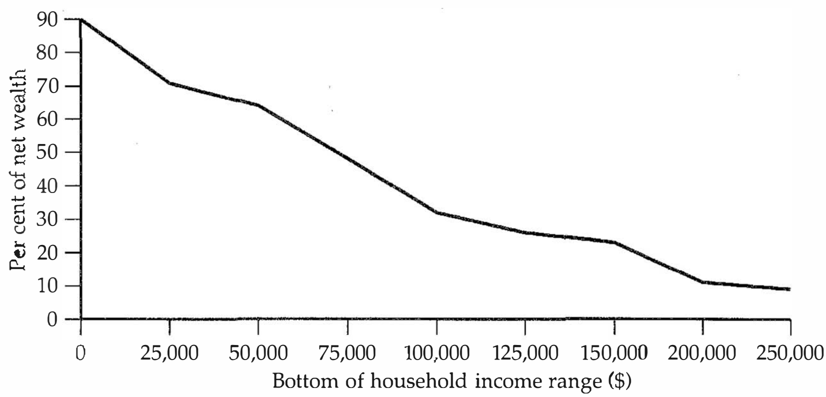
We relied on two types of analyses to evaluate this assertion, one using a study of patterns of wealth holding by Ernst & Young Management Consultants (Ernst & Young 1990), and a second examining the relationship between the market value of principal residence and household net wealth in Statistics Canada's 1984 wealth survey (Statistics Canada 1986).

The analysis of patterns of wealth by Ernst & Young shows that the value of residential property declines as a percentage of net wealth as income increases.[2] This result suggests that a tax on owner-occupied residential property will have a regressive impact compared with a tax on net wealth.

---

[2] Wealth is defined as the total assets, both liquid (savings, stocks and bonds) and non-liquid (personal residence, pension plans), of a household. Net wealth is calculated by deducting liabilities (mortgages and personal debts) from total assets. Definitions taken from Ernst & Young (1990, vol. 1, 3).

FIGURE 28.6
Value of Principal Residence as a Percentage of Net Wealth, by Household Income in Ontario, 1989



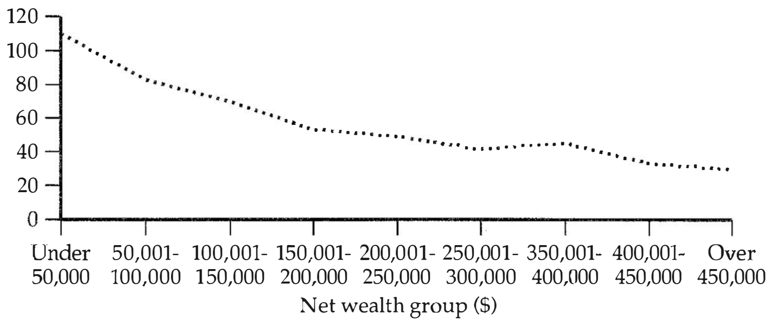
Source: Ernst & Young, *The Wealth Report* (Toronto: Ernst & Young Management Consultants, 1990), vol. 2, apps. E and N.

Figure 28.6 reveals that, in general, property value declines as a percentage of net wealth as household income increases. The higher the income of the household, the lower the percentage of that household's net wealth that is represented by the value of their principal residence. The highest-income households hold a much smaller proportion of their net assets in the form of housing than do lower-income households.

Statistics Canada's 1984 wealth survey (Statistics Canada 1986, 52) provides direct evidence that the value of housing occupied by a household declines as a percentage of net wealth as net wealth increases.

Figure 28.7 illustrates the relationship between household net wealth and the percentage of net wealth that is represented by the value of the household's principal residence. Households are grouped according to their net wealth. The figure shows that in each successively higher wealth group, the market value of the principal residence of an average household in the wealth group declines as a percentage of the net wealth of the household.

FIGURE 28.7
Market Value of Principal Residence as Percentage of Household Net Wealth, 1984



Source: Fair Tax Commission calculation based on Statistics Canada's 1984 wealth survey, microfile for Statistics Canada, *The Distribution of Wealth in Canada, 1984*, Cat. 13-580 (Ottawa, 1986).

Households with relatively little wealth tend to hold a much higher proportion of their net wealth in the form of housing than households with greater wealth. Consequently, a tax on the value of housing occupied by a household will tend to decline as a proportion of net wealth as net wealth increases. The property tax is a tax on only one component of wealth. Because residential property is the primary component of the wealth holdings of households with low and moderate incomes, the property tax is a regressive wealth tax – property taxes decline as a percentage of wealth as net wealth increases.

Using unpublished data from the Statistics Canada 1984 wealth survey, we also studied the statistical relationship between the net wealth of the households in the survey and the market value of the principal residence of the household. The study found a very weak statistical relationship. A special tabulation from the 1984 wealth survey reveals that approximately 25 per cent of the variation in net wealth among households in Ontario can be explained by variations in market value of the principal residence of the household.

We were able to shed some further light on the relationship between the value of a family's principal residence and its net wealth by looking at the relationship for different types of families and in different types of communities. As was the case for family income, the relationship between value of principal residence and net wealth was strongest in large urban areas and for families with children. For families with children under the age of 16 in large urban areas, 49 per cent of the variation in housing value could be explained by variations in net wealth. This is hardly surprising, considering that in this group, the value of principal residence averaged 85 per cent of the family's net wealth. For the group consisting primarily of single-parent families, 33 per cent of the variation in value of principal residence was explained by variations in net wealth. For this group, the value of principal residence averaged 70 per cent of the family's net wealth. For all other family types, the relationship was much weaker. The results are summarized in table 28.4.

A property tax would have its greatest impact as a wealth tax on families with children, for whom housing represents the largest proportion of net wealth and whose net wealth is relatively moderate. While this result is understandable, given the fact that families with children tend to invest heavily in housing in order to provide the best possible environment for raising children, it also highlights the problems associated with using housing value as a proxy for wealth in a wealth tax. A tax on housing value affects only a small proportion of the net wealth of the most wealthy families. Thus, a tax on housing value has the greatest impact on families that we believe should be exempt from wealth taxation and the least impact on those families whose wealth we believe should be subject to tax.

The value of a household's principal residence is a poor proxy for net wealth as a tax base for two reasons. First, a tax on a principal residence applies to a much higher percentage of the net wealth as the net wealth of the household declines. A flat rate property tax would therefore be a very regressive tax on net wealth. Second, the value of a household's principal residence is not a reliable proxy for net wealth. Because the statistical relationship between the value of a household's principal residence and its net wealth is relatively weak, a tax based on that value would apply unevenly among households in the same net wealth range. Furthermore, it would not vary systematically in its impact on households with different amounts of net wealth in different wealth ranges.

TABLE 28.4
Family Net Wealth and Value of Principal Residence, 1984
Percentage of Variation in Value of Principal Residence Explained by Variations in Family Net Wealth, Homeowner Families

Type of family	Urban areas, population over 100,000	Small cities, towns, and rural areas
	%	
All homeowner families	32.1	17.3
Two-adult families with children under age 16	48.7	12.5
Other two-adult families	26.9	23.4
Unattached individuals	23.1	3.4
Other family types (primarily single parent families with children)	33.1	3.9

Source: Fair Tax Commission calculation based on Statistics Canada, Household Surveys Division, 1984 Survey of Consumer Finances, Ontario sub-sample, microdata file.

Our studies show that if the property tax is a wealth tax, it fails both of the tests of fairness applied to taxes based on ability to pay. It is very regressive relative to both income and net wealth. And it has a very different impact on households in the same income or wealth range.

Capitalization of Property Taxes

One common argument against the type of analysis presented in this chapter of the relationship between property taxes and various measures of household income or wealth is based on the assertion that property taxes are capitalized or reflected in the prices at which property is bought and sold. Property taxes would be capitalized if buyers take into account differences in property taxes in determining how much they are prepared to pay for a property by paying more for properties that are subject to relatively low property taxes and less for properties that are subject to relatively high property taxes. For example, consider two identical houses with annual property taxes that differ by $1000. That difference would be fully capitalized if a buyer of the property subject to the lower tax were willing to pay a premium equal to a lump-sum amount that would generate annual interest of $1000. For example, at an interest rate of 8 per cent, $1000 would be fully capitalized at a price premium of $12,500.

The significance of the capitalization argument is that if property taxes are fully capitalized, a reduction in property taxes would produce a windfall gain for the owner while an increase would produce a windfall loss. The reduction would increase the value of the property by the capitalized amount of the reduction; the increase would reduce the value of the property by the capitalized amount of the increase. Property tax changes, therefore, would simply impose windfall losses and award windfall gains, with no improvement in fairness.

One concern with this line of argument is whether, even with full capitalization, the differences in prices arising from capitalization would be large enough to distinguish them from normal fluctuations in housing prices. For example, a difference in property taxes as large as $500 would be fully capitalized at $6250 (at 8 per cent interest), compared with typical house values in large urban areas in excess of $200,000.

In addition, even in its pure form, capitalization can only take place with respect to fluctuations within a given housing market. Differences in property taxes between different housing markets will not be capitalized because the houses are not substitutes for each other. Furthermore, if property taxes on all of the houses in a housing market increase or decrease, one would not expect the change to be capitalized. Thus, for example, one would not expect the across-the-board reductions in property taxes that would flow from removing education from the residential property tax to be capitalized.

The extent to which capitalization actually takes place cannot be determined theoretically. Ultimately, it is an empirical question. A review for the commission of capitalization studies concluded as follows:

> Concerning research on the degree of tax capitalization, it is important to note that the estimated degree of capitalization varies so widely from study to study that one can only assume that capitalization does occur, but that in any particular instance it will be of unknown degree. A risk averse strategy would be to assume that capitalization cannot be relied upon to remove horizontal inequities in property assessments and to assume that the property tax will not be a useful tax for redistributive purposes. Moreover, should the property tax be reformed, say by the

> implementation of market value assessment, grandparenting and postponed implementation of such reform is advisable to avoid the possibility that (an unknown degree of) capitalization in the past may lead to new inequities when the reform is undertaken. (Day and Winer n.d.)

Given the limited absolute impact of capitalization, the uncertain extent to which it actually takes place, and the somewhat unsatisfying implication of a pure capitalization analysis that it would be unfair ever to change property taxes, it would be difficult to justify attaching a great deal of weight to the capitalization thesis except, as Day and Winer note, when it comes to dealing with transitional problems.

Non-residential Property Taxes

The non-residential property tax may be viewed either as a general tax on business or as a tax related to the benefit from local services received by businesses. Looking at the commercial and industrial property tax as a general tax on business does not yield any clear conclusions with respect to fairness as measured by ability to pay. The ultimate incidence of any tax on business depends on the impact of market conditions on the distribution of tax burdens. Depending on market conditions, taxes on business may be passed on to consumers in the form of higher prices or absorbed by either employees or shareholders in the form of lower wages or lower dividends.

Each of the major taxes on business is subject to different market considerations affecting how the burden of the tax is ultimately distributed. With the exception of the payroll tax, which is generally understood to be borne in the long term primarily by labour, in the form of reduced wages, there is considerable debate in the academic and professional literature concerning how the burdens of various taxes on business are distributed. Since that debate is principally about assumptions rather than data, there is no obvious conclusion on which to base a decision about which business taxes are preferable to others on tax fairness grounds. As a result, in considering the role of the property tax as a tax on business, the principal concern is the impact of the tax on business decision making specifically, and economic development more generally, as compared with the impact of other taxes.

In the benefit framework, it can be argued that non-residential property owners benefit from local services that are available generally in the municipality. For example, police and fire protection as well as roads, planning, and zoning are services from which businesses benefit. While other services may more appropriately be funded through direct user charges, non-residential property owners also derive benefits (at least indirectly) from the existence of efficient mass transit operations and recreational and cultural services. For example, many small business owners make use of publicly available research facilities at local libraries.[3]

This analysis suggests that the non-residential property tax serves both as a general tax on business with property as the base and as a benefit tax for local services. The division of the commercial and industrial property tax into a local benefits tax component and a business tax component may appear to be somewhat arbitrary. However, the distinction does have some significance for tax policy. While it is evident that local municipalities should be responsible for local benefit taxation, it is equally clear that the provincial government should retain responsibility for general provincial taxation of business. To the extent that the commercial and industrial property tax is seen as a general tax on business, it should be the responsibility of the provincial government. Indeed, since a property tax on business would be levied in the context of payroll taxes, capital taxes, corporate income taxes, and other taxes on business, it would be difficult to justify levying such a tax at different rates in different parts of the province. The pattern of tax rates across the province would not necessarily be the same for a property tax levied as a local benefit tax as for a property tax levied as a provincial tax on business. Given the fact that the services provided by local municipalities and the nature of the tax base available to support those services vary greatly across the province, one would expect local rates of tax on commercial and industrial property tax to vary as well.

[3] For a heroic attempt at estimating the benefits from specific municipal services, see Kitchen and Slack (n.d).

Property Taxes and Benefits from Services

Property Taxes as Benefit Taxes

We have concluded from our research that the relationship between the residential property tax and ability to pay, whether ability to pay is measured by income or by wealth, is very weak. The relationship between market value assessment as measured by the Ministry of Finance and household income is very nearly random. Our analysis of the relationship between other property characteristics and household income suggests that redesign of the property tax is unlikely to affect this conclusion. Without even considering the conceptual problems with the property tax as a wealth tax, our research indicates that no strong empirical link can be demonstrated.

These conclusions have significant implications for the design of both the residential property tax and the system of local government finance of which it is a central part. In particular, our conclusions imply that the residential property tax must be reconceptualized as a benefit tax. Reconceptualizing the local property tax as a local benefit tax has implications for the non-residential property tax as well.

Considering the property tax as a benefit tax conforms well with the views of the general public on local tax fairness as they were expressed to us in our hearings and other public consultations. The relationship between perceptions of fairness in property tax and services funded from the tax underlies much of the public concern about property taxes in Ontario.

It is important to distinguish between the two general lines of argument advanced in public discussion. One suggests that services such as education and general welfare assistance that implement broad provincial public policy objectives should not be funded from local property taxes.[4] This point of view underlies much of the recent general public resistance to property tax increases in many parts of Ontario. A second argument is much more specific, suggesting

[4] This division of local services into those appropriately funded from local property taxes and those more appropriately funded from more broadly based taxes is one of the foundations of the argument for provincial/local disentanglement advanced in the Hopcroft Report. The distinction between general and local services is also explored in Graham (1991, 150–53).

that people who do not make use of a particular service should not be required to pay property taxes to support that service. For example, some groups of property tax payers such as seniors, cottagers, and others who do not have children in the local school system have taken the position that they should not have to pay taxes designated for education.

The first argument is based on the proposition that revenue sources to fund a service should be appropriate to the service being funded. It leads to the conclusion that certain services would more fairly be funded by taxes, other than property taxes, which are related to ability to pay. The second argument is based on the proposition that the property tax should be seen as a kind of fee for service and should vary with the level of service received by the individual taxpayer. This leads to the conclusion that property tax payers who do not use a particular service should be exempted on an individual basis from paying the tax.

Strictly speaking, the property tax is not a benefit tax. There is not, and likely could never be, a direct link between property taxes and specific benefits received by taxpayers from public programs (Graham 1991, 156). The property tax may be viewed as a benefit tax only to the extent that it acts as a reasonable proxy for benefits received from local public services. The framework we have adopted is consistent with the general argument advanced in public debate that there are certain services not appropriately funded from property taxes; it is not consistent with the suggestion that property taxes paid by individual taxpayers should depend on whether specific local services are used by the taxpayer or not.

The identification of the property tax as a general local benefit tax raises further questions:

- To what extent is the local property tax being used to fund services that should be funded from revenue sources that bear a relationship to ability to pay rather than from a benefit tax?
- To what extent is the local property tax being used to fund services that would more appropriately be funded from taxes and user charges more directly linked to benefits?
- On what basis should the tax burden be distributed among taxpayers?

To answer the first two questions, it is necessary to decide what services should be funded from property taxes. Distinctions must be made between services for which a benefit tax is an appropriate source of funding and those for which it is not. For services appropriately funded from a benefit tax, further distinctions must be made between those that are appropriately funded from local property taxes and those that are more appropriately funded from other user charges or benefit taxes.

Chapter 4 of this report explores in some detail the rationale for and potential role of benefit taxes in a fair tax system. It points out that benefit taxes are most appropriate where goods and services provided by government are similar in nature to private goods and services. It then identifies categories of public services in which taxation on the benefit principle is either inconsistent with the purpose of the program in the first place or is subject to significant practical problems in its application. Two categories of public services are identified in which benefit taxation would be inconsistent with program purposes: programs whose purpose is redistribution; and services to individuals deemed mandatory as a matter of right. Two further categories of public services are identified in which the application of the benefit principle is subject to practical problems: services which generate benefits that cannot be allocated to specific individuals; and services which generate benefits for others as well as the user of the service and for which only partial funding from benefit taxes would be appropriate.

In addition to education, services funded from property taxes may be divided into eight types, which correspond to the spending categories identified in the reporting framework of the Ministry of Municipal Affairs for municipal government financial statistics. These types of services are general government; protection to persons and property (police and fire, conservation authorities); transportation (roads and transit); environmental services (sewer, water, garbage); health services (public health programs, health inspections, ambulance services); social services (welfare, assistance to children, homes for the aged, day nurseries); recreation and culture (parks, libraries, etc.); and planning and development.

While these categories of locally provided services are distinct from each other, each also encompasses a variety of different types of programs. The purposes of some of these programs are clearly inconsistent with benefit tax funding. Consequently, in our framework, they are not appropriately funded from benefit taxes of any kind, whether property taxes as general local benefit taxes, more specifically targeted benefit taxes, or direct user charges. Other programs deliver services that are closely related to private goods and services and present no practical or fairness obstacle to funding from direct user charges or specific benefit taxes. The remaining programs currently delivered at the local level would logically be funded from a combination of the property tax, serving as a proxy for locally delivered benefits, and provincial grants designed to meet specific provincial policy objectives.

Looking at Services from a Benefit Tax Perspective

Education

In 1991 a total of $12.9 billion was spent in Ontario to provide public elementary and secondary education, not including provincial payments into teacher pension plans (Ministry of Education administrative data, adjusted to remove school board to school board transfers). These expenditures were funded from a combination of sources: 55 per cent from property taxes; 4 per cent from various user charges, tuition fees from the federal government or outside Ontario, and federal grants; 1 per cent net from school board reserve funds; and 40 per cent from provincial transfers, which in turn are funded from the general revenues of the provincial government. While there may be some services provided through the education system for which specific beneficiaries can be identified, in general the nature of education as a public service indicates clearly that it should not be funded from a benefit tax. First, education is viewed as a service that should be universally accessible. Indeed, universal public elementary and secondary education is generally recognized as a fundamental right in a liberal democratic society. Second, public education offers benefits both to the broader society and the local community, because everyone in the province benefits economically, socially, and culturally from a well-educated population. Third, education can be seen as having a role to play in income redistribution by offering better prospects of employment and improved earnings for students from traditionally underprivileged backgrounds and by making special efforts to ensure the success of students with special needs.

In making these general observations, it is important to distinguish between education as a public service, whose funding should be guided by certain fairness principles, and education as "what school boards do," which encompasses a number of different functions, some of which may appropriately be funded from general local benefit taxes. For example, it was suggested at our public hearings that school buildings should be seen as community facilities whose construction, operation, and maintenance should be funded from local taxes on the same basis as municipally operated community facilities. Such thinking lies behind the organization of education funding and governance in countries such as France, where responsibility for the construction, maintenance, and caretaking of school buildings lies with municipal or regional council authorities rather than with education authorities.

The general conclusion, however, is that the broader purpose of education is inconsistent with local benefit taxation. Education should be financed from provincial general revenue.

Social Services

The funding of social service programs is currently shared between the provincial government and municipalities. Total expenditures were $3.9 billion in 1991, financed 15 per cent from property taxes, 7 per cent from user charges, 76 per cent from provincial general revenues, and 2 per cent from miscellaneous local revenue sources.

This category of services includes social assistance, children's aid societies, child care, and the operation of homes for the aged. Social assistance and assistance to children both serve income redistributive and poverty relief objectives. The potential for inter-jurisdictional spillovers as a result of migration and other factors is well documented, as are the significant differences in the levels of assistance provided from one jurisdiction to the next (Ontario Ministry of Community and Social Services 1988, 348–410). We believe that it would be more appropriate to fund these services entirely from provincial general revenues rather than from a local benefit tax. This conclusion is consistent with the findings of a number of reviews of provincial/local shared cost programs in social services. It was also the basic premise of the Provincial/Local Relationship Review, where it was termed "provincial/local disentanglement."[5]

The other two major social services currently delivered through local government are assistance to the elderly – generally the operation of homes for the aged – and the operation of day nurseries, both directly and through contracts with private operators. In addition to provincial and local funding, these services are supported to a significant degree by user fees. In some municipalities this category also includes the financing of community-based services that enable the elderly to stay in their own homes. These services differ from social assistance and children's services in that there is no requirement that the municipality provide the service.

Both of these services are currently funded from a combination of fees, taxes, and provincial transfers. Given the nature of these services, there would appear to be no tax fairness reason for fundamental change.

Health Services

The funding of health service programs is currently shared between the provincial government and municipalities. Total expenditures were $466 million in 1991, financed 30 per cent from property taxes, 6 per cent from user charges, 59 per cent from provincial general revenues, and 5 per cent from miscellaneous local revenue sources.

These services include public health services, health inspections, and (in Metropolitan Toronto) ambulance services. Some specific programs of public health units such as school lunch programs, well-baby care, and children's dentistry are more closely related to provincial health programs than to other services delivered by local government. Because these programs do not fit appropriately within a benefits tax framework, they should be funded from provincial revenues. With respect to ambulance services, the issue is clouded by the fact that the service is provided municipally only in Metropolitan Toronto. The close relationships in the emergency response systems

---

[5] The disentanglement process was established by the provincial government in 1991 as a joint provincial/local initiative to review and rationalize the fiscal and program relationships between the provincial government and municipalities. It was suspended in 1993.

in place in most municipalities among ambulance, police, and fire services suggest that this inconsistency could in principle be resolved by requiring municipal funding everywhere in the province. The more reasonable approach given the current institutional framework would be to address the funding basis for these services in Metropolitan Toronto as the anomaly. It would be difficult to argue for a continuation of the funding of any portion of the cost of ambulance services from property taxes, given that the service is provincially funded everywhere else in the province. Apart from these exceptions, however, public health programs deliver services which provide benefits locally and which could appropriately be funded either from fees or from a general local benefit tax.

A local benefit tax is appropriate for public health and inspections. For redistributive services such as those provided to needy children in schools, funding from provincial general revenues would be more appropriate.

Environmental Services

The funding of environmental programs is currently shared among the provincial government, municipalities and individual users. In total, expenditures were $2.3 billion in 1991. Seven per cent of the revenue required came from provincial general revenues, 33 per cent from property taxes, 54 per cent from user charges, and 6 per cent from miscellaneous local revenue sources.

This category of services includes water treatment and supply, sanitary and storm sewage, and garbage disposal and collection. These are services in which beneficiaries can be identified and specific utilization can be measured. While there are clearly spillover benefits from private use of these services, of all the goods and services provided by local governments these bear the closest resemblance to private goods. There may be some fairness concerns related to charging for access to potable water, but such concerns can be accommodated within a pricing regime. Since, for the most part, benefits from these services can be linked to users, specific user charges would generally be preferable to local property tax funding. Some provincial funding would be appropriate to reflect benefits that accrue to individuals who live outside the municipality providing the service.

Transportation

The funding of transportation programs is currently shared between the provincial government and municipalities. In total, expenditures were $3.1 billion in 1991, funded 39 per cent from property taxes, 28 per cent from user charges, 6 per cent from other local sources, and 27 per cent from provincial general revenues.

This category of services includes roads, snow plowing and removal, public transit, and the operation of municipal airports and ferry services. Each component of this category of services has different characteristics from a benefits analysis perspective. For example, roads provide benefits to all the inhabitants of a municipality as well as to travellers from other jurisdictions. Funding from a combination of road tolls or other specific user charges and local benefit taxes would appear to be appropriate. Transit provides direct services to users, but also generates benefits for non-users, in enhanced environmental quality and reduced road congestion. The fare box is a significant source of funds for transit operations, and it is easy to identify individual benefit for this service. However, the use of property taxes or other local benefit taxes to subsidize transit use would be justified on the basis that transit usage generates benefits for non-users.

Planning and Development

Municipalities spent $377 million on planning and development in 1991. These services were funded to the extent of 20 per cent from fees, 10 per cent from other local sources of revenue, 57 per cent from property taxes, and 13 per cent from provincial grants. Planning and development that provides benefits to the community at large is a local service. It also involves the provision of some specific services to individual beneficiaries. Funding from the property tax, along with targeted user fees, is appropriate.

General Government

In total, municipalities spent $1.5 billion on general government administration in 1991. This expenditure is largely supported from local revenues, including property taxes (71 per cent), user fees (7 per cent), and other local sources (12 per cent). Provincial grants provide

10 per cent of the revenue required for general government services. Most of the services in this category provide benefits to the local community at large, although some provide benefits that are enjoyed by individuals. Thus, continued funding from the property tax and the targeted use of fees is appropriate.

Protection

Municipalities spent $2.4 billion on police and fire services and on conservation authority operations in 1991. This expenditure is largely supported from local property taxes and user fees. Property taxes fund 73 per cent of expenditures in this area; local user fees, 2 per cent; and miscellaneous local revenue sources, including fines, 12 per cent. Provincial grants provided the remaining funding.

Police and fire services may be seen as local services which provide collective benefits and which should appropriately be funded from the property tax as a local benefit tax. For fire services, which in some areas are not available on the same basis throughout a municipality, area rating (different tax rates in different areas of the municipality) based on service level may be appropriate.

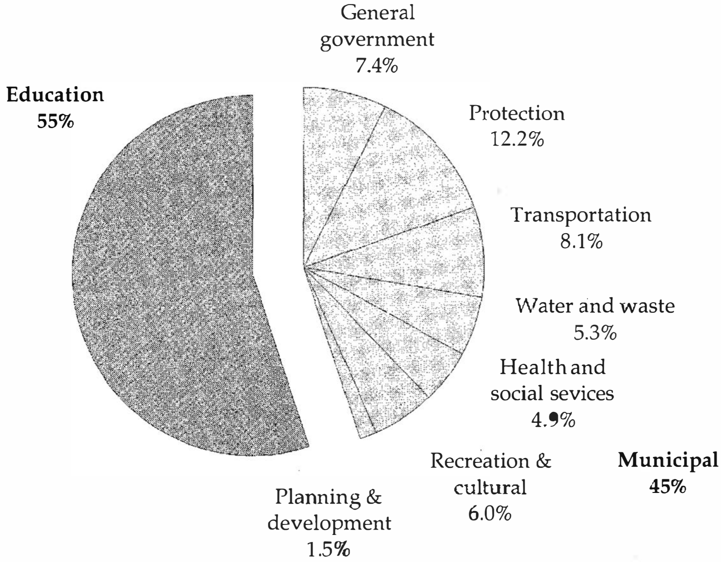
With respect to conservation authorities, the existence of spillover benefits beyond the geographical area covered by the authority suggests that some continuing level of subsidy from provincial general revenues would be appropriate, as is the case now. Because some of the services provided by conservation authorities are similar to those provided by municipalities in parks and recreation in particular, some reliance on user charges on a basis similar to that for recreational facilities would be appropriate.

Recreation and Culture

Municipalities spent $1.5 billion on recreation and cultural services. This expenditure is largely supported from local municipal revenue sources. Property taxes fund 56 per cent of expenditures in this area; user fees, 23 per cent; and other local revenue sources, 9 per cent. The remainder is funded from provincial grants.

This expenditure category includes parks and recreational facilities, libraries, and contributions to local cultural activities. Generally, these services are provided as a local service with collective benefits. Some of these services have specific beneficiaries. Thus, it would be

FIGURE 28.8
Uses of Property Tax, Ontario, 1991



Source: Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

appropriate to fund these services through a combination of the property tax and targeted fees. Given the role that cultural activities and libraries play in the general life of the province, there is a strong case for provincial transfers to support activities that generate benefits for the province generally.

Role of Property Taxes in Ontario Public Finance: Overall Implications

Ontario currently operates more than 100 programs in which grants are provided by the provincial government to support municipal services. Some of this funding is allocated unconditionally on the basis of a formula that originally took into account the type of municipality as well as such factors as population and the local assessment base. In 1991, $953.8 million, or 21.4 per cent of provincial grants to municipal governments, were unconditional.

Most provincial funding for municipal government – the remaining $3.5 billion, or 78.6 per cent – is linked directly to particular programs and activities of local governments. In fact, virtually every activity of local government involves provincial funding of one form or another. As a result, almost every activity of local government is funded partly from local property taxes and partly from provincial general revenues. One direct implication of our framework is that many of the activities of local government currently funded in part from provincial general revenues are more appropriately funded from local benefit taxes, including both direct user charges and property taxes. At the same time, a significant proportion of the funding for services that are not appropriately funded from benefits taxes of any kind is currently derived from local residential and commercial/industrial property taxes.

Local property taxes currently fund a wide range of services. Some of these services should be funded from provincial taxes related to ability to pay, and not local property taxes. Some of these services should be funded from direct user charges rather than property taxes. To provide a general picture, figure 28.7 summarizes the allocation of property tax revenues to various areas of local public spending. With the exception of education, for which property tax funding can be determined directly from available data, local expenditure data for each service must be adjusted to reflect sources of revenue specific to each service. For example, sewer and water services are funded from user charges and from conditional provincial grants as well as from property taxes. The contribution of general municipal revenues (including property taxes) to sewer and water services expenditures can only be determined by deducting user charge revenue and conditional grants from those expenditures. Adjusting the expenditure data for each area of municipal services in the same way yields the contribution of general municipal revenues to each service. The shares of general municipal revenues allocated to each service category will then determine the allocation of property tax revenue to each service category.

Education accounted for 55 per cent of property taxes in Ontario in 1991. Within the municipal sector, health and social services account for 5 per cent of total property taxes. The major spending areas that a benefits analysis suggests might appropriately be funded from provincial general revenues rather than from local property taxes – education, social assistance, and services for children – amount to approximately 59 per cent of total property taxes. At the other end of the services spectrum, environmental services (sewer, water, and garbage), which might appropriately be funded from direct user charges, account for 5 per cent of property taxes.

A significant proportion of local residential and commercial/industrial property tax revenue is directed towards spending areas for which the property tax, as a local benefit tax, is not an appropriate funding source. We believe that such funding is not acceptable from a tax fairness perspective and should be replaced by funding from general provincial revenues.

Education

Framing the Education Debate

The Property Tax Working Group adopted as the basis for its recommendations on the reform of Ontario's system of education finance a series of propositions concerning students and taxpayers. They were set out in the working group report as follows:

For students

- The overall goal of our system of education, from the perspective of the student, is to enable each student in the system to develop to his or her full potential. The overall equity objective of the system must therefore be to achieve this goal for every student. Equality of opportunity, access, and quality of service are important targets in our system of education as proxies for this overall goal.
- The ability of the education system to deliver provincially mandated services to students in Ontario should not depend on the financial resources available locally to the school board responsible for their education.
- Educational equity may require that per student spending be different across Ontario. Any funding formula must be sensitive to local needs and circumstances and must allow for the need for local boards to deliver programs that respond to the different needs and circumstances of individual students.

For taxpayers

- In principle, and to the extent that it is feasible, education should be funded from revenue sources based on ability to pay.
- The decision to provide education through local school boards should not result in significantly different tax burdens being imposed on taxpayers in different jurisdictions for provincially mandated standards of service. (Property Tax Working Group 1992, 92)

The analysis by both the Property Tax Working Group and the commission of education taxation and finance policy flows from three basic principles that arise from these propositions:

- The provision of education that is universally accessible is appropriately the responsibility of democratically elected government as a cornerstone of a liberal democratic society, as a vehicle for bringing together diverse cultural values and identities, and as a key to sustainable economic development in the future.
- Since all Ontarians are equally entitled to educational experiences that support lifelong learning, the ability of education systems to provide those experiences should not vary according to the amount of money that can be raised locally.
- The distribution of centrally allocated funds for publicly supported education should vary only according to geographical or demographic variations in the costs of meeting needs fairly and equitably.

Using these principles as a starting point, our objective is to move the public policy discussion about education finance away from the traditional debate over school boards and assessment wealth that has dominated the scene for more than 20 years. In contrast, our goal is to initiate a debate on how fairness for taxpayers and fairness for students can be realized.

We take the view that the traditional debate is much too narrow. The debate begins with the assumption that the property tax must provide the core funding for the education system. This assumption distorts discussions about fairness both for taxpayers and for students:

- Discussions about fairness for taxpayers traditionally focus on finding ways to alleviate inequities created by the reliance on property taxes. The debate focuses on such issues as taxation of farmland, cottage properties, and the homes of senior citizens, and how much relief the province should provide to individual property taxpayers in income tax credits and to school boards in grants to reduce the property tax portion of education revenues.
- Discussions about fairness for students (expressed as per pupil funds available) traditionally focus on which institutions have access to which property tax revenues. The result is that "poor" school boards square off against "rich" school boards, and public boards of education are pitted against Roman Catholic separate school boards over access to commercial and industrial property taxes.

Lost in this debate is any sense of the principles that determine how much and by what means taxpayers (whether individual or corporate) should pay for a publicly supported education system. Equally lost is the sense of what education taxes are supposed to be funding in the way of guarantees to the students themselves and to the broader society of which they are a part. The debate about how schools are actually run never gets started because property tax funding locks in the assumption that school governance has to be established as a parallel system to municipal governance.

Our analysis takes the debate over education taxation and funding back to the basics of fairness. On the one hand, this means fairness for taxpayers whose burden should be more closely related to the ability to pay. On the other hand, it means fairness for all students whose learning experiences and outcomes should not be compromised by unrecognized accidents of geography, socio-economic status, or ethnocultural origin.

Recognizing the diversity among communities in Ontario, we believe that fairness requires strong local democratic structures to support a flexible, responsive, adequate, and fair system of funding. Such structures are needed in particular to ensure that educational programs and services are designed to respond to local conditions, costs, and needs.

Our recommendations propose a framework designed to meet fairness objectives for taxpayers and students throughout the system and to provide local decision makers with the fiscal capacity to undertake initiatives that respond to local needs and conditions. The fairness principles embedded in this framework lead directly to concrete proposals for reform. Moreover, the framework clearly has implications for the way the education system works as a whole, whether in the structures of collective bargaining for teachers, the levels at which particular kinds of decision are made, or the impact of the constitutional guarantees for Roman Catholic and French-speaking communities. These implications are explored more fully in chapter 36.

Fairness for Students: Allocating Funding for Education

Determining what constitutes an adequate level of funding for the education of students in Ontario and how that funding should be allocated among schools in the province is an extremely complex task that transcends the tax fairness mandate of the Fair Tax Commission. The nature of the debate over education finance reform that took place in our public consultation program and in the Property Tax Working Group makes it clear, however, that our proposed tax fairness reforms will not be accepted unless they are accompanied by reforms in the level and allocation of education funding. These reforms must provide some assurance that provincial funding will be adequate to meet current educational needs and will be sufficiently flexible to respond to changes in the expectations placed on the education system. The formula for allocating provincial funding must also be sensitive to differences in the characteristics and needs of student populations and to local costs.

In short, equity for students does not mean equality in funding, and equity for students is not possible without adequate funding.

Concerns about the overall adequacy in funding for the education of students need not necessarily be met with increased funding for the educational system as a whole. We heard concerns expressed repeatedly about the proportion of the education budget that is spent outside the classroom.

In allocating funding for education, we have identified a number of factors we believe should be taken into account in creating a formula that meets the expectations for flexibility and responsiveness to local needs. Such a formula must ensure that a foundation level of education is fully funded throughout the province from revenues collected and disbursed centrally. It must recognize the relationship between demographic characteristics of student communities such as socio-economic status, first language learned, and household literacy, and the level of service (and therefore spending) needed to ensure equity for students.

Socio-economic characteristics of households may be measured by such indicators as the average income of residents of the community and the spread of differences from that average. For example, the incidence of low income in a community can be measured and additional funds directed to education in communities with relatively more low-income families.

Language as a cost driver can be measured using data on the number of immigrant families and families for which the language of the home is neither English nor French. This information can be used to direct additional resources to communities with higher than average language learning needs.

Finally, it is well established in educational research that the level of family literacy has a direct impact on school achievement. The data are available for the creation of an index of family literacy that could allow additional funds to be directed to schools receiving students with lower than average family literacy.

RECOMMENDATION 74

The provincial government should assume responsibility for the funding of education to a provincial standard, allocating funds to school boards based on per student cost, student needs, and community characteristics which affect education costs, such as poverty and language.

Equity for Taxpayers

Ontario's system for funding education may be divided into two portions: the funding of provincially approved expenditures and the funding of unapproved expenditures. In 1991 the average total per pupil amount (elementary and secondary combined) actually spent on elementary and secondary education by boards stood at $7409 (including teacher pension costs).[6] However, the average per pupil amount of approved expenditures in 1991 stood at $5839, only 79 per cent of the total. The difference between the two average amounts ($1570 per pupil) represents the unapproved expenditure portion.

Provincially approved expenditure in 1991 was, on average, funded 57 per cent from provincial grants and 43 per cent from property taxes. These figures include both total spending on and provincial contributions to teacher pension plans. Unapproved expenditures are funded almost entirely from property taxes, with some contribution from fees and other minor sources of income. In 1991 approved and unapproved expenditures combined were 55 per cent funded from local property taxes – 33 per cent from residential taxes and 22 per cent from non-residential taxes.

Ontario's system for funding education is unusual in Canada because of the extent of its overall dependence on property taxes, its reliance on locally levied taxes, and its lack of restrictions on local educational authorities resorting to local taxes for expenditures above provincially approved levels. Most jurisdictions in Canada rely less heavily on residential property taxes than Ontario, provide for local access only to the residential property tax base, and limit this access for spending above provincially supported levels (Kitchen 1992, 11).

Jurisdictions outside Ontario are also taking a close look at the fairness of their systems of education funding. The state of New York, for example, is considering a major change in its education funding system that would see residential property taxes for education replaced by a local income tax surcharge.

The education financing system in Ontario is currently not meeting equity objectives, either on the expenditure side or on the revenue side. On the expenditure side, in 1991 only 79 per cent of total education spending (including the provincial contribution to teacher pension plans) was officially approved by the provincial government and eligible for provincial grant support. The remaining 21 per cent was not taken into account by the provincial government

---

6 The measure traditionally used in the education finance debate excludes pension contributions from both the expenditure side and the grant side. In 1991 this calculation would have yielded approved expenditures of $5378 per pupil and total expenditures of $6948 per pupil. Excluding pensions, 77 per cent of total expenditures were recognized; 47 per cent of recognized expenditures and 59 per cent of total expenditures were financed from property taxes.

in determining grants to local school boards. Actual spending levels per pupil vary widely across the province. While some of the variations are clearly related to local cost factors and special characteristics of the student population, differences in local resources available to fund educational services over and above provincially approved levels clearly play a role. Given the importance of public education to both the value system and the economic strategy of the province, it is difficult to justify significant differences in educational quality that now occur because of differences in the fiscal resources available to local school boards.

On the revenue side, the extent to which funding for education relies on local property taxes causes significant problems. One of the direct implications of our view of the residential property tax as a local benefit tax is that, as a general rule, education should not be funded from residential property taxes. Provincially supported education spending should be funded entirely from provincial general revenue sources.[7]

As noted above, this analysis applies specifically to universal public elementary and secondary education, as opposed to "what school boards do." Because school boards perform services other than education, narrowly defined, it may be necessary, in order to carry the analysis to the next level, to set out the functions of school boards to determine the applicability of this general analysis to particular categories of expenditure. Table 28.5 provides a general breakdown of school board expenditures by category.

One potential variation from the general position that educational services should not be funded from local benefits taxes concerns the operation and maintenance of educational facilities – the physical plant of the education system. Some participants in our public hearings suggested that it would be appropriate for the operation and maintenance of physical plant to be funded from local property taxes. Because such facilities are part of the community's infrastructure and provide benefits similar to parks and recreational facilities, they could, logically, be funded on the same basis as those other

---

[7] This view has wide support among Canadian public finance authorities. See Kitchen and McMillan (1985, 238); (1991, 237–38); Graham (1991, 151); Kitchen (1992, 72). It is also discussed in Bird and Slack (1993, 58–59).

TABLE 28.5
School Board Expenditures, Ontario, 1991

Item	Expenditure ($)	
Administration		
Business	237,562,359	
General	127,193,587	
Computer	86,385,782	451,141,728
Instruction-related		
Instruction	9,156,105,295	
Tuition fees	546,036,176	
Transportation	660,626,055	10,362,767,526
Plant operations and maintenance		1,382,713,693
Capital expenditures		732,303,338
Debt charges		140,969,801
Other		111,821,825
Payments to municipalities		114,971,077
Reserve funds		189,097,475
Total		13,485,786,463

Source: Fair Tax Commission calculation based on Ontario, Ministry of Education, "School Board Financial Statements," 1991, updated as of March 1993.

Note: Board-to-board payments are included in total.

facilities. Taxes to support building operation and maintenance would be levied by municipal governments that would provide the necessary funding. While the responsibility for operating and maintaining school facilities could remain with individual school boards, municipal operation and maintenance does offer some potential advantages. It would facilitate the coordination of community facilities and the development of multi-use facilities at the local level, and it would provide a framework within which educational facilities could be shared among school boards on a rational basis. These expenditures amount to approximately 10 per cent of the total spending of school boards in Ontario.

One of the attractions of this approach is that it would somewhat reduce the extent to which revenue sources would have to shift as a result of the reforms in funding suggested by our analysis. If this approach were to be adopted, about 10 per cent of total education spending could legitimately remain on the local property tax base. Despite this, however, we see no equitable basis for making a distinction between educational services available to students and the physical facilities in which those services are delivered. Consequently, we are not recommending that any distinction of this nature be made in determining the sources of funding for public elementary and secondary education.

RECOMMENDATION 75

Ontario should replace the local residential property tax as a source of core funding for education with funds raised from provincial general revenues.

RECOMMENDATION 76

Ontario should eliminate the local education levy on commercial and industrial property.

The issue of how the provincial government should raise the revenue required to replace local property taxes on residential and non-residential property is addressed in our recommendations on tax mix, in part twelve. Chapter 32 presents our recommendations for a provincial tax on commercial and industrial property as a replacement for local non-residential property taxation for education purposes. Chapter 33 presents our overall recommendations on tax mix, including sources of the additional provincial general revenue that would be required if the province were to assume the full cost of provincially mandated elementary and secondary education.

Local Levy

To be successful, a formula funding model for education must be sensitive to differences in local factors that affect the cost to school authorities of meeting Ontario's educational objectives. Educational equity does not imply equal funding on a per student basis. In fact, it requires unequal funding in ways consistent with the different cost environments and different educational needs of different student populations. A successful funding model must be dynamic. It must be adjusted constantly to respond to changing demographic trends and educational requirements. It must also be consistent with a locally responsive system of governance.

Local governance implies a tension between the central funding and policy-making authority and the local delivery system. The funding made available by the provincial government for education will inevitably require an accommodation between locally generated demands for services and provincial educational and fiscal priorities. It is essential that formula funding be sufficiently sensitive and sufficiently dynamic to permit that accommodation to remain effective. It is equally inevitable that a formula funding model will not be perfect, and that legitimate local requirements will not be taken into account adequately in determining the resources to be made available for the provision of important local services.

Consequently, the system requires a local financial safety valve.

In determining an appropriate design for the financing of local educational expenditures beyond those approved and supported by the provincial government, we considered four critical questions:

- What should the funding base be for locally supported educational spending?
- How should access to that funding base be limited?
- How should that funding base be allocated between the public and the separate systems? and
- How should the local political decisions be made with respect to access to that funding base?

In principle, to be consistent with our reasoning with respect to appropriate revenue sources for provincially supported education spending, the local property tax should not be the funding base for any local contribution to education. The consistent recommendation would be for a local income tax that would be directed towards discretionary local education spending. However, we are not prepared to recommend the establishment of local income taxes in Ontario. As a result, the only general tax base available for the funding of discretionary local spending is the local property tax base.

In our view, access to the property tax base must be tightly restricted to preserve its role as a formula funding safety valve, to ensure that pressure is kept up on provincial governments to maintain a realistic level of formula funding for education, and to limit the potential for revenue-driven inequities to emerge for students in different parts of the system.

Access should be limited in two respects. First, the total amount of revenue that can be raised from the local property tax base should be limited. Unrestricted access would generate revenue-driven inequities among students and taxpayers. It would also provide an almost irresistible temptation for provincial governments to abandon tax fairness principles and to tap the local property tax base indirectly by restricting formula funding below realistic levels.

Such a limit could be defined with reference to the local property tax base or to the provincially approved expenditures on education in the community. We recognize that setting a limit with reference to provincially supported spending will result in differences in tax burdens for the same relative level of local discretionary spending between school areas. In our view, however, this concern must be weighed against the overall purpose of permitting a local levy for education. The purpose of the local levy, in our framework, is to enable local authorities to meet student needs that cannot be met in the overall funding formula. This purpose must take precedence over tax fairness concerns, since they would otherwise have led us to recommend that there be no local levy at all. We have concluded that the local levy limit should be determined with reference to the provincially supported level of spending.

The limit must strike a reasonable balance between the need for local flexibility and the need to maintain the pressure on the formula funding system to remain up to date, thus avoiding reliance on the property tax for core funding. A local levy limit of up to 10 per cent of a board's approved spending would, in our view, strike a reasonable balance.

Moreover, local access to the property tax should be restricted to the residential tax base. Commercial and industrial activity in Ontario is distributed so unequally that local access for educational purposes to that base would inevitably create substantial inequities, either for individual taxpayers or for students.[8] We see no reason to depart from our position that general taxes on business (as opposed to benefits-based taxes) should be levied at the provincial level.

The allocation of local discretionary funding between the separate and the public school systems has grown in importance as an issue as the gap between provincially supported spending and locally defined requirements has grown. Adoption of our recommendations with respect to provincially supported spending would cause that gap to narrow dramatically. Although a gap in revenue-raising capacity would remain through local discretionary spending, it would also be reduced by limiting the discretionary local levy to the residential tax base. As is the case in the current system, differences in funding capacity tend to be absorbed either by students, in the form of lower per pupil spending in jurisdictions with limited access to supplementary funding from local sources, or by taxpayers, in the form of higher taxes.

Even in the current system, those differences tend to be absorbed to a greater extent by taxpayers than by students. The variations in spending per student in Ontario are far smaller than the variations in local fiscal capacity among school boards would suggest (Property Tax Working Group 1992, 93–98). Our proposal to limit discretionary spending to a fixed percentage of provincially supported spending in the jurisdiction would reinforce the general tendency to put student equity ahead of local taxpayer equity as these decisions are being made. There is an important exception to this general trend where public and separate boards in the same jurisdiction have very different fiscal capacities. The pressure to keep residential tax rates close together will result in less being spent on the education of students in a poorer board than on students in a wealthier board serving the same geographical area.

One manifestation of this pressure has been intense competition among neighbouring boards for school support and therefore assessment. A growing class of local officials devoted entirely to "assessment wars" with other boards has been created in public, separate, English, and French boards across Ontario. This effort

[8] See Bird (1993, 212) for support of the argument that "some constraint should be placed on local taxation of non-residential property" in order to avoid the "tax exporting" problem.

serves no purpose other than to shift resources from board to board, to the benefit of some students and the detriment of others. We consider this activity to be wasteful and destructive to the local cooperation that is essential to make the system perform better and deliver its services more efficiently. By limiting access to the local residential tax base to a fixed amount based on provincial funding allocated to the local board, the stakes in these conflicts between boards would be reduced. The only way to eliminate this conflict entirely would be to pool the local discretionary funds based on student population. Although such an approach has some attractions as a way to eliminate assessment competition between boards, it raises two very difficult problems whose solution would take us well beyond the limits of our mandate.

First, if the local levy were to be pooled on the basis of student population or some other formula, how would the decision on the size of the levy be made? Indeed, what would prevent the local levy from moving automatically to the maximum everywhere in the province? Second, pooling the local levy would have the effect of overriding the constitutional rights of Roman Catholics to designate support for the separate school system.

Breaking the link between school board fiscal capacity and assessment would ease the administrative burden in assessment administration and appeals at the provincial level. It would also make unnecessary the administrative overhead required to sustain the intense competition between public and separate school boards for school support both in the assessment and appeal processes and within the school boards themselves. But it also begs questions of structure and governance that must be resolved on their own merits. For that reason, we do not recommend any change in current practices with respect to designation of school support for the local levy.

RECOMMENDATION 77

Ontario should permit school boards to raise funds to support local discretionary spending through a local levy on the residential property tax base. The amount of this local levy for each board should be restricted to a fixed percentage – not greater than 10 per cent – of the total amount of provincial funding provided to that board.

General Welfare Assistance and Programs of Assistance to Children

Generally speaking, our view of the appropriate funding of social and health services parallels our view of the financing of education. Some of the social and health services currently funded from the local tax base are not appropriately funded from benefit taxes. Other services, such as public health inspections, are appropriately funded from user fees or from the property tax as a local benefit tax. In grey areas such as day nurseries, homes for the aged, and public health services, joint provincial-local funding that permits some local differences in expenditure levels and tax burdens is justifiable.

There is a strong consensus within and outside the provincial government that the funding of social assistance should be a provincial responsibility, replacing the current 80/20 funding split between the provincial government and municipalities. As a significant income-redistribution program, social assistance should be available on the same basis across the province and funded from general provincial revenues, not from local benefit taxes. In 1991 the net municipal contribution to social assistance (net of specific grants) was $515 million. The provincial government has already announced its intention to assume responsibility for social assistance transfers, and to offset the increased provincial costs by charging municipalities fees for assessment services, transferring responsibility for some provincial roads to municipalities, and reducing unconditional grants.

Similarly, the costs of assistance to children through children's aid societies is an income-redistributive service appropriately funded from ability-to-pay taxes. These services also have spillover effects across jurisdictions, and, as in education, policy control is exercised by the provincial government. In 1991 the municipal contribution to children's aid societies (net of specific grants) was $76 million.

RECOMMENDATION 78

Ontario should assume full responsibility for funding general welfare assistance and provincially mandated services to children.

Realizing Property Tax Reductions from Funding Reform

Many participants in our hearings, while supporting the principle of ending local property tax funding of education, expressed considerable cynicism about the likely impact of such a change on residential property tax rates. The assumption behind this cynicism was that municipalities would react to the change in education funding by increasing their own taxes as taxes for school boards went down. In our view, however, this is unlikely to happen. The local political process in Ontario works well enough to prevent such a blatant attempt to frustrate the spirit of the reforms we have proposed. Any municipality tempted to do so would likely be unsuccessful in the current fragile state of most of this province's local economies. While we are doubtful that municipalities would in fact increase their tax rates to take advantage of the reduction in property taxes for education, we believe that it is important that taxpayers clearly understand that it will not happen. The local government finance system in Ontario is so complex that we believe extraordinary measures may be required to ensure this is understood. We have therefore concluded that, for a transitional period, there should be some restriction on the ability of municipal councils to establish tax rates that depart from those that would have been expected in the absence of education finance reform.

RECOMMENDATION 79

a) To ensure that municipal governments do not eliminate property tax savings resulting from reform in the funding of education and social services by raising municipal tax rates, those tax rates should be subject to provincial regulation during a transitional period.

b) Ontario should establish a base year municipal tax rate, which excludes taxes attributable to services no longer funded from property taxes, and should limit municipal tax rate increases to a provincial standard increase, subject to appeal. In addition, municipal governments should be required to disclose on their tax bills any increases in tax relative to this revised base year tax rate.

Local Environmental Services

User fees are already a significant source of local revenue in Ontario. The principal components of user charges include water billings and sewer surcharges, waste disposal fees, charges for recreational services, other special charges, transit fares, and the fees paid for homes for the aged and day nurseries. In general, user charges may be appropriate where:

- there is a clear relationship between fees paid by users and benefits received;
- the taxpayer has a choice about the extent to which he or she uses the service;
- it is administratively feasible to collect the charge at a reasonable cost;
- one goal of the user charge is to influence the use of the service;
- the benefits can be quantified and attributed to the user; and
- concerns with respect to equity of access can be dealt with in the design of the charge.

Municipal user fees in total increased from just over $800 million in 1977 to $3.5 billion in 1992. As a percentage of municipal revenue, fees increased during the 1980s from 22 per cent in 1980 to a high of 25 per cent in 1989. Since 1989, user fees have dropped again to less than 22 per cent of municipal revenues. The near-collapse in revenue from tipping fees at municipally operated landfill sites resulting from the combined effect of the decline in industrial activity generally, particularly in construction, and the rapid growth in the export of waste to cheaper dump sites in the United States is the major reason for this decline.[9]

There is a broad public consensus that the pricing of water and sewer services as well as waste collection and disposal must begin to reflect the true cost, without subsidy, of providing these services. There is also increasing interest in user fees for road transportation. Technological developments in the past decade have made feasible the collection of tolls and other fees related to road use. These tolls

---

[9] The composition of municipal revenue has also been affected by an increase in conditional transfers related to social assistance.

and fees can be far more flexibly designed to reflect the costs associated with road use than traditional toll systems.

There are both local tax fairness reasons and environmental policy reasons to encourage a greater reliance by local governments on direct user charges for environmental services such as water treatment and distribution, sewerage collection and treatment, and solid waste collection and disposal. From a tax fairness perspective, user charges would provide a stronger link between benefits and taxes for these services than is possible with funding from a local general benefits tax. From an environmental perspective, pricing of these services at cost would encourage environmentally sound water conservation practices and provide an incentive for reduction, reuse, and recycling of solid waste.

The major administrative issue in the reform of the sewer and water user fee system at the municipal level concerns the need to meter water consumption. It clearly makes little sense to shift from property tax funding to user fees for these environmental services if the user fee bears no better relationship than property tax to the amount of water consumed. The cost of any changes to existing systems will vary substantially among municipalities. Some regions, such as the cities of London and Windsor and the Region of Peel, are already metered. Others are not metered and would require an initial investment to fund equipment and installation. The costs of metering are generally in the range of $200 per consumer, but would vary for different types of structures.[10] In all but extreme cases, however, it is clear that the investment would be recovered. Metering has been linked to decreased water consumption through increased household awareness (Marshall, Koenig & Associates 1991, 23–24). As a result of these decreases, and further reductions resulting from fuller cost pricing facilitated by meter use, metering would reduce supply and treatment costs as well as environmental costs over the long term.

---

[10] These costs are based on estimates from the City of Toronto Department of Public Works and the Environment. The cost of meter installation can run in the thousands of dollars for commercial or industrial structures. Most of these structures, particularly in the Toronto area, are already metered. Meter installation costs may also vary with the age of the structure. Certain structures require significant overhaul in their plumbing in order to ensure the operability of the meter. The costs of reading a meter may vary across households, on access to meters and consistency in meter technologies. Emerging technologies may permit reading through radio or telephone.

RECOMMENDATION 80

Ontario should require that municipalities levy user fees for sewer and water services. Assessment-based charges for water and sewer services should be replaced by metering of all consumption. Flat rate water charges should not be permitted.

RECOMMENDATION 81

By the funding of pilot projects and other means, Ontario should encourage municipalities to levy user fees for waste collection.

29 A New Basis for Property Taxation

We have determined that the characteristics of the residential property occupied by a household cannot be related in any systematic fashion to that household's ability to pay. Our studies reveal that the relationship between the market value of residential property and household income is statistically random. We concluded that the residential property tax must be seen as a general benefit tax for local services.

The non-residential property tax, in our framework, has two roles: as a general local benefit tax reflecting the same principles of fairness as the residential property tax; and as a general tax on business, using commercial and industrial property as the tax base. In this chapter, we deal with issues arising from the role of the non-residential property tax as a benefit tax for local services. In chapter 32, we address provincial taxation of commercial and industrial property in the context of provincial taxation of business more generally and make recommendations with respect to the design of such a tax.

A view of property taxes as general benefit taxes for local services has clear implications for the design of a property tax base. To serve as the base for a benefit tax, assessment should, in principle, reflect the distribution of the benefits from the local services that are funded from the tax. Since it is not possible to measure benefits from local services directly, the fairness goal should be to identify a basis for assessment that best approximates the distribution of benefits from local services.

Assessment

Although the assessment system in Ontario is theoretically based on market value, the data presented in chapter 27 reveal that it is less a system than a patchwork of different – often dramatically different – assessment bases. The system was inconsistent with any concept of tax fairness 25 years ago; today it is in much worse shape. It would be difficult to argue, on fairness or on any other accepted grounds, that the current non-system be retained. The only question is, What should replace it?

Options for Assessment Reform

In addition to the obvious requirement that the system meet a fairness criterion, other criteria are important in evaluating different assessment systems.

From the perspective of the taxpayer, the system should produce individual assessments that:

- are objectively verifiable and easily reproduced;
- can be clearly understood;
- are consistently administered;
- are not subject to large year-to-year fluctuations; and
- may be appealed in an accessible, objective, and fair process.

From the perspective of provincial and local governments, the system should have:

- a stable revenue potential over time;
- the lowest possible administrative costs consistent with fairness objectives; and
- the least possible negative impact on economic development, both within the local area and in the province.

For most tax bases, the valuation of the base is not a principal concern. This is because, for most taxes, the tax arises from a specific transaction or series of transactions. For example, in the personal income tax system, the income base is generally measured as the amount actually paid to an individual during the calendar year. The sales tax base is the price at which a taxable good or service changes hands in a taxable transaction. The base for most taxes is the value at which a transaction subject to tax takes place. Valuation issues tend to arise when there is no actual transaction or where the transaction is not considered to be at arm's length and therefore produces a value that is suspect. These cases generally concern only a small portion of the tax base and tend to be resolved on a case-by-case basis on practical grounds. In some cases, the valuation issue is simply avoided. For example, although in principle capital gains should be taxed on accrual, in fact they are not. Capital gains are normally taxed only when the asset is sold. Determining the value at that time is straightforward. In other cases, arbitrary rules are devised to prevent abuse of the system. For example, in the retail sales tax, private sales of automobiles are deemed to have taken place at industry standard market prices. This price is used as the basis for computing tax liability, regardless of the price claimed to have been paid by the buyer. Most value-oriented systems of property assessment differ from the norm in tax base measurement in that the absence of a transaction is the rule rather than the exception. For most properties, there is no actual transaction that determines the value. The assessor must attempt to predict the price at which a transaction would have taken place at arm's length if it had occurred. This inevitably involves elements of judgment that make it difficult for the taxpayer to understand how the assessed value of the property was determined.

The assessment system must produce results that are consistent with our fairness framework. In addition, general criteria for assessment system design such as administrative feasibility, clarity, simplicity, stability, and administrative fairness must be met. We considered a number of potential methods of assessment in light of these objectives.

Market Value

The market value of a property depends on the value of the property in its current use and the value attributable to potential future uses of the property. The varying roles of these elements in determining the market value of a property contribute significantly to the practical and conceptual problems associated with the implementation of fair market value as an assessment base.

As a practical matter, the three primary bases used by assessors to measure market value – arm's-length sales, rental income, and replacement value – differ in the extent to which they measure the elements of market value. Arm's-length sale prices measure the components of value together because they represent what a buyer would pay for full enjoyment of the rights of ownership. Rental income measures only the value of a property in its current use. Replacement value reflects value in current use, but may be higher or lower than that value, depending on conditions in the industry under consideration.

In the private appraisal industry, the method used for property valuation depends in part on the type of property involved and on the purpose for which the valuation is being undertaken. For example, if the valuation is being done for a prospective purchaser and the property is not expected to generate rental income, the arm's-length sales method might be most appropriate. If the valuation is being done for a financial institution considering lending money on the security of a rental property, the rental income approach would probably be used. For insurance purposes, replacement value would be the most likely valuation method used. In the valuation process, it isn't necessary for the particular property to have been sold or rented or replaced. The appraiser values the property as if it had been sold, as if it were rented, or as if it were to be replaced.

In property assessment for tax purposes, the particular method used for estimating market value influences the final assessment. For example, in the residential sector and the commercial sector, both the arm's-length sales method and the rental income method are used for valuing different types of properties. Because arm's-length sales data reflect components of value not reflected in rental income, properties valued using the former method will tend to be overvalued relative to properties valued using the latter method.

In the current system, assessors determine the method to be used in assessment. In the commercial sector, large commercial properties and shopping centres are valued using the rental income method. Smaller commercial properties in "strip retail" areas (stand-alone stores with individual street frontages) are valued using arm's-length sales as the assessment method. In the residential sector, large multiple-unit rental buildings are assessed using the discounted rental income method; single family residences and small rental properties are assessed using arm's-length sales data. In the commercial sector, these assessment practices have led to inconsistencies that have been quite visible in rapidly growing large urban areas where market value assessment reform has been considered. In the residential sector, the inconsistencies have not been as apparent because most areas with significant multiple unit residential sectors have been reassessed in class-by-class assessments, keeping multiple unit properties as a separate class from single family and small multiple residential properties.

The use of a measure of value that includes values attributable to potential future uses or changes in value contributes to volatility in measured market values. Because values attributable to future capital gains or potential uses are essentially speculative, they tend to vary dramatically with the business cycle and with the health of the local economy.

The extent of this variability may be illustrated by the changes that took place in the assessments of major Toronto financial district properties between the market value study conducted by the Ministry of Revenue in 1984 and the study done in 1988. In 1984 the 10 largest financial district office buildings were assessed at 5.7 per cent of value on average, compared with a Metro Toronto average of 8.5 per cent. Had market value been introduced on the 1984 basis, the taxes on these buildings would have increased by 49 per cent. Taxes on buildings in other parts of Metro would have gone down by a substantial percentage. In 1988 the 10 largest buildings were assessed at 4.2 per cent of value, almost exactly the Metro average of 4.3 per cent. If these properties had been reassessed first on 1984 values and then again on 1988 values, taxes would have increased by 49 per cent with the first reassessment and would have dropped by one-third (back to the same position relative to the Metro average as existed prior to the first reassessment) with the second reassessment. Properties outside the financial district would have experienced substantial tax reductions resulting from 1984 market values and then substantial tax increases resulting from the application of 1988 market values.[1]

Another comparison by the City of Toronto of successive local reassessment studies in 1975, 1980, 1984, and 1988 illustrates the problem of volatility using market values. Assuming that properties had

---

[1] Data in this section were supplied by the City of Toronto, Department of Planning and Development.

been reassessed in 1975 and then had their assessments updated in 1980, 1984, and 1988, the study traces average percentage changes in assessment in each of the four major classes of property for each of the eleven wards in Toronto in that period. In Ward 4, a working-class area in the west end of the city, assessments on single family residences would have increased by 17.7 per cent in 1975, declined by 21.9 per cent in 1980, increased by 5.9 per cent in 1984, and increased again by 17.5 per cent in 1988. In Ward 7, a rapidly changing "white-painted" area that straddles the Don Valley, assessments would have increased by 14.4 per cent in 1975, declined by 6.5 per cent in 1980, declined by a further 10.1 per cent in 1984, and then increased by 15.6 per cent in 1988. In Ward 11, which includes the wealthy enclave of Forest Hill, assessments would have dropped by 7.7 per cent in 1975, increased by 18.6 per cent in 1980, declined by 1.1 per cent in 1984, and declined again by 2 per cent in 1988.

Commercial property in the downtown core in Ward 6 would have seen its assessment decline by 5.3 per cent in 1975, increase by 5.3 per cent in 1980, increase again by 5.1 per cent in 1984, and decline by 6.8 per cent in 1988. Industrial assessment in the heavily industrial area of Ward 2 in the city's west end would have increased by 26.8 per cent in 1975, dropped by 26.4 per cent in 1980, dropped by 12.9 per cent in 1984, and dropped again by 13 per cent in 1988. Industrial assessment in the east end in Ward 8, in contrast, would have dropped by 11.1 per cent in 1975, a further 7.5 per cent in 1980, a further 4.6 per cent in 1984, and then would have increased by 42.1 per cent in 1988.

To say the least, volatility of this order would create enormous practical problems. It would make the tax base extremely unstable. It would make it difficult for taxpayers to plan their own affairs in any reasonable manner. And by creating a succession of substantial changes in assessments, it would put the system into a permanent state of flux, in which transitional arrangements for increases in tax might end only to be replaced by transitional arrangements for reductions that offset the earlier increases.

In addition to these practical problems, there are important conceptual problems with attributing anticipated values to individual properties for assessment purposes. In assigning a value to a future change that may or may not take place, the market is in effect establishing the terms of a gamble for the buyer of a property. The buyer anticipates future increases or decreases in value and takes those potential changes into account in determining the price that he or she is prepared to pay. For example, the buyer of a property in Toronto or Ottawa in the late 1980s would have paid a premium based on an anticipation of future increases in value. That premium would have been greater in some areas than in others. By 1990 that premium would have been reduced dramatically, and by relatively more in some parts of each area than in others.

Similarly, the buyer of a single storey commercial property zoned for high-rise development would pay a price based on the potential future value that would flow from redevelopment. But that price represents a gamble. If the property is in fact redeveloped, the gain will materialize. If a neighbouring property is developed first, and the redevelopment of the property in question is delayed as a result, the gain will materialize much later. And changes in development patterns may result in the gain never materializing at all.

This process can work negatively as well. The buyer of an industrial property contaminated with waste materials would likely discount the price paid to reflect the costs of rehabilitating the site if it were to cease operation as an industrial facility.

The function of the market in attaching present values to future events that may or may not take place is an important one in a market economy. For some tax purposes – income and capital gains taxation, for example – no distinction in principle is made between changes in value that are attributable to anticipated future changes and those that are attributed to enhancement of value in current use.

The fact that the market value of a property reflects value attributable to potential future uses as well as to current uses lies at the root of many of the problems associated with the introduction of market value assessment in rapidly growing urban areas in Ontario. In such areas, the potential for future capital gain varies greatly across the urban area, and can change rapidly from year to year.

In the benefit tax framework we adopt, values attributable to potential future changes in use or increments in value are not appropriately included in the tax base. Conceptually, it would not be reasonable to attribute benefits from services currently being provided by local government either to the current value of anticipated future capital gains or to the current value of anticipated future uses of the property. For example, consider the owner of a property used as a hardware store that sits on land zoned for high-rise development. In principle there would be no reason to assume that the owner of the hardware store derives any benefit from public services flowing from the potential future value of his or her property.

Local public services overwhelmingly relate to current uses. The few exceptions, services like planning and zoning that relate to future use, are relatively low-cost municipal activities. Consequently, a benefit tax should be linked more directly to current use than to market value, which incorporates future speculative value.

This difference between value in current use and market value is taken into account in the present assessment model only in the assessment of farming property and golf courses. Most urban fringe farm land and golf courses are not assessed at fair market value. These properties are assessed on the basis of their value as farm land or golf courses.

Two-Tier Assessment

Two-tier assessment is a variant of market value assessment in which land and improvements are assigned market values separately and are taxed at different rates. Although it is obviously possible to tax either improvements or land at a higher rate, the arguments for two-tier assessment imply that land would be taxed more heavily than improvements. Historically, two-tier assessment is an outgrowth of the single tax movement that originated in the work of the American journalist, economist, and reformer Henry George in the 19th century. In writings based broadly on the theories of economic rent advanced by David Ricardo earlier in that century, George advocated significantly increased reliance on taxes on land. From the proposition that the supply of land is fixed and will not change in response to changes in prices, he argued that land could be taxed without affecting returns to labour or capital. Taxes on labour and capital, however, would alter such returns and produce a less efficient allocation of resources. Land taxes, therefore, would be a more efficient way to raise funds for public services than taxes on either labour or capital. In addition, land taxes would encourage land owners to make more productive use of their land. Advocates of two-tier assessment played a prominent role the Property Tax Working Group as well as in our hearings in a number of locations.

The principal argument in favour of two-tier assessment is a planning argument. Specifically, it is argued that two-tier assessment will create incentives for intensification of land use and more rapid economic development because two-tier assessment would permit municipalities to impose taxes at higher rates on land than on buildings. This attribute of two-tier assessment is put forward by advocates as a significant advantage of the two-tier system over other systems. They argue that the value attributed by the market to potential future uses of property is attached to the land rather than the improvements. If land is assessed on the basis of its highest and best use and is taxed at a higher rate than improvements, property that is employed in its highest and best use will be taxed at a much lower effective rate than underused property. While the economic incentive from two-tier assessment – and to a lesser extent conventional market value assessment – is exactly as described, it is not obvious that the planning outcomes would generally be desirable (Kitchen 1992, 122–23).

The problem is that Ontario's urban planning and economic development objectives are not one-dimensional. In some areas, the public policy goal is to encourage the development of land to its maximum intensity. For example, one goal may be to encourage redevelopment of vacant land in downtown areas or along transportation corridors. In other areas – preservation of agricultural land or heritage buildings, for example – the objective of planning policy is explicitly to discourage land from being developed to its highest and best use. In some situations, the goal may be to protect older industrial areas from encroachment by residential or commercial developments, or to promote neighbourhood stability by discouraging land assembly and redevelopment in residential areas. As a planning tool, two-tier assessment is far too blunt an instrument to be considered as a reasonable substitute for, or even a complement to, coherent and sophisticated planning and development policies. Because conventional market value assessment shares with two-tier assessment a highest and best-use value base, the planning implications of market value assessment are similar, although not as extreme.

We do not view the tax system as an appropriate planning tool. Even if Ontario's planning objectives were as simple and as one-dimensional as those supported by two-tier market value assessment systems, however, the tax fairness implications of such a system would still lead us to reject it.

More important, two-tier assessment and taxation would exaggerate the one characteristic of market value assessment that is most undesirable from a benefit tax perspective: the value measured includes values attributable to future uses of the property and future potential capital gains. Because the locational attributes that give rise both to potential future uses and to increases in value in excess of inflation attach to land rather than to buildings, two-tier assessment and taxation would increase the weight given to these non-use related values.

Rental Value

The most direct way to measure the value of a property in its current use is to measure its value as a rental property. Since a tenant is not paying either for the right to earn a future capital gain or for the right to change the use of the property in future to a higher-value use, rent is a direct measure of current use value. For properties that are normally offered for rent, measurement of rental value is relatively straightforward. For residential and non-residential properties that are not on the rental market, rental values must be estimated from market data.

It is apparent from the discussion above that rental value would be a better proxy for benefits from services delivered than market value. Two questions remain, however. The first concerns the administrative feasibility of measuring rental value, given that in some sectors, at least, only a small proportion of properties are actually rented. The second concerns whether there are other measures that perform as well as or better than rental value as proxies for benefits from local services and that avoid the need to impute rental values.

From a technical appraisal perspective, there is no fundamental difference between the task of estimating market value and that of estimating rental value. The principal technical issue is whether there is enough information available about the rental market to support an appraisal of rental value and, if not, what other approaches might be taken to the approximation of rental value. In markets in which property is typically rented, no imputation is required at all. The policy issue is whether there are alternative approaches to assessment that avoid the need to estimate the value of individual properties altogether and that perform adequately as proxies for benefits from services.

Physical Measurement

Assessment systems based on physical measurement, or unit assessment systems, clearly offer advantages of simplicity, transparency, and administrative ease. Physical measurement systems avoid the problem of valuation in the absence of a transaction because the assessment of the property is based on an objective determination that can be reproduced by the taxpayer without expert assistance. It is essential, however, that physical measurement systems be designed carefully to avoid creating unintended distortions. A tax on windows in England in the 18th century led to the construction of houses with tiny windows and to bricked-up windows in existing homes. A more topical example is the commercial concentration tax, established in 1989 and dismantled in the 1993 provincial budget. This tax applied to commercial space in the Greater Toronto Area in buildings of over 200,000 square feet, and it created a market for buildings of 199,000 square feet – just small enough to avoid tax.

While systems based on physical measurement may be superior in simplicity, stability, and administrative cost, they raise important fairness questions. Assessment based strictly on floor area or a combination of floor area and lot area would be insensitive to the quality of the living space and to its location. For many local services, both location and quality of a dwelling unit would tend to influence the benefits received by the household from local services. Keeping in mind that the services under consideration do not involve income distribution or social policy entitlements, it would be reasonable to assume that, other things being equal, residents of dwelling units in central locations receive greater benefits from local services than residents of dwelling units in more remote locations. Similarly, residents of higher-quality dwelling units receive greater benefits than residents of lower-quality dwelling units. One complication in introducing location as a factor in assessment is that it becomes necessary to distinguish between location values related to current service-level variations (a basis for tax) and location values related to future development prospects (not a basis for tax).

Designing an assessment system to reflect the concept of the property tax as a local benefits tax involves a trade-off between practical concerns of administrative cost, simplicity and administrative fairness, and the degree of precision with which the measure adopted reflects benefit from local services. We have concluded that while an assessment system based on physical measurement would be extremely economical to administer, the insensitivity of such a system to differences in quality and location of property would result in assessments that do not adequately reflect benefit from local services.

Value-Weighted Unit Assessment

One approach, which would be consistent with actual practice in the current system, would be to establish rental values per square foot for various categories of property and then calculate individual assessments based on category and area. This approach would, in concept at least, be similar to mass assessment techniques currently used by provincial assessors in measuring market values. The issues to be resolved in assessing a property would include determination of the property category, definition of areas for which different value factors might apply, physical measurement of the property, and measurement of value per square foot by property category and area. Values, categories, and areas would be determined within a municipality on the basis of available rental data and could be subjected to a broad public hearing process at the time of a regular reassessment. Appeals related to physical measurement or category allocation would be dealt with on an individual basis. Appeals related to the determination of rental value factors would be dealt with through a broader public hearing process.

Residential Assessment

For the assessment of residential properties, we were attracted to unit assessment systems for their administrative simplicity and clarity. Assessment based on some combination of lot, building area, and building type would be easily reproduced by the owner of a property, would require little judgment by the assessor, and would simplify the appeal process. As attractive as unit assessment is for its simplicity, a number of considerations led us to recommend a modification of the unit concept in order to introduce elements related to the value of the property in its current use, or rental value.

First, assessment based on a combination of building area and lot area would require the adoption of weighting factors to be used in adding the various elements of the assessment together. The introduction of building type as another variable in a unit assessment system would require the adoption of different weighting factors to be used for each type of building. We believe these weighting factors should not be determined arbitrarily, but should reflect some underlying principle that would establish the relationship between the assessment of different types of properties.

Second, we conclude that residential properties in more advantageous locations, as reflected in the general rental values in those locations, receive a greater benefit from certain public services than do residential properties in less advantageous locations. For example, residential properties located close to rapid transit facilities receive greater benefit from the public transit system than residential properties located on bus routes on the fringe of urban areas.

Third, studies of unit assessment in the City of Toronto in 1986 indicate that the introduction of a pure, unweighted unit assessment system in the single family and duplex residential category would have generated substantial shifts in assessment away from the wealthiest areas of the city and towards the poorest areas. We believe that local governments would find it extremely difficult to justify such shifts on a benefit principle.

Finally, we conclude that a system of unit assessment based on building area, lot area, type of building, and location, modified by requiring that the resulting assessments reflect variations in the rental value of residential property, would retain much of the simplicity and transparency of unit assessment from the perspective of the individual property tax payer while recognizing the importance of locational values as a reflection of benefit from local services.

In addition to requiring that the resulting weighted assessments reflect values in current use or rental value of residential properties, we believe it is important to impose some restriction on the definition of assessment areas or locations. Although there is no inherent reason why any one restriction would be preferable to any other, there is some merit in selecting as the basis for such a restriction geographical areas that are already recognized for some other purpose. One potential basis that offers some advantages would be to limit assessment areas to geographically contiguous areas that have a common zoning designation for planning purposes.

RECOMMENDATION 82

Residential assessment of individual properties for local taxation purposes should be based on the following factors:

- **size of building,**
- **dimensions of lot, and**
- **type of building.**

Weighting factors used in combining the factors of size of building and dimensions of lot for each type of building should be designed to ensure that the resulting assessments reflect variations in the value of properties in their current use, as shown in their rental value.

Weighting factors would be permitted to vary, based on location, subject to the following requirements:

- **Without differential weighting factors based on location, it would be impossible to achieve assessments which reflect value in current use.**
- **Assessment areas could not be smaller than geographically contiguous areas which carry the same zoning designation for planning purposes.**

Special Issues

Taxation of Residential Tenants

The current treatment of property taxes on rental property is unsatisfactory for a number of reasons. First, and most important, on average tenants are overtaxed relative to single family homeowners. Multiple unit residential properties are assessed at between two and three times the rate of single family homes in most municipalities in the province. Since a common tax rate is applied to the assessed values of all residential properties, this results in tenants paying taxes at a higher effective rate than homeowners. Second, tenants are not aware of how much property tax they actually pay through their rent and, as a result, are less aware than they should be of the property tax and of the local issues that affect them. There is an inconsistency between the basis on which the Assessment Act allocates assessment and the way the regulatory system for rents allocates tax. Currently, the Assessment Act allocates assessment on the basis of the physical dimensions of rental units. The provisions of rent control, in contrast, allocate tax to be passed through to tenants on a percentage-of-rent basis. In buildings in which rents on units of similar size vary for historical and other reasons, those same distortions are reflected in the distribution of property taxes paid by the tenants through their rents.

Third, because there is no explicit indication to tenants of how much they pay in property taxes through their rent, there is no adequate basis for a mechanism to pass through to tenants any reductions in property taxes that may result from tax reform or any other change. Fourth, because tenants are not recognized by the assessment and local tax systems as paying property taxes (although they are for rent control and property tax credit purposes), they have difficulty gaining standing to appeal the assessment on the buildings in which they rent. This lack of official recognition also creates difficulty for tenants in hiring agents, who usually work on a contingency basis, to represent them in assessment appeals.

The lack of any direct relationship between tenants and the property taxes they pay through their rents would be a problem in any local government finance reform, and, in a reform of the magnitude we propose, it is a very serious concern. The reforms proposed for education finance would cut residential property taxes, on average, roughly in half. Using the general rule that property taxes average 20 per cent of rent, this change alone should lead to a reduction in rents of about 10 per cent. In addition, the proposal that all residential property be assessed and taxed on the basis of its value in its current use would produce significant changes in the split of the remaining residential property tax burden between tenants and homeowners. In a pure market value system, reassessment would have to address the full amount of the difference in effective tax rates between single family residences and multiple unit residences. While the shift would likely be less extreme in a current use value system, it would still be substantial.

Individuals and organizations representing tenants told us they are discriminated against because of unfair assessment practices. They complained that individual tenants in multiple unit residential buildings are overtaxed relative to people who live in properties assessed as single family residences, and that buildings are taxed more heavily if they have more than six units.

Every presenter called for increased property tax visibility and said that municipalities should make tenants aware of any changes in the property taxes levied on a dwelling.

The information on which to base an allocation of tax to occupants of residential property is currently available. It would be technically possible to attribute tax to individual units. There are, however, significant collection and administrative problems associated with the immediately obvious solution of making tenants responsible for the property taxes on their own units. At a minimum, however, tenants should be made aware directly of the property taxes paid on their behalf on their individual units by requiring that municipalities send notices to that effect to the tenant in every rental property listed on the assessment roll. The information is readily available and could be mailed out to tenants at a modest cost to local authorities.

Our recommendations on the taxation of residential property would result in substantial reductions in property taxes on rental residential property, for two reasons. First, rental residential property would benefit along with other residential property from the replacement of property taxes as a source of core funding for education. Second, assessment reform within the residential sector at the local level would generally result in significant tax reductions for rental property relative to owner-occupied residential property. These changes are intended to reduce the level of property taxation borne by residents, not to improve the profit picture of residential landlords. As a result, it is essential that mechanisms be put in place to ensure that reductions in property taxes resulting from these changes are passed on to tenants. Changes in local government finance with respect to rental residential property should not be implemented until a means of ensuring that tenants receive the benefit of those changes is in place.

RECOMMENDATION 83

Residential tenants should be made aware of the assessment and corresponding property taxes that apply to the property they occupy and that are reflected in their rents. Municipalities should be required to send property tax notices to all tenants, informing them of all taxes applicable to their units.

Administrative mechanisms should be developed to ensure that landlords are able to pass on increases in property tax and that tenants receive full credit in their rents for any reductions in property tax that result from reform of local government financing.

Local government finance reforms affecting residential rental property should not be implemented until such a mechanism has been developed.

Assessment of Recreational Trailers

Issues related to the assessment and taxation of recreational trailers and trailer parks played a prominent role in our hearings as trailer park operators reacted to recommendations put forward by the Property Tax Working Group on the issue. The working group recommended that recreational trailers located on a site for more than 90 days be considered permanent and be assessed and taxed on the same basis as cottage and residential property.

Trailer park operators pointed out that many trailers are located on a given site for only one season, which may generally exceed the 90-day limit specified in the recommendation. It would be very difficult for owners to collect property taxes from seasonal occupants of trailer parks. Differences in values of trailers would make adding tax to the ground rent in the trailer park an unrealistic solution. Park operators urged us to support the recommendations of an interministerial committee of the provincial government as described in the working group report and to reject the working group's recommendation. This approach called for the introduction of an annual permit fee for all mobile trailers located in campgrounds for more than 90 days and occupied by persons who have a principal residence elsewhere. Trailers occupied by persons who do not have a principal residence elsewhere would be assessed and taxed.

A fair approach to the taxation of recreational vehicles and trailers must distinguish between transient and temporary use, and between temporary and permanent use. Where use of a site is to a significant degree permanent, in that the mobility of the vehicle or trailer is impaired, the vehicle or trailer should be assessed and taxed as residential property. Where use is transient, no tax other than vehicle licence fees should be applicable. Where use is temporary, we accept the position that assessment of recreational vehicles and mobile trailers would be impractical. As an alternative to assessment and taxation, we would recommend a flat fee. The terms under which a fee is applied, however, should address the concern that seasonal and recreational residents of trailer parks should be required to pay taxes on a basis which is comparable to that applied to other seasonal residents. The minimum period of occupancy triggering the fee should be 30 days rather than the 90 days contemplated by the interministerial committee. The fee should vary with the length of the period of occupancy. The fee should be a monthly rate at a level that reasonably reflects on a pro-rated basis the property taxes that would be paid on the unit if it were assessed and taxed as residential property.

RECOMMENDATION 84

All recreational vehicles and trailers located permanently in a campground or trailer park should be assessed as residential property. Location would be considered permanent if the mobility of the vehicle or trailer is impaired. Vehicles and trailers located in a campground or trailer park for more than 30 days and not assessed should be subject to a monthly fee. The fee should be established by the provincial government to approximate the local taxes that would apply if the structure were a permanent dwelling, pro-rated to a monthly amount.

Fees would be collected by the operator and remitted to the local municipality or local roads board.

Commercial and Industrial Assessment

The Recommended System

The problem of identifying an appropriate assessment system might appear to be more complex for commercial and industrial property than it is for residential property. Whereas the residential assessment base must serve only a single purpose as a local benefit tax, commercial and industrial assessment must serve as the base for both a local benefit tax and a provincial general tax on business.

In our framework, the base for the non-residential property tax as a local benefit tax should reflect the value of the property in its current use. As is the case with the residential property tax, since the goal in designing a base for a benefit tax on non-residential property is to reflect benefits from local services, it makes no sense to include in the base values attributable to potential future gains or potential future uses. A store located on land zoned for high-rise development does not receive greater benefit from local public services than a similar store located on land zoned for a two-storey walk-up building. Therefore, it would not be appropriate to tax the store based on its value as a site for a high-rise building.

While this analysis is helpful in determining the appropriate base for the non-residential property tax as a local benefit tax, it leaves open the question of the appropriate tax base to be used for a commercial and industrial property tax designed as a general tax on business. In our view, the concept of value in current use would be an appropriate base for a property tax designed as a general tax on business as well. If the tax is conceived as a tax related to current business activity and is intended to be related to the cash flow of an existing business, the business subject to tax would be better reflected in the value of the property in its current use than to the value of the property in a potential future use. Thus the same reasoning that led us to reject market value as the basis for assessment in a local benefit tax leads us to reject market value as the basis for assessment in a general property tax on business. Value attributable to a future change of use should be subject to tax when it is realized, through the capital gains tax or a special tax on land value increments.

Because the assessment system must serve as the base for a provincial tax as well as for a local benefits tax, all commercial and industrial property in Ontario must be assessed on a uniform basis.

This uniformity would address two particular problems brought to our attention. Hotels in Metropolitan Toronto have been assessed as a separate class of property within the commercial class and have been subjected to much higher effective rates of tax than other commercial properties. Hotel operators argue that this approach to assessment is placing many of them in financial difficulty. It is estimated that the property taxes on an average available room were $4428 in 1991 in Metropolitan Toronto. By contrast, income after deducting all expenses, including property taxes but excluding debt service, was $1114 per room (Pannell Kerr Forster 1992, 3, 26). While commercial property in Metropolitan Toronto is generally assessed at just over 4 per cent of market value, hotels are assessed at about 8 per cent. Because all hotels are assessed at the same rate, and because on appeal a property owner must prove that his or her property is overassessed relative to similar real property in the vicinity, assessment appeals do not resolve this problem. Uniform assessment based on value in current use would address this concern.

Another issue concerns the allocation of property taxes within shopping malls. The current system of allocating property taxes according to actual rents favours the anchor tenants. In a value-in-current-use system, assessment would be based on the rental value of properties of that type and quality in the municipality, not on the actual rents paid on a particular commercial unit.

The concept of value in current use is actually much simpler to apply in the commercial and industrial sector than in the residential sector. Well-established rental markets exist for most types of commercial and industrial property throughout Ontario.

RECOMMENDATION 85

Non-residential property should be assessed on the basis of the rental value of the property – the price that would be paid for property of that class and type for the right to employ the property in its current use.

Special Issues

Some properties are difficult for assessors to value, regardless of the assessment system. Some types of industrial property are difficult to value because they were built as single purpose properties. Although the property falls generally into the category of industrial property, it is difficult to value because there aren't enough properties similar to it to serve as a basis for comparison. Other properties have unique characteristics that make it difficult to establish a value.

Single Purpose Industrial Property

Certain properties pose major problems for assessors, regardless of the assessment system. This category of property consists primarily of large, special purpose properties such as automobile assembly plants, steel mills, mines, and smelters. While these properties would pose significant problems for assessors attempting to determine values in current use or rental values, similar problems are already encountered in determining fair market values for these properties in the current system. Essentially, values for these special properties are determined through negotiation between the assessment authorities and the property owners. The process begins with an assessment of replacement value, which is then modified in negotiations to reflect market conditions. The only difference between the current system and the rental value system for these properties is that the goal of the negotiations would be to determine rental value rather than market value.

Fixed Unit Assessment Rates for Unique Properties

For some properties, their unique characteristics mean that even negotiated assessments cannot work. Railway and utility rights of way, cemeteries, and churches are examples of properties for which conventional assessments pose very serious problems. The current approach is to attempt to fabricate assessments that appear to be consistent with assessments of other types of property. We believe that such properties should be assessed at fixed unit rates established by statute or regulation.

The current approach applied by provincial assessors in the valuation of railway and utility rights of way has generated considerable controversy. Such properties are valued on the average values of abutting lands, rather than on any measure that reflects either the potential market value of the property if put up for sale or the use to which the property is actually being put.

Rights of way are unserviced, mostly inaccessible strips of land that cannot be used for anything else. They have no development potential and, when abandoned, have been demonstrated to have only marginal value on the market. Rights of way also require virtually no municipal services. Although the taxation of rights of way has been debated for many years (property tax studies in 1963, 1967, and 1976 recommended that the abutting-lands approach be abolished), the issue came to a head with the market value reassessment proposal for Metropolitan Toronto tabled by the Ministry of Revenue in 1992. Ontario Hydro's taxes would have increased dramatically, at considerable cost to Hydro consumers across the province. As a result of the potential reassessment, CP Rail's roadway taxes would have increased by $13 million. [2]

The assessment of churches and cemeteries is not a problem for the current system of assessment in Ontario because these properties are exempt from assessment for local property taxation under the Assessment Act. As a matter of taxation policy, however, we believe that these properties should be assigned an assessed value and be subject to tax under certain circumstances. Our position on exemptions from local property taxation is set out in chapter 30.

---

[2] Information supplied by CP Rail to the Ministry of Municipal Affairs, November 1992.

Given this position, it will be necessary for churches and cemeteries to be assigned an assessed value. Because of the nature of both types of property, it would be extremely difficult to measure a value for these properties in their current use. As a result, we believe that churches and cemeteries should be assessed at uniform statutory unit rates.

RECOMMENDATION 86

Statutory assessment rates should apply to non-residential properties whose value in current use is difficult to determine.

Railway, pipeline, and electrical transmission rights of way should be assessed at provincial standard unit rates which are updated on a regular basis as assessed values generally are updated.

Church sanctuaries and cemeteries should be assessed at a standard unit rate.

Taxation of Vacant Land

Where a property is in use or is available for use for an economic purpose, the identification of the use of the property is relatively straightforward. In many cases, however, there is no current use for the property. The property is simply being held as an investment based on its future use potential.

Strictly speaking, such a property would have no value in its current use. At the same time, the owners of such properties clearly benefit from local public services. It would not be fair to exempt vacant land from taxation.

There are three potential options for the assessment of vacant land by assigning a use to the land. The basis for assigning a use to vacant property could be:

- the previous use to which the property was put;
- the current use of similar properties in the vicinity; and

- the maximum-value use that would be permitted by the zoning of the property.

The benefit principle provides no useful guidance on how to assign a use to vacant property for assessment purposes. Assessment based on the previous use of the property would be somewhat artificial, because that use is unlikely to reflect the basis on which the land is being held vacant. Assessment based on the highest and best use permitted by zoning would base assessment on a use that may never be realized on the property. Perhaps the best guide to the use to which the owner anticipates putting the property would be the use to which similar property in the vicinity is currently put. Such a basis for assignment of use also has the advantage of providing the appropriate incentive to landowners from a planning perspective. The incentive built into the system would be to maintain property in use until it is ready to be redeveloped.

RECOMMENDATION 87

Vacant land should be assessed based on the preponderant use of property in the area. Vacant land includes surface parking lots zoned for other purposes and unused rights of way.

30 Municipal Taxation Policy

One of our fundamental goals in developing a framework for local government finance reform was to establish a clear separation between assessment policy – the system for valuation of real property for tax purposes – and taxation policy. In chapter 29 we set out our recommendations with respect to assessment policy. We now turn to the key elements of taxation policy: the establishment of tax rates on residential and non-residential property; taxation of farm land, wetlands, and woodlots; the future of the business occupancy tax; the question of allowance for vacant non-residential property; and the determination of exemptions from local property taxes.

Local Tax Rate Policy

Beyond the establishment of the annual tax rate to meet the revenue requirements of municipalities and school boards, the current system for local government does not acknowledge the existence of municipal taxation policy in Ontario. The residential and farm tax rate is set in legislation at 85 per cent of the commercial and industrial tax rate. Behind the facade of official uniformity in tax policies, however, differences in assessment policies between municipalities mean that there are also substantial variations in the real relationship between residential and non-residential tax rates across Ontario. In other words, taxation policies in fact vary from municipality to municipality. On average, single family residential property is subject to the lowest effective tax rate – less than half (36 per cent) the effective rate applicable to multiple unit residential property. The average effective rate of tax on commercial property is more than double (2.3 times) the average effective tax rate on single family residential property. The average effective rate of tax on industrial property is 12 per cent higher than the average effective tax rate on commercial property. The data also show that there are wide variations around these average effective tax rate relationships at the local municipal level across Ontario.

The differences in effective tax rates shown in these data also lie behind some of the most energetic debates about property taxes, and particularly education taxes. These differences help fuel the public perception that the current system is arbitrary and unfair. For example, in the urban municipalities in both Peel and York regions, the effective tax rate on commercial property is much closer to that of residential property than it is in the municipalities in Metropolitan Toronto. In both Mississauga and Markham, the effective tax rate on commercial property is 17 per cent higher than the effective tax rate on single family residential property. In Etobicoke, the effective rate of tax on commercial property is 2.4 times the effective rate of tax on single family residential property; in Scarborough, 2.8 times; in North York, 3.2 times; and in the City of Toronto, 3.75 times. Compared with Metropolitan Toronto, commercial taxpayers in Peel and York pay less tax and residential taxpayers pay more. The results are evident in the dramatically higher education taxes on homes north of Steeles Avenue in York compared with those on similar homes south of Steeles Avenue in Metropolitan Toronto.

What should be done about these significant differences in policy at the local level? In the 1970s and 1980s two extreme approaches were tried. In attempting to implement a uniform system of assessment and taxation for all types of property across Ontario, the provincial government treated these tax policy differences as accidents of history that should be eliminated. When that attempt at reform failed, the government attempted assessment reform on a class-by-class basis, a process that hides and then maintains in perpetuity the implicit local tax policies that were reflected in the assessment system before it was reformed.

Establishing consistent assessment systems for all residential property and for all non-residential property, as we have proposed, forces the issue. To maintain the taxation policies that are implicit in assessment practices, municipal governments would have to approve budgets that call for explicit differences in tax rates. To what extent should municipal governments be permitted to do so?

In the commission's framework for fairness in local government finance, the residential property tax and the non-residential property tax are seen as different taxes. The residential property tax is seen as a local benefit tax intended to reflect the benefits received by residents from the provision of local public services. The non-residential property tax is seen as a local benefit tax intended to reflect the benefits received by non-residential property owners from the provision of local services. In the abstract, there is no reason why the relationship between the rates for these taxes should be the same in every municipality or why they should bear any fixed relationship to each other. By the same token, however, differences in rates of tax within each of these broad categories of property are somewhat more difficult to defend.

In addition to tax rate policy, this chapter deals with reform of the business occupancy tax, exemptions from local property taxation, and the administration of the property tax system.

Residential

A One-Class System

Given our focus on the residential property tax as a benefit tax, we can see no justification for a distinction in tax rate policy on the basis of the type of tenure enjoyed by the occupant of the dwelling unit under consideration.

RECOMMENDATION 88

All residential property should be assessed on the same basis whether the property is occupied by an owner or a tenant.

Taxation of Seasonal and Recreational Properties

The residential property category currently includes cottage and recreational properties as well as farming properties. Cottage and recreational properties fall into a legitimate middle ground. They are included in the residential class based on a literal analysis of physical characteristics. If the analysis were to be based on the economic function of the property, however, a case could be made that cottage and recreational property should be seen as equivalent to commercial property.

We believe that the non-residential property category should be restricted to properties whose use involves a commercial or industrial business activity or the equivalent. Because operation of a cottage for one's own use is not considered to be a business activity, cottages and private own-use recreational properties should not be included in the commercial and industrial property sector for taxation purposes.

We are well aware of the controversy surrounding the property taxation of cottage properties. At many of the commission's hearings, cottagers expressed the view that they should not have to pay some of the local taxes they currently pay because they cannot fully benefit from locally provided services. In particular, cottage and recreational property owners argue they should not have to pay local taxes to support municipal services that are not available to them as seasonal residents.

We cannot accept the premise on which these arguments are based. We do not see the property tax as a benefit tax tied to the use of particular local services and cannot support the idea that property taxes should be rebated to taxpayers if they do not or cannot use a particular service.

We view the reformed property tax as a general local benefit tax and not as a direct benefit tax that links taxes and specific services. Therefore, we do not accept arguments that certain taxpayers should be exempted from paying for particular elements of the package of local services funded from property taxes on the grounds that they derive less benefit from those services than other taxpayers. In some areas, however, recommendations based on different reasoning address these concerns to some extent. For example, our recommendation for increased reliance on user charges for sewer and water services and for garbage collection and disposal would have the effect of linking costs to use on an individual household basis. In general, however, our view of the property tax as a local benefit tax is not consistent with a system of partial exemptions from property tax tied to the use or non-use of particular parts of the package of local services funded from that tax.

In communities where permanent residents currently receive sewer and water services and garbage pick-up services funded from the general tax base, cottage and recreational property owners would see general tax reductions as funding for these services is shifted to user charges. In addition, municipalities already have the power to levy area rates for services that are available only in certain geographical areas. There is no reason why municipalities in cottage and recreational areas could not alleviate the problems experienced by cottagers through a system of area rates for services that are not generally available in the municipality. This aspect of the problem should, however, be resolved at the local political level.

RECOMMENDATION 89

Non-commercial cottage and recreational property should be assessed as residential property and be subject to local municipal taxes on exactly the same basis as other residential property.

Cottage and recreational property owners also argued they should be exempted from local education levies to which other residential and commercial/industrial property owners are subjected. They see the requirement to pay education taxes on two properties as double taxation. While our general recommendations on education finance achieve much the same result as that sought by cottagers and others who sought exemption from property taxes, we reached that conclusion based on very different reasoning. As long as property taxes remain a source of funding for education in Ontario, we can see no justification for exempting cottages and recreational property from those taxes. In particular, we do not believe that ownership of a second residence should cause the owner to qualify for an exemption from local taxation on one of them.

With respect to education, our general recommendations would have the effect of reducing substantially the burden of property taxes on all property classified as residential property, including cottage and recreational property. The only local education tax remaining in our funding reform package would be a limited local discretionary levy. We believe that all local levies on residential property should apply in full to all properties taxed as residential property, whether they are used as principal residences or for recreational purposes.

RECOMMENDATION 90

Local levies for education should apply to all properties assessed and taxed for municipal purposes as residential property, including non-commercial cottage and recreational property.

Limits on Residential Taxing Powers

Should there be limits on the power of local governments to tax property in the residential sector? In our view, none of the arguments advanced for a limitation on the power of local governments to tax apply to the residential property tax. In one way or another, all the concerns relate to the potential problems that might arise from policy freedom in commercial and industrial taxation. Having imposed the requirement that the residential sector be assessed and taxed as a single class, we can see no reason for further limiting the freedom of municipal governments to set their own tax rates in the reformed regime.

Commercial and Industrial Taxation Policy

The overriding issue with respect to local policy authority over the property tax is the extent to which it is appropriate for the relationship between property taxes on different types of property within a community to vary. A tax system with the same relationships among tax rates across the province would tax all classes of property in a given community at the same effective rate. Tax rates would differ between communities as a result of differences in local services and overall assessment wealth, but within the community the rate of tax on each class of property relative to the rate of tax on other classes of property would be the same.

A system that allowed tax rate relationships to vary would permit the tax rates on one class of property to vary in relation to the tax rates on other classes of property between communities. For example, in a variable tax rate system, one community might decide to tax commercial and industrial property at a higher rate than residential property; another community might decide to tax commercial and industrial property at a lower rate than residential property.

The issue of tax rate flexibility in the commercial and industrial sector raises legitimate concerns. Not every municipality in Ontario has the same share of its assessment base in each class of property. Some municipalities have large commercial and industrial tax bases. Others are predominantly dependent on residential assessment. Tax rate flexibility leaves open the possibility that municipalities could use their taxation powers competitively, with significant consequences.

For example, a municipality with a large commercial and industrial tax base could reduce residential taxes and maintain services with a relatively modest commercial and industrial tax increase. A neighbouring municipality with a smaller commercial and industrial base might be forced to levy much higher taxes on residential property or to cut back on services because it could not use its commercial base to keep residential tax rates down.

Alternatively, a municipality with a small commercial and industrial tax base could reduce its tax rates substantially to attract industry at relatively little cost in lost tax revenue. A neighbouring municipality with a larger industrial base would be unable to compete without either cutting services or raising residential taxes to unacceptable levels.

The policy concern is that this competition could create a "beggar-thy-neighbour" system in which municipalities compete against each other to achieve the lowest tax rates in the hope of attracting mobile business operations. There are two major problems with these kinds of local subsidies. First, the competition they engender will almost inevitably reduce the capacity of the local community to pay for local services. Second, such policies may result in location decisions being made on grounds of tax policy, rather than real differences in economic and/or social characteristics of the community, such as the skills base or education level of the workforce or the presence of complementary industries in the jurisdiction. Tax-driven mobility among municipalities in Ontario is not in the province's overall economic interest and should be prevented. We are opposed to tax-based subsidies or "bonusing" in any form.

In order to limit the potential for this kind of destructive competition, we believe it is necessary to place limits on the permitted scope for tax rate variability. Totally unrestricted local policy flexibility would not be appropriate (Bird 1993, 206). Restrictions could apply in one of two ways. They could limit the relationship between commercial/industrial and residential tax rates; or they could impose direct limits on commercial and industrial tax rates themselves.

Focusing on the relationship between tax rates, the provincial government could follow the current general regime and limit the range within which effective tax rate relationships could vary at the local level. For example, the Working Group on Property Tax recommended provincially set bands within which tax rate relationships would be permitted to vary. Thus, if the provincial average effective tax rate on residential property was 50 per cent of the effective tax rate on commercial and industrial property, banded restrictions might permit a range between 40 per cent and 60 per cent.

This approach to restricting local tax policy flexibility is subject to some problems when applied in the commission's proposed framework. The most important of these problems is that restriction is inconsistent with our view of the residential property tax and the commercial and industrial property tax as separate and distinct taxes. In addition, imposing the restriction in this way obscures its real purpose – to address the concern that inter-municipal tax competition might erode the local tax base and potentially frustrate provincial economic development objectives.

Our recommendation that there be a common basis for assessment of commercial and industrial property is consistent with a more direct approach to restrictions on the flexibility of local government tax policy. We considered two approaches. In one approach, a range of permitted flexibility would be defined in relation to the provincial average rate of tax on commercial and industrial property in the previous year. Local governments would be permitted to vary their rates of tax on commercial and industrial property within a fixed percentage above or below that rate of tax.

A second approach would deal more directly with the policy problem that a restriction on commercial and industrial tax rates is intended to address. Our concern is not that municipalities will overtax commercial and industrial property; rather, it is that municipalities will compete with each other to reduce commercial and industrial taxes, creating a kind of subsidy for all commercial and industrial property. The direct approach would be to impose a lower limit on the rate of tax on commercial and industrial property, leaving municipalities to determine for themselves, considering local economic and political conditions, what the rate of tax should be beyond that point.

RECOMMENDATION 91

Ontario should allow municipal governments to establish their own rates of tax on non-residential property, subject to a minimum rate of tax established by the provincial government.

Taxation of Farming Property, Woodlots, and Wetlands

With respect to farming property, the current practice is to assess the farm home and one acre of land as residential property subject to all the taxes applicable to residential property. The remainder of the farm is assessed as farm property and taxed at the same rate as residential property, and is also eligible for the farm tax rebate, which is intended to give farmers a rebate equivalent to the educational portion of their property taxes.

Farmers told us at our public hearings that the farm tax rebate did not adequately compensate them for municipal taxes on their farmland. Based on their argument that they should not have to pay full municipal taxes because they do not benefit fully from municipal services, they argued that the rebate should be higher. In addition, they questioned the timing of the rebate because farmers are forced to pay the property taxes up front, then wait months for the rebate cheque.

We believe that the current treatment of the farm residence should be continued, but see no reason why farming property should be taxed at the same rate as residential property. Farming should be considered for tax purposes to be a non-residential land use, and should be assessed and taxed on the basis of its value in current use or rental value. In the commission's framework, the local education levy would not apply to farm property. The questions of an exemption for farming property from a provincial commercial and industrial property tax and the future of the farm tax rebate program are considered in the context of provincial commercial and industrial property taxation and dealt with in more detail in chapter 32.

Similar tax treatment should be provided for managed forests and wetlands. They should be assessed based on their current use and subjected to local taxation on that assessment. The issue of exemption from provincial commercial and industrial property taxes should be addressed directly rather than through a taxation-and-rebate system.

RECOMMENDATION 92

The farm residence and one acre of land should be assessed and fully taxed as residential property.

RECOMMENDATION 93

Wetlands, managed forests, and farming property other than the farm residence and one acre should be assessed as non-residential property based on its value in current use, established using available provincial data on soil quality and productivity, and should be subject to local non-residential property taxes.

Business Occupancy Tax

The business tax was introduced in 1904 to replace the municipal tax on personal property and business income. Business assessment is computed by multiplying the assessed realty value of a property by a percentage rate that is specific to the particular business. The business occupancy tax is then computed by multiplying the local non-residential tax rate by the business assessment. The percentages attached to various businesses were assigned in 1904 on the basis of perceived ability to pay. These percentages remained in force largely unchanged until the 1980s, when the number of rates was reduced and the high rates for distillers (likely motivated originally by prohibitionist sentiments) were eliminated.

Currently, there are five business assessment percentages:

- 25 per cent for car parks;
- 30 per cent for race tracks, telephone and pipeline companies, and most small retail businesses;

- 50 per cent for lawyers, doctors, dentists, engineers, and other professionals, agents, radio stations, newspapers and magazines, photographers, printers, stock or commodity exchange operators, and department stores or retail chains with more than five outlets in Ontario;
- 60 per cent for manufacturers, mines, smelters, and concentrators;
- 75 per cent for wholesalers, financial institutions, courier and delivery companies, brewers, and distillers.

The business occupancy tax is a significant source of revenue for Ontario municipalities and school boards, totalling some $1.5 billion annually. Business occupancy taxes account for approximately 12 per cent of all property taxes collected by municipalities for education and municipal purposes.

These two key elements of the business occupancy tax – the variable rate structure and the fact that it is a tax on the occupant rather than the owner of the property – give rise to the two principal issues concerning the tax. Whatever the rationale may have been for the variable rate structure in 1904, it is difficult to justify on any logical or consistent basis today (Kitchen 1992, 68; Boadway and Hobson 1993, 161). For example, while it may have appeared reasonable to apply a higher tax rate to wholesale than to retail business in 1904 on the grounds that wholesale businesses tended to be larger, this is difficult to rationalize in the economy of the 1990s.

The categories are arbitrary, based on a 90-year-old perception of ability (or moral responsibility) to pay. The arbitrariness of the categories and the associated rates of tax make it inherently unfair. The tax is also criticized by business taxpayers on the grounds that the level of the tax bears no relationship to the health or level of activity of the business.

At the same time, however, collapsing the schedule of rates into a single rate would result in significant tax shifts within the business sector. Current estimates suggest that a province-wide, revenue-neutral uniform rate would be approximately 45 per cent, a rate that would result in a 50 per cent business occupancy tax rate increase for many small businesses currently in the 30 per cent rate category and, for those businesses, a 12 per cent increase in property and business occupancy taxes combined.

A more general argument made in our public hearings is that business occupancy taxes contribute to a generally higher level of property taxation on commercial and industrial property in Ontario than in jurisdictions in the United States. This argument would imply that business occupancy taxes should be eliminated and their elimination used as a basis for reducing property taxes on business more generally. While evidence suggests that business pays a higher proportion of total property taxes in Ontario than in comparable jurisdictions, a number of additional factors must be taken into account in evaluating this evidence. First, jurisdictions in the United States rely much more heavily on user charges, payroll taxes, and on tax bases other than property as revenue sources than is the case in Ontario. Second, it is misleading to make such comparisons on the tax side of the ledger only, without reference to the services that are provided from those taxes (Kitchen and Slack n.d.).

The fact that the person operating the business rather than the owner of the property on whose value the tax is based is liable for business occupancy tax creates significant collection problems for local government. Unlike property taxes, where the ultimate recourse for unpaid taxes is the registration of an enforceable lien against the property, there is no effective means for a municipality to collect unpaid business occupancy taxes. A 1987 survey of 38 municipalities, conducted for the Municipal Financial Officers' Association (MFOA), found that municipalities incurred extraordinary collection costs of $2.4 million and a loss of revenue from write-offs of uncollectable business occupancy taxes of $4.88 million (MFOA 1989, 5). Evidence from larger municipalities suggests that in the current depressed economic environment, collection and write-off problems are significantly greater than they were in 1987. The City of Toronto, for example, budgets approximately $1 million a year for uncollectable business occupancy taxes – funds that have to be provided through higher rates on other taxpayers.

Two broad approaches to reform have been suggested. One approach is to retain the link to property assessment, but with a uniform rate structure. The other is to replace the business tax entirely with another form of business taxation more closely related to the level of business activity. With a uniform rate structure, the tax could either continue to be an obligation of the occupant of the property or could be folded into the non-residential tax rate as an obligation of the landlord. While folding the business occupancy tax into the commercial and industrial property tax would address the collection problems faced by local governments, any such move would have to take into account the difficult transitional problems created by long-term leases. Such problems would have to be dealt with in the legislation. In addition, the design of the tax would have to include a vacancy allowance similar to that for commercial and industrial property tax. (At present, vacant commercial and industrial properties are taxed at the lower residential rate.)

Despite these transitional problems, we believe that the basic structure and purpose of the business occupancy tax cannot be justified on fairness grounds. While the tax may have been consistent with the social views and perceptions of ability to pay of the times when it was introduced in 1904, there is no rational basis for its structure today.

We see no reason for continuing to provide for a business occupancy tax, levied on the same base as the non-residential property tax, imposed at rates that cannot be justified on any rational basis and structured administratively so that it is much more difficult to collect. To replace the revenue forgone as a result of the abolition of the business occupancy tax, municipal governments would, in our local taxation policy framework, have the authority to replace the revenue from non-residential or residential property taxes.

RECOMMENDATION 94

The business occupancy tax should be abolished as a separate form of taxation of non-residential property. Municipal governments should have explicit powers to replace the revenue forgone from residential or non-residential property taxes.

Allowances for Vacancy

In the current property tax system, allowance is made for vacancy in non-residential property in two respects. First, vacant property is taxed at the residential tax rate rather than the non-residential tax rate. In the current system, this results in a 15 per cent reduction in taxes, because residential tax rates are required to be 85 per cent of non-residential tax rates. In the system we propose, this relationship would no longer hold.

Second, because the business occupancy tax is a tax only on properties occupied for business purposes, the tax does not apply at all when the property is vacant. Since the average business occupancy tax is 45 per cent of the non-residential property tax, this would mean that, by virtue of this provision, the amount of property tax on the average non-residential property would be reduced by 31 per cent when the property is vacant. With the abolition of the business occupancy tax as we have proposed, this type of relief for vacant property would also be eliminated.

The combined effect of these two forms of relief is to reduce total non-residential property and business occupancy taxes from an average of 145 per cent of the non-residential tax rate to 85 per cent of the non-residential tax rate. Since it is not our intention in proposing these reforms to eliminate the allowances in the current system for vacant property, we would propose that the revised system allow for tax relief for vacant property approximately equivalent to that provided in the current tax system. The equivalent result, on average, would be produced by reducing the non-residential tax rate by 41 per cent when the property is vacant.

This tax preference would be provided for the owners of vacant non-residential property on the assumption that vacant property imposes a lesser burden on local services than a property used for a business purpose. In some cases, however, vacant property imposes higher costs for security, fire protection, or environmental protection. To deal with these problems, municipalities should have the authority either to levy special fees or to reimpose property taxes at the full rate where a vacant property imposes extraordinary costs on local governments.

RECOMMENDATION 95

To replace the relief provided for vacant non-residential properties in the current non-residential and business occupancy tax systems, the local non-residential tax rate should be reduced by 40 per cent for property that is vacant.

Exemptions

Exemptions from property taxation are granted primarily through the Assessment Act. When a property is granted a tax exemption, it is normally exempt from school taxes as well as municipal taxes. Some of the exemptions stem from provisions of the British North America Act, 1867, that reflected the British tradition that junior levels of government should not tax senior levels of government. Others reflect decisions to support institutions that provide services for general public benefit.

The principal categories of properties that are exempt from all local taxation throughout the province are:

- Crown lands
  Property of the Government of Canada or any province of Canada is tax exempt as Crown land. This exemption category includes the property of foreign governments. The federal government may make payments to municipalities to compensate for lost tax revenues under the authority of the Municipal Grants Act (Canada). In Ontario, the Municipal Tax Assistance Act allows the minister of municipal affairs to make property tax payments to local municipalities on properties owned and occupied by the provincial government. These payments are to be based on commercial mill rates for local and upper-tier municipal purposes. The province is also permitted to pay appropriate special area rates, drainage charges, and local improvement levies.
- Indian lands
  Property held in trust for a band or body of Indians is exempt. This exemption has been expanded administratively in recent years as it has been extended to off-reserve properties located in areas under municipal jurisdiction and receiving municipal services.
- Churches and cemeteries
  Churches, cemeteries, churchyards, and burying grounds are exempt, but must be enclosed and in use as a place of interment. The exemption does not apply to lands leased to a religious organization, unless they are leased out by another religious organization. Manses, rectories, and the like are subject to taxation, as are vacant lands held for future development or buildings no longer used as a place of worship.

- Property of public educational institutions
  The buildings and grounds attached to or used in connection with a university, high school, public school, or separate school are exempt. Lands rented by such institutions are not exempt unless they are rented from an exempt organization. For colleges and universities, the Municipal Act provides for the payment to the municipality of $75 in lieu of property taxes for each student registered at the institution.
- Religious and educational seminaries
  The buildings and grounds belonging to, attached to, or used by a seminary of learning maintained for philanthropic or religious purposes, the profits from which are devoted to the purposes of the organization, are exempt from municipal taxation. Educational seminaries are exempt to the extent of 50 acres of land. The definition of this exemption has given rise to a large body of case law as various types of institutions that provide training, including religious organizations, community colleges, manufacturing corporations, and trade unions, have sought to have their training facilities classified as exempt. The criteria developed by the courts have been fairly stringent.
  - The organization must be a seminary of learning.
  - The property must be maintained for religious or philanthropic purposes.
  - The buildings and grounds have to be "of and attached to or otherwise bona fide used in connection with and for the purpose of" the seminary.
  - All the profits must be applied to the purposes of the seminary.
  - The buildings and grounds to be exempted must be used and occupied by the seminary.
- Public hospitals
  Land and buildings belonging to hospitals eligible for aid under the Public Hospitals Act, unless occupied by a tenant, as well as farms belonging to the hospital are exempt from taxation. Properties leased by hospitals, but deemed to be integral to the operations, have also been deemed exempt by the courts. The Municipal Act provides for the payment by the province of $75 per rated bed in lieu of taxation.

- Highways and municipal property
Highways and lanes are exempt, as are properties belonging to a municipality or vested in or controlled by a public commission or local board. The exemption does not apply either when the property is occupied by a taxable tenant or a parking property of a harbour commission or where the public commission is a public utility (section 27) as defined in the Municipal Affairs Act.
- Property owned by the Boy Scouts and Girl Guides
The property owned, occupied, and used solely by the Boy Scouts Association and the Canadian Girl Guides Association or its chartered or recognized members is tax exempt.
- Reform institutions
Land owned and occupied by an industrial farm, house of industry, house of refuge, institution for the reformation of offenders or for the care of children, boys' and girls' home, or a similar institution conducted on philanthropic principles and not for profit or gain is tax exempt.
- Charitable institutions
Land owned, occupied, and used by an incorporated charitable institution organized for the relief of the poor, the Canadian Red Cross Society, the St. John Ambulance Association, or any similar incorporated institution conducted on philanthropic principles and supported, in part at least, by public funds is exempt from municipal taxation.
  A large number of organizations have sought to claim exemption as reform or charitable institutions. The courts have interpreted the exemption for institutions for the care of children very narrowly. In the case of the exemption for charitable institutions, the courts have insisted that an organization must meet all the conditions stipulated in the legislation. An organization that is not definitely for the relief of the poor, or is not in receipt of public funds from a government source, does not qualify.
- Children's Aid Societies
The property of a children's aid society under the Child and Family Services Act is tax exempt. Currently, the funding of children's aid societies is shared between the province and the municipal sector.
- Public libraries and agricultural societies
The property of public libraries or other public institutions, literary or scientific, and of agricultural or horticultural societies or

associations, to the extent occupied for the purposes of the society, is deemed to be tax exempt.

- Battle sites
  Land belonging to a society or association by reason of being the site of any battle in any war, and being maintained or preserved and open to the public in order to promote the spirit of patriotism, is tax exempt.
- Exhibition buildings
  Lands belonging to a company formed for the erection of exhibition buildings are exempt to the extent determined by municipal by-law.

Other exemptions are provided for only if they are authorized by a by-law of the municipality in which the property is located:

- recreational land owned by religious institutions (municipal taxes only)
- property owned by the Navy League.

Various other general provincial statutes provide property tax exemptions. For example, the Agricultural and Horticultural Organizations Act exempts lands belonging to agricultural societies. The Power Corporation Act exempts land belonging to Ontario Hydro. There are, however, provisions for payments in lieu of taxes calculated at statutory rates for generating facilities. The Municipal Act provides the authority to municipal councils to exempt Royal Canadian Legion facilities for a period of up to ten years.

In addition, many organizations that do not meet the requirements for the various general exemptions from property taxes have sought private legislation authorizing an exemption. Since 1980, approximately 50 organizations have obtained private legislation exempting them from local property taxes. Seventy per cent of these bills authorize a municipality to pass by-laws that exempt the property owned and occupied by the organization from taxes for municipal and school purposes, except for local improvement rates. The remainder provide a direct statutory exemption. The organizations are generally cultural centres, recreational and cultural organizations, YMCAs, and other similar community service organizations.

Previous Reviews of Property Tax Exemptions

The Ontario Committee on Taxation (Smith Committee) in 1967 reported on an extensive review of exemptions from local property taxes. The committee stated its main conclusion as follows:

> We favour several exemptions that we regard as justifiable on a continuing basis. But for the remainder, we believe that property tax exemptions are being used to convey a privilege that might better be provided through some alternative means if in fact the community is prepared to continue such positions of privilege when made conscious of their cost and reminded of it at regular intervals. (Smith Committee 1967, vol. 2, 126)

The Smith Committee also identified six objections to the practice:

- Exemptions narrow the tax base, thereby increasing the tax load on owners of taxable property.
- A tax exemption is an indirect subsidy, the cost of which is not generally apparent, and is subject to less control than a grant, which ordinarily is renewable annually.
- A tax exemption may not distribute a government subsidy in the most equitable or desirable manner.
- The proportion of all properties in the community that is exempt varies from one municipality to another, thereby creating disproportionate burdens among local communities.
- Exemptions are for the most part legislated by the province, but their burden falls on municipalities and local school boards.
- Exemptions, once established, are not readily terminated. They tend to perpetuate community wishes of an earlier day. In addition, the range and extent of exemptions can grow well beyond justifiable limits.

The Smith Committee conducted an exhaustive review of all the then-current exemptions from municipal taxation, based in part on reports on assessment exemptions from municipalities. These reports were required of municipalities in the 1960s but are no longer provided by the Ministry of Finance, which now has the responsibility for assessment.

With respect to government properties, the Smith Committee recognized that the properties of the Crown could not be made taxable, but suggested that full payments in lieu of taxes be made except for public highways, land betterment works conferring unrestricted community benefits, recognized historic sites not being exploited commercially, and remote Crown land not under lease and not benefiting from local government services. It suggested that federal and foreign government properties be subject to full payment in lieu and that the issues be negotiated. Indian lands would continue to be exempt.

The Smith Committee also addressed the issue of local government properties. It recommended that local government properties occupied for the purpose of a business enterprise be taxable as nonresidential property. Full taxes, excluding upper-tier or other second-tier requisitions, would be paid to local municipalities and school boards on upper-tier property, on the property of a local authority having jurisdiction overlapping local boundaries, on local municipal property situated beyond its boundaries, and on a local board situated outside the municipality where it exercises jurisdiction. The exemptions noted for federal and provincial properties would continue to apply.

The tax treatment of non-government properties was also addressed. The Smith Committee recommended the termination of the tax-exempt status of institutions of higher education and private schools, arguing that provincial subsidy of the payment of full payments in lieu of taxes by accredited institutions would be more appropriate. Similar treatment of public hospitals was also recommended.

The committee recommended that places of worship and religious seminaries not classified as institutions of higher learning be fully assessed and subject to a phase-in of taxation up to perhaps 35 per cent of the maximum tax liability of similarly valued property. It also suggested that new cemeteries become taxable, while existing cemeteries continue to be exempt for a maximum of three years, or until the land use is changed, whichever occurred earlier.

After reviewing the issues of uneven tax subsidy to charitable organizations, social and community service groups, and the like, the Smith Committee recommended the termination of tax-exempt status. It suggested that the merits of direct subsidy by the governments concerned be reviewed and that municipal granting powers be extended to make local subsidy possible. A three-year phase-in period was recommended.

The Smith Committee report was reviewed by a select committee of the legislature. The committee generally supported the Smith Committee's recommendations, with the notable exceptions of the proposals to require taxation of churches and hospitals.

In the 1970s a commission to review property tax reform, chaired by former East York mayor Willis Blair, revisited the issue of exemptions. It took the position that only the exemptions for churches, cemeteries, and Indian reserves should be retained (Ontario Ministry of Treasury, Economics, and Intergovernmental Affairs 1977, 55–74). Property owned by charitable and non-profit institutions fell into a second category of exemptions that could be authorized locally through by-law.

None of these reviews led to any substantial action by government on exemptions from property taxation. If anything, the ad hoc practice of extending exemptions through private legislation has expanded in recent years.

Current Issues Concerning Exemptions

There are a number of serious problems with current practices regarding exemptions:

- There is no consistent underlying rationale for the exemptions. From an original list established in the Assessment Act in 1904, additions have been made on an ad hoc basis. Additional exemptions are provided for in both general legislation and special private bills that apply to particular municipalities and taxpayers.
- While the provincial government is ultimately responsible for the exemptions granted through this ad hoc process, it is not responsible for the consequences of the process for the local tax base. Municipalities have no formal voice in exemption decisions affecting their tax base except where a private bill specifies the need for a local by-law.
- Exemptions are often tied to the institution that owns the property rather than the use to which the property is put, and are generally only available to institutions that own, rather than rent, the property they use.

- The exemption for "property held in trust for a band or body of Indians" is an issue in some communities. For example, in the townships of Bosanquet and Brantford and the City of Sudbury, native bands have purchased off-reserve investment property and are taking advantage of this exemption.
- The present system of exemptions blurs lines of accountability. The use of private legislation involves the provincial legislature in decisions in which it has little at stake financially. Municipalities have also been adversely affected by provincial or federal decisions to close institutions on which payments in lieu of taxes are made by the federal or provincial government and to replace them with facilities run by charities that are tax exempt.

In addition to these particular concerns regarding exemptions as they are treated in the property tax system, exemptions in general raise important questions of principle. From the perspective of taxpayers generally, an exemption from a tax is equivalent to a grant to the exempted taxpayer, with one important difference: tax exemptions are generally not accounted for in the annual budgetary process of local governments and, as a result, are delivered invisibly. The total cost of the exemptions granted is not disclosed in the process, nor are the recipients of the subsidies identified. In effect, tax exemptions can become a way to deliver subsidies that might not warrant political support if they were delivered directly in the form of grants.

From the perspective of those concerned about assistance to particular types of organizations becoming a local political football, however, these disadvantages of tax exemptions are a benefit. The Smith Committee stated this perspective succinctly: "[An exemption] sets and maintains a specified extent of public support without the necessity of further action to maintain the assistance at what may be regarded as an appropriate level. Tax exemption avoids the controversy that may be occasioned by an annual grant. It produces a stabilized allocation of community benefits to good causes" (Smith Committee 1967, vol. 2, 125).

Putting the issue somewhat differently, many organizations that might be considered eligible candidates for exemption from local taxes are also, from time to time, critical of the action or inaction of governments. Many social service agencies, for example, play a dual role of delivering important services to the community and functioning as knowledgeable critics of government actions affecting the clients they serve. Provision for an exemption may be seen as making such organizations less vulnerable to punitive actions of local politicians sensitive to such criticism than they would be if assistance were delivered more openly through grants.

A Perspective on Tax Exemptions

The exemptions from property taxation fall into three general categories:

- exemptions related to the taxation of property owned by governmental or quasi-governmental organizations;
- exemptions provided for the purpose of furthering a general public policy objective; and
- exemptions provided for the purpose of delivering a public subsidy.

Each of these types of exemptions gives rise to three general questions: Should the exemption be granted? Which level of government – provincial or local – should grant the exemption? And which level of government – provincial or local – should bear the cost in forgone revenue?

Exemptions for Government Property

In general, we consider that property owned by other governments or their agencies should be exempt from property taxation, but should be subject to full payment in lieu of taxation by the level of government benefiting from the exemption. Thus, property of the federal government, the provincial government, and any agency of the provincial government would be tax exempt, but payments in lieu of taxes would be made to the municipalities in which the property is located. We would interpret this rule quite broadly to include public hospitals, public colleges and universities, conservation authorities and other public agencies, as well as private organizations such as Children's Aid Societies that are de facto government agencies directed by private boards. Roads and highways should be exempt and should not be subject to payment in lieu of tax.

It is extremely important that the issue of payments in lieu of taxes be addressed. The exemption we are proposing for government property is not intended to deprive municipal governments of revenue they would otherwise expect to receive from these properties. The concept of the local property tax as a local benefit tax is a critical factor in the formulation of our view on this matter. We see no reason why the provincial and federal governments should be exempted from the support of local public services from which they benefit and which are enjoyed by their employees or clients. At present, payments in lieu of taxes are widely criticized by municipal governments for their inadequacy. This criticism was expressed energetically by municipal officials at our hearings in Ottawa and Kingston. We believe strongly that such payments should be fully equivalent to municipal taxes.[1]

Property of public and separate school boards located within their own jurisdiction would be tax exempt, as would the property of a lower-tier (local) municipality located within its own jurisdiction. Property of upper-tier municipalities (counties and regional, district, and metropolitan municipalities) would be taxable.

The concept of the municipal property tax as a tax related to local benefits is also helpful in sorting out the application of the exemption for property owned in trust for a body or band of Indians. The basis for the exemption for property located on reserves is clear. Such property is not part of the municipality in which it is located and should not be subject to tax. Property not located on reserves should be taxable if its owners derive benefit from the provision of local public services. Thus, commercial property located in an urban area would be taxable, but property off reserve acquired for the purpose of expanding the land base of a native community should be tax exempt when it becomes part of the extended reserve area and ceases to benefit from the provision of local services.

Exemptions for Private Organizations

As a general rule, private property should be exempt from taxation only on one of two bases. First, a property might be exempted from taxation if it is determined that its owners should not be required to pay for local services. For example, it might be determined that the

---

[1] This point is also made by Kitchen (1992, 108).

particular use of a property delivers such substantial benefits to the community that its owners should receive the benefits of local services at no charge. Second, a property might be exempted from taxation if there is a public policy rationale for linking a subsidy directly to the amount of tax paid on a property. It is important to note here that the issue to be resolved is not whether it is appropriate to provide grants to certain organizations, but whether it makes sense to tie the amount of assistance the organization receives directly to the property taxes payable on the property it owns.

In addition to these general requirements, the rules should stress that exemptions should be contingent not only on ownership of the property by an organization deserving of public support, but also on the use of the property for a purpose considered deserving of public support. For example, if the property of charitable organizations were to be exempt from tax, the exemption should apply only to property used directly for the charitable purposes of the organization and not to property held as an investment by the organization or leased for use as a commercial or industrial property.

Finally, we believe it is extremely important for exemption policies to be established clearly in a single provincial statute and for the authority to grant exemptions to be allocated in a way that ensures that those policies are followed.

At present, the private organizations that benefit from statutory exemptions may be categorized as follows:

- Organizations that provide services to the public, including public libraries, agricultural and horticultural societies, the Navy League, organizations that maintain battle sites.
- Charitable organizations, including Boy Scouts, Girl Guides, private reform schools and orphanages, charitable organizations for the relief of the poor, the Canadian Red Cross Society and the St. John Ambulance Association, as well as certain YMCAs, cultural centres, recreational and cultural organizations, and other similar community service organizations that have obtained ad hoc exemptions through private legislation.
- Certain types of private, non-profit educational institutions, including religious and educational seminaries.
- Churches, cemeteries, and recreational land owned by religious institutions (municipal exemption only).

- Anachronistic exemptions such as the municipal-option exemption for land belonging to a company formed for the erection of exhibition buildings.

Based on our criteria, exemptions for libraries and for agricultural and horticultural societies should be limited to property owned and operated by a municipal government or an agency of a municipal government and located in a municipality. There is no overriding reason why private organizations such as these should be exempt from paying for local services. And to the extent that such organizations merit public subsidy, there is no apparent reason why such a subsidy should be tied to property taxes paid on property owned by the organization.

Anachronistic exemptions such as those for battle sites, property owned by the Navy League, and property owned by companies formed for the purpose of erecting exhibition buildings should be eliminated and any problems that result dealt with case by case.

The exemptions for certain private educational institutions would also be difficult to justify without extending the exemption to any private educational institution, a move we do not believe would be consistent with our general criteria for exemption.

Two categories of exemptions pose particular problems: the exemption for the property of charitable organizations and the exemption for churches and cemeteries. These exemptions are discussed separately because they raise different questions of principle.

Without reference to the criteria set out above, it would appear to be difficult to justify imposing local taxes on charitable organizations. It should be noted, however, that charitable organizations are not exempt from all forms of taxation. Charitable organizations pay payroll taxes, excise taxes, and some sales taxes. Local taxation would not be precedent setting. Moreover, given the framework within which we are considering property tax reform, such organizations would generally pay local user charges for such services as water and sewage disposal. Given that fact, it would appear difficult to justify exempting organizations from paying for services for which they would have to pay if subject to a user fee. Furthermore, an exemption from property taxation only benefits organizations that own property. Organizations that rent property which is itself not exempt from taxation pay property taxes through their rent. As a result, support for charitable organizations delivered through property tax exemptions benefits only those organizations that are well enough established to own property.

Taxation of churches and cemeteries raises many of the same issues. However, the sensitivity of the relationship between church and state adds a dimension to the debate that is missing from the debate over taxation of charitable organizations. Historically, the fact that we do not have a state-supported religion in Canada led naturally to a policy that exempted all religious property from taxation because adherence to one generally recognized faith or another was almost universal. That cannot be said today. In the 19th century, delivering an implicit subsidy to religious organizations would not have been particularly controversial provided that every religious organization was covered. Today, implicit subsidies for religious organizations are being funded in part by individuals who do not adhere to any of the organizations. The variety of religious affiliations of people in our culturally and ethnically diverse society puts a government granting exemptions in the difficult position of having to decide which religious organizations are legitimate and deserving of the implicit subsidy and which are not.

A recommendation that charitable organizations and churches should be subject to local property tax will be controversial. As a counterpoint, we reiterate that the impact of the cessation of existing exemptions will be cushioned to a significant extent by other recommendations in this report. The recommended change in the basis of assessment from market value to value in current use will reduce the relative assessed values of many properties owned by churches and charitable organizations, particularly in urban and urban fringe areas. For churches and cemeteries, we have gone further and recommended that statutory unit rates of assessment be established in lieu of attempting to measure the value in current use of church sanctuaries and cemetery plots. Most important, our recommendation that local non-residential property taxes for education be eliminated will reduce by more than half the property taxes that would otherwise be paid by charitable organizations and churches, since these organizations would be exempt from the provincial commercial and industrial property tax on the grounds that they do not engage in a commercial activity.

The considerations set out above would apply in the same way in every municipality in Ontario. It would be difficult to argue that the same organization should be exempt from property taxes in one jurisdiction and subject to property taxes in another. As a result, we believe that municipal governments should not have the authority to exempt properties from taxation. Exemptions should be provided for in provincial legislation and should apply throughout the province.

Where property is exempt from taxation by provincial statute, the provincial government should take the financial responsibility as well as whatever political credit is involved and should make full payments in lieu of taxes to the local governments in which the properties are located.

RECOMMENDATION 96

Ontario should develop general legislation regarding exemptions from local property taxes and should repeal the exemption provisions of existing private legislation.

Property should be exempt from local taxation only if it is determined that the owner should not be required to pay for local services or if there is a public policy rationale for linking a subsidy directly to the amount of property tax paid on the property.

Exemptions should be based on the nature of the use of a property rather than on the characteristics of the owner of the property.

Municipal governments should not have the power to exempt property from taxation.

RECOMMENDATION 97

Crown land should continue to be exempt from local property taxation, but should be subject to full payment by the province in lieu of all local property taxes, based on the assessment of similar property. Roads and highways should not be subject to taxation or to payments in lieu of taxes.

RECOMMENDATION 98

The exemption from local property taxation for "property held in trust for a band or body of Indians" should be restricted to reserve lands and other lands for which municipal services are not provided.

RECOMMENDATION 99

Public hospitals and public educational institutions should continue to be exempt from local property taxation. Formula payments in lieu of taxes based on the number of beds or the number of students should be eliminated and replaced by full payment in lieu of taxes by the province based on the assessment of similar property.

RECOMMENDATION 100

The exemption from local property taxation for Children's Aid Societies should be continued. The provincial government should make payments in lieu of taxes for Children's Aid Societies.

RECOMMENDATION 101

The property of lower-tier (local) municipalities and school boards located within their geographic jurisdiction should be exempt from local property taxes. Property of upper-tier municipalities (regional, district, and metropolitan municipalities and counties), other than roads, highways, and public transit rights of way, should be subject to local property taxes.

RECOMMENDATION 102

The local property tax exemptions for public libraries and agricultural and horticultural societies should be restricted to property owned and operated by a municipal government or an agency of a municipal government and located within the municipality.

RECOMMENDATION 103

The local property tax exemptions should be eliminated for property owned, occupied, and used by: the Boy Scouts Association; the Canadian Girl Guides Association; private reform schools and orphanages; charitable organizations for the relief of the poor; the Canadian Red Cross Society; and the St. John Ambulance Association.

RECOMMENDATION 104

The local property tax exemptions for churches, cemeteries, and religious and educational seminaries should be eliminated.

RECOMMENDATION 105

The local property tax exemption for battle sites should be eliminated.

RECOMMENDATION 106

Other local property tax exemptions should be limited to property owned and used by institutions of provincial interest or importance. The provincial government should make full payments in lieu of taxes for all such exempt property.

Transitional Rules

Because many of the organizations that would lose their exempt status are supported from contributions by members, they will require some time to ensure they are able to make the transition from tax exempt status to taxable status without undue disruption of their operations or financial base.

RECOMMENDATION 107

The following transitional rules should apply to the repeal of existing exemptions from property taxation:

a) After advance notice of one year, there should be a phase-in period of up to five years to permit taxpayers to adjust.
b) Exemption policies should only be changed following the introduction of assessment based on value in current use for commercial and industrial properties and unit value assessment for residential properties.
c) Special statutory assessment rates should be established for exempt properties for which it is impossible to determine a value in current use, such as the portion of church property used as a sanctuary.
d) Properties such as cemeteries which are supported by fixed endowments based on tax exempt status should continue to be exempt. New cemeteries established after the change in policy should be taxable.

Technical Exemptions

In addition to the exemptions provided for above, the Assessment Act also provides for exemptions of a technical nature that go to the definition of what is and what is not real property for the purposes of local taxation. These exemptions include:

- machinery used for manufacturing or farming or for smelting and concentrating ore;
- machinery used for the production of electricity (generation stations are subject to flat statutory assessment rates for tax purposes);
- forestry property attached to a farm, to a maximum of 20 acres;
- buildings and machinery for mining located underground;
- telephone and telegraph company equipment (telephone and telegraph companies are subject to a special telephone and telegraph company tax);
- amusement rides (because of their temporary nature); and
- modifications to property for the accommodation of elderly or disabled residents who would otherwise be institutionalized.

These exemptions are, for the most part, of a different nature from the institutionally based exemptions discussed earlier in that they are concerned chiefly with the definition of real property for assessment purposes. The key issues in this area concern exemptions for underground mining facilities and for forestry land attached to a farm as well as for modifications to property to accommodate the elderly or the disabled.

The taxation of underground mining facilities has been a major issue for municipalities in Northern Ontario for many years. Mining municipalities have argued that the exemption from assessment for underground mining facilities excludes from the local tax base a major component of the economic base of the community. The provincial Ministry of Revenue concluded in a 1988 study, however, that assessment of mining facilities located underground that would not otherwise be exempt as production machinery would add only marginally to the assessed value of mining properties.

In principle, we believe there is no reason why property that would be subject to assessment if it were located on the surface should be exempted from taxation simply because it is located underground.

The exemption from taxation for a woodlot of up to 20 acres attached to a farm is also difficult to justify. While our proposal for managed forests (including woodlots) and wetlands would result in lower assessments for these properties than for productive farmland, thus providing some tax relief, we see no reason here for a tax exemption.

With respect to the exemption for modifications to property to accommodate the elderly or disabled, we would note that in a unit value assessment system as we have recommended, assessments of individual properties would change only if the area of the living space changed. Since most modifications for the elderly or disabled do not increase the living area of the property, such modifications would not affect assessment in any case. As a result, the need for an exemption would be drastically reduced. In any case, our general position with respect to assistance for people with disabilities is that such assistance should be delivered through direct spending programs rather than through the tax system.

RECOMMENDATION 108

The special local property tax exemption for mining buildings and machinery located underground should be eliminated. Any building, machinery, or equipment that would be taxable if located on the surface should be taxable if located underground.

RECOMMENDATION 109

The exemption from local property taxation for up to 20 acres of forestry land attached to a farm (a wood lot) should be eliminated. Such property should be assessed and taxed based on its value in use as a wood lot.

RECOMMENDATION 110

Provided a unit value residential assessment system is adopted, in which assessments of individual properties of the same type and in the same geographic area vary only with differences in physical dimensions, exemption from local property taxation for modifications to property for the accommodation of elderly or disabled residents should be eliminated; any appropriate assistance should be provided through direct spending programs.

Administration

Simplicity

One critical element in improving the administration of the local government finance system in Ontario is simplification. Our proposals would accomplish this objective in five ways. First, the measurement of the assessment of individual properties would be much clearer and much more straightforward. Second, the assumptions and weighting factors used in translating individual property measurements into assessments would be explicit and subject to open public review. Third, the separation of taxation policy from assessment policy made possible by permitting municipalities to set different tax rates for residential and non-residential properties would make both provincial assessment policies and local tax policies clearly visible to the taxpayer. Fourth, the establishment of uniform bases for residential and non-residential assessment would make it possible for taxpayers to make reasonable comparisons of tax systems in different parts of Ontario and would make knowledge of the system accumulated in one municipality relevant to an understanding of the system in another municipality. Fifth, the changes in funding for education and some social services we recommend would address much of the confusion in people's minds about the role of the property tax and about the relationships among governments in the provision of local services.

Appeals Process

Any reform of the property assessment system must be accompanied by a comprehensive reform of the assessment appeals system. The Property Tax Working Group recommended several measures it believed would make the system "more accessible and understandable," especially for residential ratepayers who wish to appeal. Included in the working group's recommendations were suggestions to add to the process a tribunal called the Assessment Appeals Board (appeals board), which would hear appeals from decisions of the Assessment Review Board (review board). The Assessment Appeals Board, a division of the review board, would replace the current mechanism of appealing review board decisions to the Ontario Municipal Board. The working group also suggested that the members of the appeal board be knowledgeable in assessment matters.

Another part of the group's recommendation would see complex cases bypass the first level of appeal and go straight to the appeal board for a final decision upon consent of both the appellant and the regional assessment commissioner. This would save the board, the commissioner, and the taxpayers time and money in cases where all parties know at the beginning that the review board decision will be appealed to the higher tribunal.

The group recommended that the burden of proof be shifted from the taxpayer to the assessor, and that annual refilling of unresolved appeals be made automatic. It also suggested that all appeals be scheduled for hearing within one year of filing and that decisions be rendered within 90 days of a hearing. Finally, the group recommended that non-controversial matters such as corrections of names, addresses, and school support designation be dealt with at an administrative level and not in hearings.

While the Property Tax Working Group recommendations address some of the weaknesses of the current system, a more comprehensive overhaul is needed. The most critical problem for the system is in Metropolitan Toronto. The two Metropolitan area offices of the review board are swamped with appeals, some of which date back several years and involve millions of tax dollars. More than 75 per cent of the commercial tax base in the City of Toronto is appealed each year, a recipe for chaos in the appeal system.

Currently, the Metro area of the review board is understaffed and underfunded. Each year, after the appeal period, the task of entering all the appeals data into the computer system takes weeks. A sophisticated information management system is needed to help with the organization of the appeals load. Further, in the past several years, hearings have not been scheduled towards the end of the fiscal year because the board has run out of money. Any meaningful reform of the assessment and appeals system must ensure that the board is adequately funded to deal with its legislated responsibility.

On the policy side of the issue, reform is also needed. Many of the members of the Assessment Review Board are unfamiliar with the intricacies of property assessment. Their decisions are therefore not based on a solid understanding of the issues before them, but on which of the parties organizes and argues best. Considering that in most residential appeals the ratepayers act on their own behalf and often have only a limited understanding of assessment matters, the arguments are usually won by the assessors or by the ministry's lawyers. Board members should be knowledgeable enough to understand the assessment issues in a case and to make decisions based on the evidence and on relevant precedents.

If the Assessment Review Board were composed of members who understood better the laws, policies, and principles of property assessment, fewer of their decisions would be appealed to the higher tribunal. It is also possible that fewer assessments would be appealed overall. There are many property tax agents who make a profit in Metro and other large municipalities just by appealing hundreds of residential assessments, seeking authorization from the owners afterward, and appearing at the board to argue their cases with a minimum of data. This is profitable for them because some review board members routinely reduce assessments 5 or 10 per cent virtually as a matter of principle. Large commercial properties are often appealed on almost the same basis. A well-informed tribunal that makes consistent decisions would discourage such speculative appeals and leave ratepayers with more confidence in the fairness of the procedure.

More information should be provided to ratepayers who file appeals. Although it is the policy of the Assessment Division of the Ministry of Revenue to assist ratepayers in preparing their appeals, the amount of help they actually receive is completely dependent on the assessor assigned to the case. Some are genuinely helpful, while others can be obstructive because of the adversarial nature of the appeals process. Some ratepayers are sceptical of assistance offered by assessors and avoid it. Others are simply not aware that the assistance is available. Clear step-by-step instructions should be prepared and distributed to all residential and small commercial appellants. These instructions should outline the Assessment Division's responsibilities both to assist and to defend the tax base on the municipality's behalf.

31 Making the Local Financial System Work Better

The new system for education finance, property assessment, and local taxation proposed in chapters 28, 29, and 30 forms the basis for a system of local government finance that is consistent with principles of tax fairness. These proposed changes all flow from a framework for fairness in which the property tax is seen as a benefit tax for local services. In this chapter, we deal with three further policy areas for which this framework has important implications: the role of provincial grants and equalization in the system of local government finance; the formula for sharing of regional, district, metropolitan, and county (upper-tier) costs among local (lower-tier) municipalities; and the funding of local infrastructure.

Provincial Grants and Equalization

The provincial government currently provides grants to municipalities and school boards totalling more than $11 billion annually to support public services delivered through local governments. This support is provided through more than 100 programs for sharing the cost of locally delivered services between municipal governments and the provincial government. In addition, the provincial government provides unconditional grants for the general support of municipal governments. Approximately 30 per cent of total municipal operating expenditures are financed through these conditional and unconditional grants.

The financial implications of these programs in the major areas of provincial policy are summarized in table 31.1.

TABLE 31.1
Major Provincial-Municipal Cost-sharing Programs, Ontario, 1991–92 ($ millions)

Provincial transfer policy area	Provincial share (grants)	Local share (taxes)	Fees (est.)	Total
Municipal affairs				
Unconditional grants	947	—	—	947
Conditional grants	36	—	—	36
Other	6	—	—	6
Education	5,201	6,992	—	12,193
Transportation				
Roads	823	1,811	146	2,780
Transit	382	468	655	1,505
Other	14	48	—	62
Community and social services				
Social assistance	1,883	526	—	2,409
Child care	231	63	21	315
Homes for aged	370	205	211	786
Child welfare	348	76	—	424
Environmental	275	1,455	1,588	3,318
Health				
Health units	210	81	28	319
Other	45	102	—	147
Natural resources				
Conservation authorities	53	52	—	105
Culture and communications				
Library boards	41	353	13	407
Tourism and recreation	57	1,076	298	1,431
Total	10,922	13,308	2,960	27,190

Source: Fair Tax Commission calculation based on Ontario Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS); Ontario, Ministry of Finance; and Ontario, *Public Accounts of Ontario, 1991–1992.*

Note: Education transfer includes only general legislative grants and capital grants.

Our recommendations with respect to the funding of education, social assistance, and services for children would eliminate or reduce the grants programs in these areas. Most of the remaining grants are provided in policy areas in which local spending would appropriately be funded either in whole or in part from property taxes functioning as local benefit taxes. While there may be a case for provincial grants continuing in these remaining areas, that case cannot be based on the general tax fairness propositions advanced by the commission in support of its recommendations with respect to education, social assistance, and services for children.

The argument for continued provincial support for local spending in these areas must be based on the need for the provincial government to influence levels of spending by local governments in areas within the jurisdiction of local government. There are two general circumstances under which the provincial government might want to influence levels of spending by local governments.

First, in areas where local provision of a service generates benefits beyond the local area, local spending will generally be at less than the appropriate level if funded entirely from local benefit taxes. For example, local roads that cross municipal boundaries generate benefits in other jurisdictions. Local spending on public transit produces both local and more general environmental benefits. Sewage treatment facilities reduce environmental costs that would otherwise be borne by residents of downstream jurisdictions. It might be argued that libraries, by contributing to literacy, generate benefits for Ontario or Canadian society as a whole. The provincial government might also appropriately subsidize local public spending required where underspending in one jurisdiction would impose excessive costs or diminish the value of services in other jurisdictions. As an alternative in some areas, the provincial government might simply set standards for local public services without providing a subsidy, on the grounds that every jurisdiction both receives and generates spillover benefits. In the environmental area in particular, the "polluter pays" principle would suggest a standards-based approach rather than provincial subsidy.

Second, the provincial government may have an interest in ensuring that basic public services are available everywhere in the province at a reasonable cost to local taxpayers. The objective of provincial assistance in this case would be to ensure that people are not deprived of necessary public services simply because they live in a jurisdiction that lacks the fiscal capacity to provide those services from local revenue sources.[1]

Each of these arguments for grants implies a different design for provincial grant programs. Since the spillovers/general benefit argument is based on a need to provide assistance for spending above levels that would prevail in the absence of the subsidy, this rationale points towards subsidy systems designed to provide assistance only for services beyond certain specified standards. Subsidy programs designed to address the spillover problem should provide assistance for spending above the levels that would normally be provided by the municipality in the absence of assistance. Such programs should not provide for cost sharing of all spending from the first dollar.

The basic services argument, in contrast, implies a program designed to provide assistance from the first dollar of spending up to some defined minimum standard. And because the objective is to achieve an adequate level of service at reasonable cost to taxpayers, basic services subsidy programs must provide for equalization of the tax impact of providing the basic service level.

Our view is that the amount of the conditional and unconditional grants remaining after reforming education, welfare, and children's services could be reduced in size substantially without compromising either tax fairness objectives or the public policy purposes served by the grants programs. This reduction would be accomplished by restricting provincial grants to those that either support basic services or subsidize incremental spending on services that benefit people who live outside the municipality, and by redesigning the remaining grants programs to reflect better these public policy purposes. Limiting assistance to spending above threshold amounts and/or introducing an equalization component to reflect local fiscal capacity would tend to reduce the funding required.

Property taxes would be reduced substantially by the changes in funding for education, social assistance, and assistance to children. This reduction in the overall level of property taxation would more than offset any property tax increases that might result from reductions in provincial grants in other areas of local government responsibility. In addition, many spillover benefits issues could be

[1] The rationale for intergovernmental transfers at the local level is discussed in detail in Bird (1993, 217–19) and Boadway and Hobson (1993, 93–97).

addressed more effectively by encouraging creative efforts at cooperation among municipalities in services delivery and by re-organizing municipal structures, boundaries, and responsibilities. It doesn't make much sense, particularly in this fiscal environment, to use provincial subsidies to do what better coordination of services at the local level could achieve much more economically.

With respect to basic services, two factors work against the continuation of general subsidies. First, our recommendations with respect to education, social assistance, and assistance to children will reduce property taxes significantly, and this reduction will have a significant impact on the affordability of local municipal services. The removal of education from the property tax alone would cut those taxes dramatically. Second, basic services affordability tends to be an issue for specific services, under special circumstances and in particular areas of the province. Basic services affordability arguments do not make a case for general subsidies to all municipalities. For example, if policing were to be made a local responsibility, affordability might be a special problem in some areas, but would not justify a general grant to all municipalities for police services. Likewise, affordability issues that arise from particular events – a plant closure or a provincially ordered replacement of a sewage treatment plant in a small community – are best dealt with as special cases. General programs will not deliver sufficient assistance quickly enough.

If equalization grants for basic services are required, there should be a consistent system for determining the amount of the payments across all equalization programs. At present, a variety of equalization systems are employed in provincial programs. Although these systems differ, all include assessment (residential and commercial/industrial combined) as the measure of a jurisdiction's ability to pay. The most important of these – the system of equalization for provincially recognized expenditures in education – illustrates clearly the problems with this approach. Because the system combines residential and commercial/industrial assessment (usually on a weighted basis), it does not work effectively for either the residential property tax or the non-residential property tax. Commercial and industrial tax rates for recognized spending vary depending on the amount of residential assessment in the community.

For residential taxes, the system fails both because effective residential tax rates vary depending on the amount of non-residential assessment in the community and because assessment turns out to be no better an indicator of ability to pay at the community level than it is at the individual level. Because income is a better measure of individual ability to pay than assessment, the average percentage of household income spent on residential property taxes to support recognized education spending would be a better measure of the impact of residential taxes than any measure that involves adjusting assessment figures.

Using this measure of impact, the system is not very effective in equalizing burdens of taxes across the province. There are significant variations in the percentage of household income required for residential taxes to support recognized spending levels. The average percentage of household income required for residential taxes to support recognized spending in Ontario was 1.15 per cent. Figure 27.4, in chapter 27, illustrates that in many municipalities in Ontario the impact of residential property taxes for recognized expenditures differs substantially from this average.

Although, in our recommendations, equalization payments would no longer be a feature of the system for education finance, these data for the current education funding system illustrate the problems associated with equalization formulae that use a blending of commercial/industrial and residential assessment as the measure of the community's ability to fund services locally.

For commercial and industrial taxpayers, the system should equalize the rate of tax on commercial and industrial property required to support the basic service. For residential property taxes, the appropriate measure of fiscal capacity is the ability to pay of the taxpayers who ultimately have to pay the taxes. In our view, the appropriate measure of ability to pay in the residential sector is income, not assessment.[2] Consequently, in the residential sector, any fiscal equalization system should equalize the impact of residential taxes paid by residents of the municipality required to support a given level of local service on the incomes of those residents. Grants would be allocated to ensure an equal rate of tax for commercial and industrial taxpayers and an equal impact on household income for residential taxpayers in all municipalities. This approach differs from the

[2] In our modelling, we used income as measured in the 1991 census. For non-census years, census income data could be adjusted using income tax data or other income indicators.

traditional view, which is based on the potential revenue-raising capacity of the taxing jurisdiction (Bird 1993, 219). The problem is that this view defines potential revenue-raising capacity without reference to the capacity of the taxpayers in the jurisdiction to pay the resulting taxes.

While the focus of our recommendations in this area is on the application of principles of tax fairness to local government finance, one effect would be to clarify the relationship between the provincial government and the municipalities by allocating the funding of programs that are principally of provincial interest to the provincial government and allocating the funding of programs that are principally of local interest to local governments. Thus, revenue reform can have the effect of reinforcing efforts to reform the relationship between provincial and local governments that have been pursued through the Provincial Municipal Social Services Review (1987), the Advisory Committee to the Minister of Municipal Affairs on the Provincial-Municipal Relationship (1991), and the Provincial Local Relationship Review (1991 to 1993). In our view, reforms of this type are more easily achieved if revenue reform is part of the package and if the diversity within the municipal sector is acknowledged explicitly in the reformed structure as it is in our recommendations with respect to local revenue policy flexibility.

RECOMMENDATION 111

Ontario should limit provincial grants and subsidies to municipal governments in areas of local jurisdiction to:

a) areas in which the province wishes to increase local spending because such spending generates spillover benefits outside the local area or in the province generally; and
b) areas in which it is considered appropriate that the province guarantee the availability of a basic level of service, regardless of local fiscal capacity.

Grants intended to increase levels of local spending on programs that generate benefits for people who live outside the local area (spillover benefits) should be designed to provide assistance for spending above minimum levels rather than matching funding from the first dollar spent.

RECOMMENDATION 112

Ontario's subsidy programs for municipal governments should be targeted to deal with factors that limit the ability of municipalities to provide access to adequate local services at reasonable cost. These programs should focus on particular local services; should be based on factors such as climate, geography, and density of population; and should be designed to respond to emergency situations, such as the closure of a business vital to the local revenue base.

To ensure that assistance is available only to offset excessive local tax burdens required to fund minimum standard services, subsidies under such programs should vary based on local fiscal capacity – the ability of the municipality to raise revenue to pay for those programs while imposing a reasonable burden on local taxpayers.

Local fiscal capacity should be measured separately for the residential and non-residential sectors. For the non-residential sector, local fiscal capacity should be measured using assessment, adjusted by equalization factors so that it is measured on the same basis throughout Ontario. For the residential sector, local fiscal capacity should be measured based on residential property taxes paid by residents of the municipality as a proportion of the total income of all households in the municipality.

Subsidies should equalize the impact on household incomes in the municipality of residential property taxes required to support a particular service, after allowing for local revenue from the application of a standard effective rate of tax on commercial and industrial properties and after allowing for revenue from the taxation of residential property used by non-residents.

Sharing of Upper-Tier Costs among Local Municipalities

The changes we recommended to the assessment base and to accompanying tax policy arrangements require changes in the way costs of upper-tier municipalities (county, regional, district, or metropolitan) and other inter-municipal activities are shared among local municipalities. The current system relies on the use of equalized assessment to create a total for residential and commercial/industrial assessment, which in turn is used to determine each local municipality's share of upper-tier and other inter-municipal costs.

The basic issue in sharing of upper-tier costs is how to distribute the costs of upper-tier municipalities or other upper-tier bodies among taxpayers who live within the jurisdiction. If the tax systems were the same at the local level throughout the area, the most direct way to allocate costs among taxpayers would be for the upper-tier municipality to levy taxes directly on individual taxpayers. Although this approach would be the simplest way to resolve the issue of apportionment, it gives rise to other concerns.

First, there is no reason to expect that tax systems would be the same among municipalities in an upper-tier area. Even with reformed assessment systems for both commercial/industrial and residential property, taxation policies would likely vary among municipalities – the relationships between residential and non-residential property tax rates would differ at the local level within an upper-tier area. If the upper tier were to levy taxes directly, the result would be more than one tax policy applicable to the same municipal area – one local, the other upper tier. This multiplicity of tax policies would frustrate our general objective of simplification of the local government finance system. In addition, if provincial restrictions were imposed on commercial and industrial tax rates, upper-tier and lower-tier municipalities would be competing for the same commercial and industrial tax room.

Second, most county, regional, and district municipal governments are not directly elected. It might be considered inappropriate for delegated bodies – which often fall far short of the one-person-one-vote ideal in their representation – to be making independent taxation policy decisions.

If direct taxation by the upper-tier municipality is not considered to be an appropriate basis for distributing upper-tier costs among taxpayers directly, an indirect method of apportioning these costs must be developed. There are two main issues to be resolved in apportionment of costs of upper-tier municipalities among the lower-tier municipalities that make up the geographical area. Costs must be allocated among municipalities and, within municipalities, among taxpayers.

These issues should be resolved separately, given our conclusion that tax policy should be a local municipal responsibility. Our recommendation that tax rates on residential and non-residential property be set separately enables us to determine seperately the shares of costs to be allocated to each municipality within the upper tier, and the distribution of upper-tier costs among taxpayers in each municipality.

With municipal property taxes functioning as benefits taxes for local services in our framework for reform, the allocation of costs should be based on residential and non-residential assessment. With a revised assessment system as recommended by the commission, this would be relatively straightforward. The difficulty at this level is to determine the weighting of residential and non-residential assessment to use in allocating shares of upper-tier costs to lower-tier municipalities. The basis for this weighting should be as simple as possible and should not be arbitrary. The approach we recommend would base shares of upper-tier costs on actual tax policies in the previous year. Each municipality's share would be based on what its share of total taxes in the upper-tier area would have been if it had taxed residential property and non-residential property at the average rates for these types of property. This share, combined with the budget for the upper-tier area, would generate a local share of upper-tier costs for each lower-tier area. While this proposal is put forward in the context of our proposals for assessment reform, it could also be used as the basis for apportionment in the current system, using equalized assessments instead of reformed assessments, and average effective tax rates instead of average tax rates in the calculations.

The following example illustrates the way this procedure might work. The relevant data on taxation and assessment for an upper-tier municipality consisting of three lower-tier municipalities are presented in table 31.2. It is assumed that the assessment is either consistent among the three municipalities or has been equalized to put it onto a comparable basis for all three municipalities. Municipality X has residential equalized assessment of $100 and residential taxes for upper-tier purposes in the previous year of $15, non-residential equalized assessment of $200, and non-residential taxes of $50. The totals for the three municipalities are, for residential equalized assessment, $700; for residential taxes, $65; for non-residential equalized assessment, $600; and for non-residential taxes, $100.

The average rates of tax are 9.3 per cent for residential property ($65/$700) and 16.7 per cent for non-residential property ($100/$600).

The shares of upper-tier costs to be paid by each municipality are determined by multiplying the average tax rates on residential and non-residential property in the upper-tier area (9.3 per cent and 16.7 per cent, respectively) by the corresponding assessment in each municipality.

Each municipality's share of upper-tier costs would be determined by the share of total taxes for upper-tier purposes that would have been paid by that municipality if it had levied residential and non-residential taxes at the average rate for the upper-tier area. Thus, municipality X's share of total taxes to support upper-tier municipal services would be 26 per cent.

Each lower-tier municipality would be free to determine the allocation of its share of upper-tier costs between residential and non-residential taxpayers in its local area, subject to any applicable provincial restrictions on tax rates.

TABLE 31.2
Apportionment Example

		Municipality			
		X	Y	Z	Total
Assessment (equalized)	Residential	$100	$200	$400	$700
	Non-residential	$200	$300	$100	$600
Taxes	Residential	$15	$10	$40	$65
	Non-residential	$50	$30	$20	$100
Average tax rates					
Residential: 9.3%					
Non-residential: 16.7%					
Share calculation					
Residential tax at average rate		$9	$19	$37	$65
Non-residential tax at average rate		$33	$50	$17	$100
Total		$43	$69	$54	$165
Share		26%	42%	33%	100%

Note: Totals do not add due to rounding.

RECOMMENDATION 113

Each local (lower-tier) municipality's share of county, regional, district, or metropolitan (upper-tier) costs should be based on its share of total residential and non-residential assessment.

Residential and non-residential assessment would be measured on a consistent basis throughout the upper-tier area. The share of each lower-tier municipality would be determined as follows:

a) The weighted average rate of tax on residential property in the upper-tier area in the previous year would be calculated by dividing total residential property taxes levied for upper-tier purposes by all municipalities in the upper-tier area by total residential assessment in the upper-tier area.

b) The weighted average rate of tax on non-residential property in the upper-tier area in the previous year would be calculated by dividing total non-residential property taxes levied for upper-tier purposes by all municipalities in the upper-tier area by total non-residential assessment in the upper-tier area.
c) Residential assessment would be multiplied by the weighted average rate of tax on residential property as calculated above.
d) Non-residential assessment would be multiplied by the weighted average rate of tax on non-residential property as calculated above.
e) The share of each municipality would be calculated by adding the figures obtained in (c) and (d) above and dividing by total residential and non-residential property taxes for upper-tier purposes in the upper-tier area in the previous year.

Once the share of each lower-tier municipality is determined in this fashion, lower-tier municipalities would determine the mix of residential and non-residential property taxes used to raise the required revenue in accordance with their own taxation policies.

Infrastructure Funding Reform

Financing Urban Growth

Our view of local property taxes as benefits taxes provides an adequate basis for the funding of current expenditures for local services, but it raises the question of how to fund capital spending for local infrastructure development. The benefits from capital spending are received by taxpayers over a much longer time span than the local budgetary cycle.

The issue of paying for urban growth has been the subject of public discussion and debate in Ontario throughout the postwar period. In the earliest part of this period, based on the belief that urban growth "paid for itself" in higher property taxes, infrastructure development was typically funded from property taxes. Infrastructure developments were financed by capital borrowing, which was eventually repaid from property taxes as the debt came due.

As the pace of development increased, the emphasis gradually shifted to a variety of different forms of special charges or taxes levied for the construction of particular capital projects against property that, in the opinion of the municipal council, derived special benefit from the project. This, in turn, reflected a revisionist view that growth imposed net costs on existing residents. On the basis of fairness or as a necessary expedient to counteract resistance to growth on the basis of costs, this view held that new residents should be required to make a special financial contribution on an ongoing basis for the infrastructure required to support new communities. These charges were levied under a variety of different legislative authorities, but primarily under the Local Improvement Act and the Municipal Act.

The third phase in the evolution of mechanisms for funding growth in the postwar period was an increased reliance on capital financing by property developers. This process was formalized in amendments to the Planning Act in 1961, which gave municipalities the authority to require developers to make cash contributions as a condition of approval of a subdivision plan. Although the authority to require payment of "lot levies" or "cash imposts" was formalized by these changes, the issue continued to give rise to controversy, particularly because there were no formal rules governing the size of lot levies and what types of infrastructure they were intended to cover.

Two major questions arose during that period. First, who should pay for the infrastructure required for new development: residents of the new community; all residents of the newly expanded community, including existing residents; provincial or federal governments; and in what combination? Second, if new residents are to be required to pay for new development, what should they be required to pay for?

By the early 1980s the debate over whether new residents should have to pay for infrastructure subsided as the legitimacy of development-related charges appeared to have been accepted; the debate narrowed to questions of application rather than of principle. The issues in dispute included the method of calculation of lot levies and determination of what services and costs should be covered by the levy; the application of lot levies in situations where subdivision agreements were not required; and the application of lot levies in situations in which capital construction by one developer would eventually benefit other land owners. These issues were debated throughout the 1980s, and culminated in 1988 with the publication of "Lot Levies and Front-End Financing" by the Ministry of Municipal Affairs and the issuing of a green paper, "Financing Growth-Related Capital Needs," by the Ministry of Treasury and Economics.

The green paper attempted to resolve a number of issues. It set out a framework for development charges intended to establish a process for the documentation of such charges at the local level. It dealt extensively with front-end financing through development charges. It resolved the issue of what services could be funded from development charges by adopting a narrow definition of capital costs, but allowing 100 per cent financing of such costs from these charges. It broadened the circumstances under which development charges could be levied to situations in which developers had applied for rezoning or development review. Finally, it added a new dimension to the debate over development charges by recommending that the power to levy development charges be extended to school boards.

In the years since the introduction of legislation authorizing development charges, education development charges have become a major issue for property developers. Various builders' organizations have challenged school board by-laws in court. On 20 May 1993 the Ontario Divisional Court decided that part III of the act, pertaining to education development charges, is unconstitutional because the charge constitutes indirect taxation and is in violation of section 92(2) of the Constitution Act, 1982. That decision is under appeal. Municipal by-laws are also being challenged on technical grounds at the Ontario Municipal Board.

In addition to these specific issues, the financing of infrastructure in general continues to be an important issue. The Federation of Canadian Municipalities has drawn attention to the deterioration of the physical infrastructure of urban areas in Canada as federal funds have been withdrawn and provincial governments have had to deal with increasingly difficult financial circumstances.

The Municipality of Metropolitan Toronto and the provincial government have expressed interest in the financing of major capital projects through "value capture taxes" or betterment levies. While both value capture taxes and development charges impose charges related to urban development, value capture taxes would be designed to capture in tax revenue a portion of the increase in the value of property resulting from public infrastructure development, whether or not any decision with respect to planning or zoning was involved; in contrast, development charges are clearly linked to planning or zoning approval.

User-based Funding

The traditional argument for development charges or lot levies has been that new residents should pay for the capital assets required to service new residential communities and that the existing residents should not have to subsidize new growth. This philosophy was reflected in the Development Charges Act, which limits the use of these funds to servicing the needs of new developments (Slack and Bird 1991, 1288–1304).

In general, there are four approaches that might be taken to the funding of infrastructure from beneficiaries, as opposed to taxpayers generally: development charges, betterment levies, area rating systems, and user fee amortization of capital. Development charges and betterment levies both impose taxes for infrastructure on a lump-sum basis rather than spreading them out over time. Development charges impose an up-front payment on new projects to generate a fund from which local infrastructure is built. Because the amount of the charge is generally passed on in the form of higher prices for the housing or commercial property in the project, the extent to which such charges are absorbed immediately or spread out over time depends on the nature of the financing arrangements of the individual purchaser.

Betterment levies take a different approach by imposing taxes on increments in the value of property. They are based on the assumption that public infrastructure development contributes to increases in the value of the property served by the infrastructure project. They differ from development charges in that they are based on a market outcome – the increase in value attributable to infrastructure development – rather than the cost of the infrastructure. Revenue could precede or follow construction of the infrastructure under consideration, depending on the market, but the tax would be levied as a lump sum.

Area rating systems and incorporation of amortized costs in user fee structures also impose the costs of infrastructure on defined beneficiaries. However, they spread payments out over time rather than imposing them in a lump sum.

Betterment or value capture levies are alternatives to development charges as lump-sum beneficiary taxes for infrastructure funding. These levies have been described as a means of taxing back some of the benefits accruing to landowners, where the introduction of improved or new local services results in an increase in land values with no effort or investment on the part of the landowner (Slack and Bird 1991, 1300). In the context of developing countries, this type of taxation has been described as a valorization tax. This type of tax, to operate successfully, requires a close linking of the costs of specific projects and the enhanced value of the benefiting properties (Bird 1992, 165–67).[3]

Area surtaxes (used in business improvement areas in Ontario, for example) and amortization of capital costs in user fee structures apply the beneficiary pay principle, but attempt to spread the taxes over time to better reflect the distribution of the benefits flowing from the infrastructure development. Such charges are only appropriate where there is a user fee structure in place, in the case of amortization of infrastructure costs in user fee structures, or where the benefits may be isolated to owners of property in a defined geographical area, in the case of area surtaxes.

General Revenues

The alternative to these user-based systems is for infrastructure developments to be funded from general revenues of the municipality or the provincial government. The timing question would then be resolved in a decision about whether to finance infrastructure projects or to fund them out of current revenues.

Fairness Issues

The fundamental fairness question in financing urban growth is whether it is appropriate to pay for the infrastructure required to

---

[3] Bird outlines a set of criteria and supports his argument for such taxes in terms of the merits of taxing property holders where the distribution of property is highly inegalitarian and the saving rates of proprietors is low (Bird 1992, 165–69).

support urban growth through the imposition of special benefit taxes on new residents. This general question, in turn, gives rise to two specific questions. First, are there particular kinds of infrastructure that should not be funded from beneficiary pay taxes of any kind, whether on new residents or on all residents of a municipality? Second, does the imposition of development charges create unfairness between new residents and existing residents of a municipality?

In the general fairness framework for local government finance we have adopted, we found that education is not appropriately funded from local beneficiary pay taxes and should be funded from provincial general revenues. As we noted in chapter 28 in our discussion of the operation of school facilities, we see no basis on which to argue that school construction should be funded from benefit taxes when we have concluded that education more generally should not be funded from such taxes. Within this framework, therefore, education development charges would clearly be inappropriate.

Considering the more general question of equity between existing and new residents, it might be argued that an unfairness is created when development charges are imposed in new developments to finance facilities that, in existing communities, were financed from property taxes. With the exception of the situation in which current property taxes are funding debt retirement for infrastructure in the pre-existing community, however, the housing market will operate to make the situations equivalent. In either case, the value of the infrastructure that is in place will be reflected in the price paid for a house, regardless of the original method of financing of the infrastructure. Where property taxes are funding the retirement of debt incurred for infrastructure in the pre-existing community, it would be legitimate to exempt residents of the new community from paying that portion of the property tax. Given the variety of different approaches taken to the funding of infrastructure in the past, however, it would be impractical to require that such adjustments be made in every case.

An issue of fairness may still arise, however, if development charges are imposed on new residents in situations in which the new development does not impose any net costs on the pre-existing residents. In a paper dealing more generally with the question of local taxation as an instrument of policy, University of Toronto economist David Nowlan proposes a two-stage test to determine the appropriateness of a development charge. The first test asks the question: "If a property is developed and begins paying normal property and business taxes, will the general tax rate in the municipality increase because of the development?" If the answer to the question is no, a development charge is not justified because the development will generate enough additional property tax revenue to offset any additional costs imposed by its presence in the municipality. If the answer is yes, Nowlan proposes a second test, asking "whether the additional public costs and higher tax rates would exist if the increase in municipal population or employment generated by the new development were exactly offset by a decrease in population or employment elsewhere in the jurisdiction" (Nowlan 1991, 22–23). Generally speaking, community facilities that are available throughout the municipality, but which might have to be expanded as a result of the additional population or employment in the new development, would fail the second test. For example, the expansion of an arena that serves a broad area within a municipality because of increased demands from people living in a new development would not pass the second test. Conversely, a development charge imposed to recoup additional costs of providing transit services in a low-density suburban area might pass the test if the costs of providing the service in a different area would be lower.

These tests suggest that the categories of infrastructure covered by municipal development charges should be restricted so they cannot be used to fund capital expenditures that arise simply because the population or total employment of the community has increased. Moreover, development charges should apply only to the extent that the establishment of the new development imposes costs that exceed anticipated revenues from property taxes.

RECOMMENDATION 114

Development charges for education should be eliminated, and the infrastructure costs associated with education should be funded from provincial general revenues.

Municipal development charges should not apply to infrastructure development that is related solely to the total population of the municipality, irrespective of its location within the municipality,

and should apply only to costs that would not be recovered from increased property taxes on the new development.

Part Twelve
The Tax Mix

32 Provincial Property Taxation

Replacing Local Education Taxes

Our analysis of property taxes and services in chapter 28 reviewed the relationship between residential property taxes and both income and wealth. We reached the conclusion that the residential property tax could not be justified as a fair tax on the basis of ability to pay. Our studies show that, on average, residential property taxes are regressive and that their relationship to the ability to pay of individual households is statistically very weak.

We developed a benefit tax framework for property taxes from which we concluded that a fair local property tax system would be one that funded services appropriately from a local benefit tax. On that basis, we have recommended that funding for provincially mandated public education should become a provincial responsibility; that local residential property tax should play a small role in education finance as a way to enable local school authorities to respond to local needs not adequately recognized in the provincial funding framework; and that there should be no local non-residential property tax – and no business occupancy tax – for education.

This view of local non-residential property tax for education is supported in a study of commercial and industrial property taxation conducted for the commission and the Government and Competitiveness Project at Queen's University. The study concluded that:

> Financing elementary and secondary education from a local non-residential property tax is difficult to justify. For example, a better and more expensive education system in one jurisdiction generates positive spillovers or benefits for other jurisdictions ...
>
> Commercial and industrial property benefits from the provincial education system and not the expenditures made locally. For these reasons, there is considerable question as to whether or not a local property tax on the non-residential sector should be used to finance education at the local level. (Kitchen and Slack n.d.)

A Basis for Provincial Commercial and Industrial Taxation

Our analysis suggests that the non-residential property tax could be seen as playing two roles in a fair tax system: as a local benefit tax levied to support local services of benefit to business; and as a general tax on business. While our analysis does not lead to a conclusion about the potential role for a provincial commercial and industrial property tax as part of Ontario's mix of taxes on business, it does suggest some parameters within which consideration of that potential role should take place.

First, we do not believe that general taxes on business or on individuals should be earmarked for particular services. Revenue from such taxes should flow into the general revenue fund and be directed along with other revenue sources to support government expenditures in general. Second, in our view, it is not appropriate for general taxes on business in Ontario to be levied as local taxes. A business tax with property as its base should be considered in the context of other general taxes on business such as payroll taxes, capital taxes, and corporate income taxes and should be levied at the provincial level. Third, there can be no justification for any geographical variation in tax rates for a general business tax with property as a base. Such a tax should be levied at a uniform rate across the province. Fourth, if the purpose of the tax is to tax business, the scope of the property base for the tax should be somewhat narrower than that for local non-residential property taxes. The link to business suggests, for example, that property owned by non-profit organizations and used for a purpose that is neither commercial nor industrial should be excluded from the base of the tax.

Do We Need Another Provincial Tax on Business Activity?

An important argument against a new tax is that, because property taxes are essentially unrelated to the level of activity in a business and bear no relationship to its ability to generate revenue to pay the tax, the mix of taxes on business should be shifted away from property taxes towards other taxes better related to business activity. The elimination of the local non-residential property tax for education would create an opportunity to use other business tax sources to meet the additional general revenue requirements created by provincial funding for education.

Concerns about overall levels of property taxation on commercial property in major urban areas in Ontario were raised by a number of participants in our public hearings. Kitchen and Slack, in their study for the commission, concluded that non-residential property taxes in Ontario were probably too high relative to the benefits received by business from local services. However, they also cast doubt on often-cited statistics suggesting that Ontario's higher municipal property taxes, compared with those in other jurisdictions, put this province at a competitive disadvantage. They found that "relatively low property taxes often occur in those jurisdictions where the total tax burden is relatively high. In other words, just because the non-residential property tax is lower does not necessarily mean that it is cheaper to do business in these jurisdictions" (Kitchen and Slack n.d.).

Another argument is based on the principle that property taxes should be retained as strictly local revenue sources. The implication of this argument is that the provincial government should leave non-residential property taxation to municipalities and, as a result, allow the overall level of property tax paid by business to fall.

While the arguments against a provincial commercial and industrial tax are based on principles of taxation policy and local finance with which we have considerable sympathy, practical considerations led us inexorably to the conclusion that such a tax is necessary. The local education portion of the non-residential property tax raises a substantial amount of revenue – just over $3 billion in 1993. Only two taxes on business raise close to that amount of revenue: the corporate income tax and the payroll tax. Under current economic circumstances, neither of these tax bases is capable of generating the additional revenue that would be required. Replacement of the revenue through the corporate income tax would require a near-doubling of the revenue yield. We do not believe it would be possible to raise as much revenue from that tax, given the ease with which corporations are able to organize their affairs to minimize their tax liabilities. With respect to the payroll tax, although there is evidence that payroll taxation is one area in which taxes in Ontario are lower than they are in other jurisdictions (Dahlby 1993), we are concerned about the potential impact of a substantial payroll tax increase on employment – even a transitory impact – in an economy that has been battered by recession and restructuring.

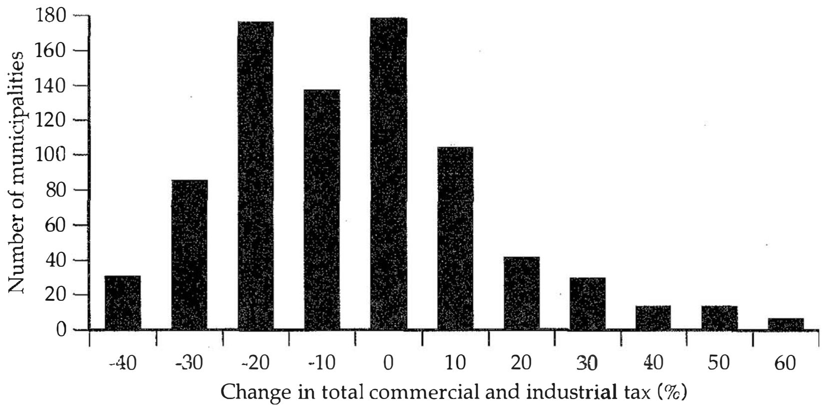
We have therefore concluded that to generate the additional revenue required to meet the province's responsibility for funding primary and secondary education implied by our recommendations on education finance, Ontario requires a new provincial tax on commercial and industrial property to replace the education portion of the existing local levy.

RECOMMENDATION 115

Ontario should establish a provincial property tax on commercial and industrial property, levied at a uniform effective rate across the province, to replace the revenue raised by the local education levy on non-residential property and the education share of the business occupancy tax.

As we demonstrated in chapter 27, the effective rate of tax currently levied for education at the local level on non-residential property varies from municipality to municipality across Ontario. There are a number of reasons for these variations. First, average rates of business occupancy taxation vary from municipality to municipality. A uniform tax rate would effectively eliminate the business occupancy tax portion of taxes on business for education purposes and therefore effectively replace a variety of different average rates of tax with one rate. Second, differences in assessment practices across the province result in dramatically different tax rates between different types of property within the non-residential sector. A uniform provincial tax would wipe out those differences. Third, spending levels on education vary across Ontario and produce a corresponding variety of tax rates for education on non-residential property.

FIGURE 32.1
Impact on Total Commercial and Industrial Taxes of Uniform Commercial and Industrial Rate for Education, Ontario, 1991



Source: Fair Tax Commission calculations based on Ontario, Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

Note: Figure shows the distribution of impacts on total commercial and industrial taxes of changing to a uniform rate for the education portion of the tax, by municipality.

The replacement of the current range of effective tax rates with a single uniform rate would create significant tax shifts within the commercial and industrial sector both across geographical areas and among different types of commercial and industrial property in the same geographical area. We analysed the shift from the current tax structure to a uniform rate province-wide in terms of impact on total property taxation (provincial plus local). The base for the province-wide uniform-rate tax was assumed to be 1991 market value equalized assessment.[1] The elimination of the variations in effective tax rates for education in the current system will result in tax increases in some municipalities and reductions in others. The impacts will also differ between commercial and industrial

---

[1] Equalized market value assessment was used as a proxy for rental value assessment, data for which are not available.

properties. Figure 32.1 illustrates the range of impacts among municipalities. Industrial properties will, generally speaking, experience larger decreases and smaller increases in tax than commercial properties.

Shifts in taxation of this magnitude cannot be absorbed easily or immediately. We believe that special transitional arrangements will be necessary to provide taxpayers with an opportunity to adjust to these shifts, and we make our recommendations to that effect in chapter 38.

The Tax Base

Although the rationale for the local non-residential property tax differs from the rationale for a provincial commercial and industrial property tax, we reached similar conclusions about the tax base, for both principled and practical reasons. In principle, if the provincial commercial and industrial tax is to play a role as a tax on business activity, the base of the tax should be measured by the value of the property in its current use, rather than its value in exchange. The arguments advanced in chapter 29 in favour of value in current use rather than market value as an assessment base for local property taxes apply here as well. Value in current use will generally be a better reflection of current business activity than market value because it is not distorted by values attributable to potential future uses or potential future capital gains or losses.

As a practical matter, if non-residential property is already being assessed on the basis of value in current use for municipal purposes, it would make sense to use the same tax base for those properties that are subject to the provincial commercial and industrial tax.

RECOMMENDATION 116

The provincial commercial and industrial tax should be levied on the assessed value of commercial and industrial property as established for municipal taxation purposes and equalized to a common base across Ontario.

Exemptions

The different roles played by the provincial commercial and industrial property tax and the local non-residential property tax will affect what exemptions are appropriate from such a tax. As we outlined in chapter 30, we believe that exemptions from local non-residential property tax, which is related to municipal services, should be much more tightly restricted than they are in the current system. We recommended that all non-residential property be subject to tax unless an exemption serves a clear public policy purpose; a reason for exemption would be that a subsidy to the organization owning the property is justified and the amount of subsidy should be equal to the local non-residential property tax that would otherwise have been payable.

Exemptions from a provincial tax on business with property as the base would appropriately be much broader. In principle, since the purpose of the tax is to tax business, property not owned by a business or used for a business purpose should be exempt from the tax. Property owned by non-profit organizations and used for a non-commercial or non-business purpose should be exempt from the tax. Property owned by non-profit organizations engaged in a commercial activity, such as Blue Cross, credit unions, and cooperatives, would be subject to tax. So too would property owned by non-profit or charitable organizations that is not used for a charitable or non-commercial purpose.

RECOMMENDATION 117

The provincial commercial and industrial property tax should apply to all non-residential property which is used for a business purpose. Property owned by a non-profit organization and used for a non-profit or charitable purpose should be exempt from the provincial commercial and industrial property tax.

Taxation of Farming Property

A property is defined as a farm if the land and buildings are used to grow and/or raise a product. The goods being produced may take many forms, including grains, cash crops, fruits and vegetables, milk and other dairy products, beef, pork, poultry, eggs, fish, fur-bearing animals, and equestrian operations. In the current property tax system, farming property is assessed as residential property, rather than as commercial and industrial property. Farm land is assessed at its market value for farming purposes, market value being based on farmer-to-farmer sales of property. When the farmer dies or retires, the farming designation is retained for at least two years – or longer if a surviving spouse continues to occupy the property. The farm residence and the one acre of land surrounding it is assessed in the same manner as other residential property in the municipality. In addition, farming property is eligible for a special rebate, originally intended to offset education taxes on farm property, equal to 73 per cent of the taxes paid by the farmer on farm land and farm buildings. To be eligible for a rebate, the farm property must have gross production of at least $7000 in value.

In chapter 30 we recommend that farming property be assessed as non-residential property on the grounds that farming is a business activity, not a residential use. Valuation on the basis of current use rather than market value would tend to reduce assessments of farm properties relative to other commercial and industrial properties. Furthermore, the elimination of the education portion of the local non-residential tax on farming property would have the effect of reducing local property taxes on farming. However, farming property would be included in the base for a provincial tax on commercial and industrial property.

Because of the special treatment afforded farming property in the current local property tax system, and because farming property would be the only category of property that would potentially experience a significant tax increase as a result of our recommendations, special attention is merited.

As a commission formed to examine the tax system, we are not in a position to second-guess the objectives pursued by governments in offering special tax provisions to farmers. In our discussions of farming issues, we identified two possible objectives that might underlie the special treatment provided for farms and farming: the preservation of family farming as a way of life, and the preservation of Ontario's food lands and food production capability. The eligibility requirements for the farm tax rebate suggest either that Ontario is pursuing a mixture of these two objectives or that it is not clear which of these objectives it is pursuing. Because assistance is made available to commercial agricultural production as well as to family farms, it would appear that the overriding objective is the preservation of food lands.

Since we have concluded that farming property should be valued and taxed as commercial and industrial property, such property should, in principle, be subject to our proposed provincial commercial and industrial property tax. And since the rationale for the provincial commercial and industrial property tax has nothing to do with local benefit, the original rationale for the farm tax rebate would disappear as well. To make these changes, however, would single out the farming industry for significant tax increases. We have concluded that a reduction in net support for the farming industry on the scale implied by our recommendation for a provincial commercial and industrial property tax on farming could be contemplated only in the context of a much broader evaluation of the economics of the farming industry, government policy objectives, and the appropriate extent of government financial support, an evaluation that goes far beyond our mandate. As a result, we have concluded that farming property should be cushioned from the impact of any provincial commercial and industrial property tax.

While these tax increases could continue to be offset by the farm tax rebate or some similar program, it would make even less sense to collect a provincial tax on commercial and industrial property and then rebate it than it does to collect a local property tax and rebate it. Rather than continue with the farm tax rebate, we have concluded that farming property should be exempt from the provincial commercial and industrial property tax.

RECOMMENDATION 118

Provincial policy towards the taxation of farming should be reformed as follows:

a) **Farming property should be exempt from the provincial commercial and industrial property tax pending a broader review of the economics of the farming industry in Ontario and the policy objectives of government with respect to the farming industry.**
b) **The Farm Tax Rebate Program should be abolished.**

Revenue Objectives

A provincial commercial and industrial property tax is needed to replace the revenue forgone as a result of the elimination of the education portions of the local non-residential property tax and the business occupancy tax. In taking this position, we may be missing an opportunity to reduce the burden of non-residential property taxation on business in Ontario. On its face, the argument that taxes related to the level of business activity are preferable to taxes that apply as a lump sum regardless of business activity or success is compelling. As the Kitchen and Slack study points out, however, little is known about the impact of property taxes on business activity or about their influence on Ontario's competitive position compared with other jurisdictions; little more can be learned unless new sources of data are generated to shed light on these important questions. At this point, therefore, we can see no basis for a recommendation that taxation of commercial and industrial property in Ontario be substantially reduced.

RECOMMENDATION 119

The rate for the provincial commercial and industrial tax should be set to generate approximately the same amount of revenue as is currently raised for education at the local level from the business occupancy tax and the non-residential property tax.

33 Reducing Reliance on Regressive Taxes

As the preceding chapters make clear, Ontario levies a wide variety of different taxes, each with different characteristics, different impacts on the economy, and different impacts on people. Only one of the taxes levied in Ontario – the personal income tax – is clearly progressive. Payroll taxes are progressive through the bottom and middle of the income range, but are regressive at the top end and result in different tax burdens for people in similar economic circumstances. All the other major taxes in Ontario's current revenue system are regressive.

Tax reform in its broadest sense refers to two distinct processes: changes to particular tax statutes or bases; and changes to the proportion of revenues raised from each tax base, or the "tax mix." In previous chapters, we focused on particular tax bases, identifying specific areas in which we believe reforms would improve fairness. For most taxes, the changes we recommend would either improve fairness among taxpayers in similar economic circumstances (horizontal fairness) or establish a more appropriate link between services and benefits taxes. In income taxation and wealth taxation, we recommend changes that would both improve horizontal fairness and make the tax system more progressive. In this chapter, we consider the potential role for changes in the tax mix in making the overall tax system more progressive.

Importance of a Mix of Taxes

Academic discussions of taxation often do not address tax mix issues; instead, they tend to focus on a search for an ideal tax base that can be relied on to raise all required revenues. Yet no industrialized country relies on a single tax for its revenues. They all derive significant shares of revenues from several distinct tax bases – among them, income and profits, property, goods and services, payroll/social security, and wealth – and if all the variations were counted as separate taxes, the number would be much higher. Governments rely on a number of tax bases for several reasons.

In general terms, a tax mix is needed to attain some balance among competing tax principles – for example, between equity and economic neutrality. Achieving this balance is impossible with a single tax base, but several bases provide additional degrees of freedom to satisfy competing criteria. More specific reasons for reliance on several tax bases include the need for stability of revenues, the suitability of different tax bases for various policy purposes, the need to address tax evasion or avoidance, and the desirability of maximizing economic efficiency.

Revenue Stability

Public sectors in developed economies are significant relative to the total economy. For example, to support public spending, tax revenues range from about 30 per cent to more than 50 per cent of gross domestic product in the OECD countries (OECD 1992c). A variety of tax sources is required to generate revenues of that level.

Government revenues are more stable when they come from several tax sources rather than one. Corporate income taxes, for example, are very sensitive to business cycles, while property taxes are not. Broad-based consumption taxes tend to be less cyclical than personal income taxes. By spreading revenue requirements across a range of bases, there is less volatility of government revenues than if the tax sources were more heavily concentrated.

Taxes as Policy Instruments

A mix of taxes provides a wider array of policy instruments for the pursuit of policy objectives than does a single tax. If a tax base is available that in some sense corresponds to the policy area under consideration (for example, environmental protection, investment incentives, or social policy), then policy implementation may be more effective as a result. For example, social policy objectives can be related to income tax by taking individual or family circumstances into account. Policies related to consumption can be attached to sales taxes.

In practice, the major taxes have differed sharply in the extent to which they have been used in the pursuit of other policy objectives. The personal and corporate income taxes have been used most extensively to implement specific policy objectives of government. General sales taxes and specific excise taxes have been less relied on for these purposes. Property tax bases have been designed to exempt particular types of properties. We have been critical of many of these provisions, largely on tax fairness grounds. Nevertheless, we have also enunciated criteria for the use of tax measures to pursue policy objectives. The point to be made here is that a combination of taxes provides governments with more instruments to meet these criteria.

Avoidance / Evasion

If a tax can be avoided (legal reduction of tax by planning) or evaded (illegal reduction of tax by non-reporting or false reporting) to any significant degree, the implications are likely to be significant not only for government revenue, but also for the equity and neutrality objectives of the tax. There may also be a backlash in the level of compliance by other taxpayers, as they see taxpayers in similar circumstances taking advantage of opportunities – legal or otherwise – to avoid paying their taxes.

There are three ways in which relying on a mix of taxes instead of a single tax may help to minimize avoidance or evasion. First, the use of a mix of taxes makes it possible to keep the tax rate and the average tax level of any particular tax lower than it would have been if there were only one source of revenue. The incentive for avoidance or evasion rises directly with the tax rate. As the tax rate rises, increasing numbers of taxpayers are tempted to adopt complex plans or strategies to reduce their taxes. The infrastructure to support such activities also expands. Leaving the taxing jurisdiction is an extreme form of avoidance or evasion.

There is ample evidence of the legal and illegal compliance problems that are associated with high tax rates. Canada's experience of compliance problems with tobacco taxes is one example; the United Kingdom's experience with very high marginal income tax rates is another.

Second, a mix of taxes helps to minimize avoidance and evasion activities because what is avoided in one instance is taxed in another. For example, an individual who has avoided income tax will at least be taxed under the retail sales tax when the income is used for consumption. Businesses that may be able to avoid income tax will be subject to the capital tax and payroll tax through salaries and wages paid to employees.

Third, a mix of taxes may be useful in enforcement, since there may be some spillover from one tax base to another in identifying avoidance or evasion by taxpayers or in types of transactions. Sometimes, however, a set of taxes may function effectively as a single tax and be of no benefit in exposing the underground economy. For example, this may be the case with respect to the income tax and the Goods and Services Tax (GST) for self-employed tradespeople. By failing to report the value of services provided to consumers, the person evades both income tax on the income earned and GST on the value added of the service. If the underlying GST on inputs can be passed on to the consumer, both income tax and GST are fully avoided. Having a mix of taxes in such cases is not beneficial in reducing the incentive to avoid or evade.

Economic Neutrality

A major consideration in designing a tax system is its effect on the level of output in the economy. From an economic perspective, this is usually looked at from the viewpoint of economic neutrality, which considers the impact of taxation on the decisions of taxpayers.

Virtually all taxes have some effect on the choices taxpayers make, whether it is between work and leisure, between present and future consumption, or among various goods and services. In general, the greater the behavioural effects of a tax, the greater its negative impact on economic efficiency. All the taxes currently in use, including the major bases (personal and corporate income taxes, retail sales tax, property tax, and payroll tax), have efficiency consequences.

The impact of taxes on people's choices is affected by the level of tax rates. The impact (efficiency costs of taxes) increases quickly as the rate is increased, and high tax rates on any base can result in large efficiency costs relative to low-tax rate alternatives on a number of bases (see Hamilton et al. 1988, 267). Even quite modest reductions in tax rates can have significant benefits for efficiency, and thus for economic well-being in an economy (Ballard et al. 1985, 128, 136).

The cost arising from the induced change in taxpayer behaviour when an additional dollar of revenue is raised from a particular tax base is related to the responsiveness of the activities being taxed to changes in prices, including taxes. This cost is related to the responsiveness of choices about paid employment and saving when the taxes involve income from labour and capital, and to the responsiveness of demand in the case of a product. The cost of applying higher taxes when the affected behaviour is highly responsive is greater than applying them when behaviour is less responsive. Since capital investment choices are highly responsive in an open economy, the cost of raising an additional dollar of revenue from capital is relatively high.[1] The availability of foreign tax credits has important implications for the application of this general observation in an actual economy.

These observations suggest that the use of a wide mix of taxes may be desirable for reasons of economic efficiency. This positive result provides at least a partial explanation for the use of a variety of tax bases in all countries with a significant public sector.

A key objective of the commission has been to increase the overall progressivity of Ontario's tax system. On this score, changes in the mix of taxes can have a more wide-ranging effect than changes to the structure of any one tax base. Personal income tax is the exception. It is the only fully progressive tax in the overall system and the one in which significant broadening of the base or restructuring of the rate can contribute to the overall progressivity of the tax system. Yet before any increase in progressivity is introduced, by changing the personal income tax, by introducing new taxes, or by altering the mix of existing taxes, certain constraints should be considered.

---

[1] Ballard et al. (1985, 136) found marginal excess burdens (that is, the costs of changes in behaviour that are additional to the actual amount of tax paid) per dollar of additional revenue raised of 31.4 cents for personal income taxes, 46.3 cents for capital taxes, and 38.8 cents for sales taxes.

Constraints in Considering Tax Mix Changes

Constraints on Rate Increases

Increased overall tax progressivity can be achieved by increasing reliance on the personal income tax, and by increasing the progressivity of the rate scale. In addition, broadening the tax base of the personal income tax will increase progressivity. There are limits to the extent one can pursue these approaches in terms of the efficiency costs discussed above.

Large increases in personal income tax rates may lead to a loss of economic output. High marginal rates are a concern because of their possible impact on work, investment, and other forms of economic behaviour. That concern underlies the move to lower rates and less graduated schedules in the international tax reforms of the 1980s. While we must be concerned about these potential effects of high marginal rates, there is no good evidence as to how high is too high and how progressive is too much.

The second method of increasing reliance on personal income tax in the tax mix would be to broaden its tax base. At first glance, this would appear to be more likely to lead to improvements in economic efficiency than to losses because all forms of income would be taxed more uniformly. Tax expenditures that distort private decisions would be eliminated. However, to the extent that changes are of a particular type, all relating to capital income, there may be problems because these changes are equivalent to increased taxation of capital, the base considered to be the most mobile.

The potential for rate increases on other taxes is also limited. Increases in the corporate income tax and base have been discussed in chapter 20. Tax rate increases for those corporations facing the highest corporate tax rates are also limited by concerns associated with high rates and mobile capital.

Mobility

One response to increased taxation is to move the activity that is being taxed to another jurisdiction. While in some instances this would involve physically removing the activity or tax base from the province, in other cases it could involve tax planning or business reorganization that left the substance of the economic activity unchanged, but effectively removed the tax base from the province. These concerns arise with respect to both labour and capital.

Mobility of Labour

Historically, labour has not been particularly sensitive to tax levels, though there are some exceptions. Examples include high-income executives in large companies, professionals, and business advisory services. Self-employed business people may also be able to relocate.

However, in general, taxation is a relatively minor factor in inducing labour mobility. Within Canada, the provincial tax rates applied to Basic Federal Tax have varied by some 15 percentage points between the highest and the lowest without inducing significant mobility. Other taxes applicable to labour, such as payroll taxes, have also varied significantly. There thus seems to be a significant degree of flexibility in the selection of tax rates as they apply to labour.

Mobility of Consumption

Taxes do not appear to have much impact on consumption, though there can be significant effects near borders if specific tax rates such as gasoline, alcohol, or tobacco taxes vary sharply between jurisdictions. Recent experiences with cross-border shopping are obvious examples, but other powerful influences such as exchange rates and adjustments to new trade rules also have an impact. Cross-border consumption may not be significant if tax differentials fall in a moderate range, but it can rapidly become a concern once tax differences are outside such a range.

Mobility of Capital

Capital is the most mobile of the factors responding to differences in tax rates. Tax differentials are only a secondary factor, however, for several important elements of capital, such as direct investment in new plants. There are still major gaps in our knowledge of the impacts of taxes on business-location decisions. The new studies on international capital movement suggest a significant role for corporate income taxes, primarily, although not exclusively, through their impact on retained earnings.

These comments suggest two important caveats to the conclusion that direct investment may be only moderately subject to tax influences. First, the extensive role of international and interprovincial corporations, combined with opportunities to determine strategically the prices of non–arm's-length transactions between the corporate affiliates (transfer pricing manipulation), corporate financial restructuring, and pricing of intangibles (technology, marketing), may cause the tax base to be shifted in response to tax rates, even if the effect on real activity is limited (Eden n.d.). Second, portfolio investments may be quite sensitive to tax effects. Indeed, concern has been expressed by some writers whether capital taxation will be able to survive the globalization of capital markets (see, for example, Gordon 1992a). Under the extreme form of this view, competition for highly mobile capital will be so intense internationally that the ability to tax capital will eventually be lost as tax rates are forced down to the lowest common denominator. Other writers have supplied various reasons why capital taxation will be able to survive. For example, capital taxation can continue if a dominant capital exporting country (in the past the United States) combines a domestic tax on capital for its residents with credits for capital taxes paid in other jurisdictions. This, in effect, creates an umbrella for capital-importing countries to tax at rates up to the levels applied in the capital exporter.

The message from this analysis and information on capital flows may be that it will be difficult – and counterproductive if it also drives out economic activity – for a jurisdiction to attempt to tax capital more heavily than the norm, since capital, or at least the return from capital, will simply be diverted from the jurisdiction. At the same time, it will be non-productive for a jurisdiction to provide lower tax rates, since they may have only marginal benefits for economic activity and will often end up as merely a transfer of revenue to another jurisdiction.

A study by David Conklin and John Whalley (n.d.) reviewed the nature of the forces at play and concluded:

> The increase in global interdependence, the various potential shocks to the global economy, the trade practices and agreements of the 1990s, tax reforms in other countries, and differences in legislation and regulations are making Ontario's tax system increasingly sensitive to developments abroad.

Pressures of these types are likely to become more intense. International agreements may be necessary to retain a reasonable level of taxation on capital. Evidence of some rudimentary steps or pressures in this direction can be seen in the US position on "treaty shopping" – the use of treaty provisions to take advantage of an agreement inappropriately – as evidenced in the US–Netherlands new bilateral tax treaty,[2] European Community proposals on harmonized corporate taxation, and the pressure in the United States for arbitrary "minimum taxes" on foreign corporations operating there.

Costs of Complexity

While efficiency may be improved by having a mix of taxes, a significant price must be paid in terms of the compliance cost to taxpayers. Each tax base will impose certain fixed compliance costs on taxpayers, though there will be some decline in the average cost of compliance as greater use is made of a particular tax. Use of fewer bases, therefore, would reduce compliance costs and, presumably, administration costs as well. The compliance and administrative costs of using many tax bases must be balanced against the other benefits of using a mix of taxes. Once a given set of taxes is in use, however, any costs in moderate shifts among the bases are likely to be small.

The Ontario Tax Mix

The tax mix recommendations we make in this chapter were developed taking into account the Ontario tax mix, how it has changed,

---

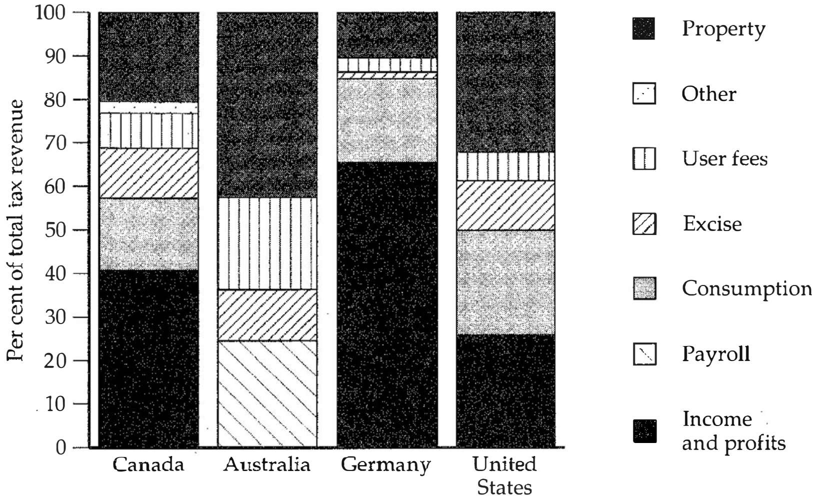
[2] An example of such treaty shopping in the US–Netherlands treaty was "double-dipping." A Canadian (or other foreign) company would borrow money in its domestic market and invest it in a holding company in the Netherlands. The Netherlands holding company would then lend the funds to a US subsidiary of the foreign company and the loan payments from the United States would be deductible for US tax purposes. However, the interest payments to the Netherlands company were exempt under the terms of the treaty. Dividends from the Dutch holding company to the Canadian parent also would be exempt. Two deductions of interest are thus available in respect of the one loan – one in Canada, the other in the United States. The new treaty would make the interest payments from the US subsidiary to the Netherlands company subject to withholding tax where a third-party parent is involved.

and how it compares with the existing tax mix in other jurisdictions. It is necessary to examine the tax mix data over a number of years so that we may distinguish between revenue changes that reflect structural changes in the overall tax system (true tax mix changes) and revenue changes that result from fluctuating or cyclical levels of economic activity. For example, corporate income tax revenues are highly sensitive to the business cycle, while general sales tax and excise tax revenues tend to be less sensitive.

Also in this discussion we follow the conventional practice and focus on the major tax sources and the shares of revenues coming from each. However, one can also examine the tax mix in terms of how much taxpayers pay in their capacities as income earners, wealth holders, and consumers. This would involve an examination of tax incidence – that is, how the burden of taxes is distributed among taxpayers in different economic circumstances. Such an examination makes assumptions and draws conclusions about whether taxes levied on a business are passed on to consumers in the form of higher prices for the goods it sells, to workers in the form of lower wages, or to the shareholders or investors. The corporate income tax is then seen as a tax on individuals as consumers, employment income earners, or investors, depending on the assumptions and conclusions of the analysis. This is the approach taken in chapter 9, which analyses the impact on taxpayers of the current tax system.

Our discussion of the tax mix naturally focuses on the provincial tax system. But our recommendations take into account the federal tax mix, and some data on the federal mix are presented below. Discussions such as this raise the issue of the appropriate mix of taxes in terms of how they are shared by the federal and provincial governments. For example, proposals have been made that corporate income and capital taxation should be left to the federal government, in part because a larger jurisdiction is better able to meet the challenge posed by mobile capital and investment. These proposals have the federal government leaving the commodity tax fields (general commodity taxes such as the GST and excise taxes) available only to the provinces (Ip and Mintz 1992, 119–24). Another perspective is that competition in a multi-tier governmental system inevitably leads to complex intergovernmental fiscal arrangements in which the federal government, to economize on administrative costs, will collect taxes required to meet the provinces' responsibility for providing certain goods and services (Breton 1993).

FIGURE 33.1
Selected OECD Sources of Tax Revenue as a Proportion of Total Tax Revenue, Subnational Level of Selected OECD Jurisdictions, 1990



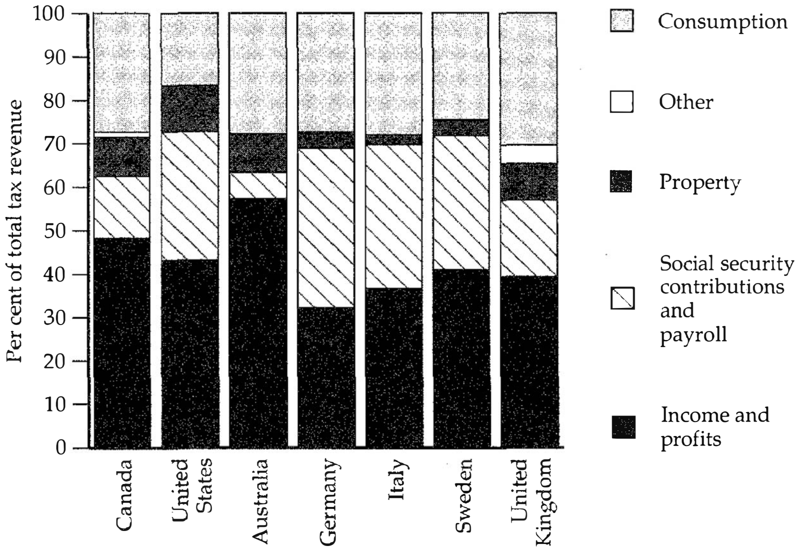
Source: Fair Tax Commission calculation based on OECD, *Revenue Statistics of OECD Member Countries 1965–1991* (Paris: OECD, 1992) tables 122, 126.

Note: Social security contributions accruing to social security funds are excluded from payroll figures. Payroll taxes levied by subnational governments are often treated as separate social security fund taxes in the OECD classification system.

Trends and Comparisons

Between 1971–72 and 1991–92 the share of Ontario total tax revenues generated by the personal income tax increased steadily, rising from about one-fifth to just less than one-third of the total. Residential and non-residential property tax shares declined slightly as a proportion of total tax revenue over the period, as did the revenue share generated by corporation taxes. Finally, the share of revenues from excise taxes (alcohol, tobacco, and gasoline and fuel) has, in relative terms, fallen quite markedly, from about 14 per cent of the total to about 9 per cent (see figure 8.2 in chapter 8).

FIGURE 33.2
Tax Sources as a Percentage of Total Taxation in Selected OECD Countries, 1991



Source: OECD, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992), table 7.

Subnational Level

Overall, Canadian provinces and local governments relied on income taxes for about 40 per cent of revenues in 1990, with other significant proportions coming from property taxes, general consumption taxes, and excise taxes (figure 33.1). At the subnational level, Germany, by comparison, is much more reliant on income taxes, while the United States draws relatively equally on income, property, and general consumption taxes. Australia is noteworthy because income taxes are absent at the subnational level, and because a relatively large portion of revenues come from user fees.[3]

---

[3] Note that most "social security" taxes in the OECD classification are reported separately, rather than as part of the revenues of either the central or the subnational governments. They are excluded from this comparison.

TABLE 33.1
Tax Revenue as a Share of Provincial and Local Own-Source Revenue,[a] 1990/91 Fiscal Year (%)

Province	Personal income tax	Corporate income tax	Retail sales tax	Local property tax[b]	Payroll tax[c]	Excise taxes[d]	Taxes on resource
Ontario	**27.2**	**5.1**	**14.2**	**19.4**	**4.9**	**3.9**	**0.5**
Quebec	34.0	2.1	13.0	13.5	11.4	5.1	0.3
Alberta	17.1	5.1	—	12.5	4.5	4.1	20.5
BC	24.0	3.5	11.6	7.3	7.0	5.3	6.8

Sources: Fair Tax Commission calculation based on Statistics Canada, *Public Finance Historical Data, 1965/66–1991/92*, Cat. 68-512 (Ottawa, 1992).

a. Own-source figures exclude federal transfers to the province and federal/provincial transfers. Local own-source figures have been converted to fiscal year.
b. Property tax figures have been converted to fiscal year.
c. Figure composed of health and social insurance levies.
d. Includes motor fuel, alcohol, and tobacco taxes.

Note: 1991 figures are estimates.

National and Subnational Levels Combined

Income taxes, consumption taxes (general consumption and excise taxes combined), and social security/payroll taxes are the major revenue sources in many OECD countries (figure 33.2). Compared with most of the countries shown, Canada is more reliant on income taxes and less reliant on payroll taxes to finance government activities.

Canadian Provinces and US States

Table 33.1 compares the Ontario tax mix from its principal revenue sources with three other provinces. Alberta, because of its large resource revenues, is less dependent on income taxes than the other provinces, and Alberta also has no retail sales tax. Quebec, more than the other provinces, derives a smaller share of revenue from taxing corporate income and relies more heavily on personal income and payroll taxes. This pattern corresponds to what we might expect,

TABLE 33.2
Major US Taxes as a Share of Total Tax Revenue for Selected States, 1986 (%)

State	Personal income tax	Corporate income tax	Retail sales tax	Property tax
Michigan	20.9	9.3	17.2	38.2
Minnesota	27.0	5.1	18.8	30.8
New York	25.7	4.2	10.5	29.5
North Carolina	28.5	6.6	17.9	21.6
Tennessee	1.3	5.2	36.1	21.9
California	24.4	8.2	22.3	26.1
US mean	18.1	4.9	20.1	29.9

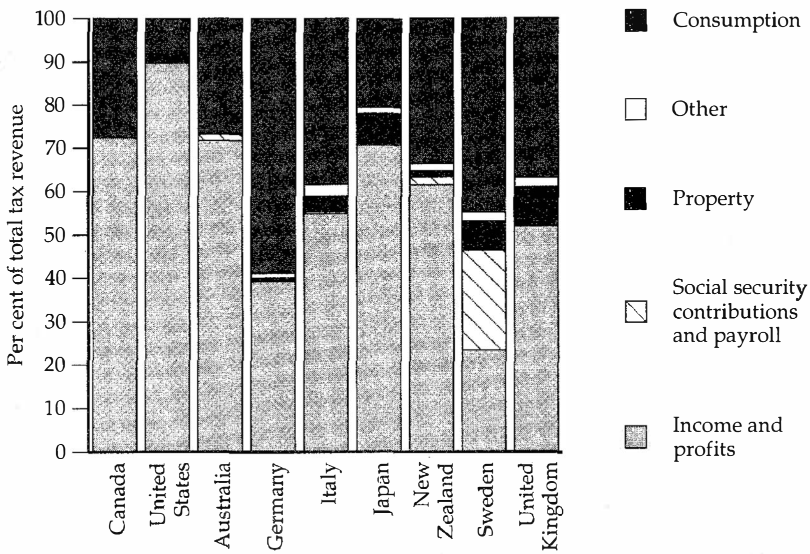
Source: United States, Bureau of the Census, *Statistical Abstract of the United States, 1988* (Washington, 1988), table 445; *1989*, table 457; François Vaillancourt, "Subnational Tax Harmonization, Canada and the United States: Intent, Results, and Consequences" in *Canada–U.S. Tax Comparisons*, ed. John B. Shoven and John Whalley (Chicago and London: University of Chicago Press, 1992), figures produced in table 11.4.

given the lower mobility of the Quebec labour force because of linguistic reasons. Table 33.2 provides data on major US taxes as a share of total tax revenue for several US states. The tax mix among US states is not dramatically different, though there appears to be less reliance on personal income taxes and heavier reliance on property taxes.

Central Governments

Figure 33.3 shows the tax mix for central governments in Canada and several other OECD countries. The United States raises a larger share of its revenues at the national level from income taxes than do any of the other countries shown. Canada, Australia, and Japan raise about 70 per cent of their national revenue from income taxes while the remaining countries all generate smaller shares from income taxation. Canada ranks in the middle in terms of the share of revenues raised from consumption taxes; however, there is a marked contrast with the United States, which raises a very small proportion of revenues in this way. The non-federal states tend to have some central government revenues from property taxes, which are virtually nonexistent in the central governments of the federal states.

FIGURE 33.3
Central Government Tax Sources as a Percentage of Total Taxes in Selected OECD Countries, 1990



Source: OECD, *Revenue Statistics of OECD Member Countries, 1965–1991* (Paris: OECD, 1992), table 124.

Notes: Social security contributions accruing to social security funds are excluded from figures. Also, only social security contributions accruing to the central government are included.

Revenue Implications of Rate Changes

Table 33.3 provides some indication of the magnitude of the shifts among the major Ontario tax bases that would be involved in rebalancing the tax mix. It shows the revenue impact of "one unit" rate changes in each of the taxes. The personal income tax estimates are shown in terms of a one percentage point increase based on Basic Federal Tax – in line with the existing Tax Collection Agreements – and, as well, in terms of a one point increase based on taxable income.

The latter option would be relevant if the collection agreements were amended to allow the provinces to "tax on base" rather than "tax on tax," as we recommend, or if Ontario were to leave the agreements. The property tax estimates are presented in terms of two standards of comparison, the average property tax per family in Ontario and the proportion of income going to property tax.[4]

Designing a Tax Mix

Our analysis suggests that reforming individual tax bases will make only a modest contribution to the overall goal of changing the distribution of the tax burden in Ontario. For example, alternative assessment bases for the property tax can make the tax less random and less arbitrary in its impact, but its overall pattern of regressivity will not be substantially altered. Changes in the tax mix are needed to increase progressivity in the tax system within the constraints discussed above, and beyond what is available through changes in individual tax bases.

Nevertheless, recommendations for changing the tax mix must take into account the reforms to particular tax bases we recommend. Some of these reforms would result in significant revenue increases or decreases and have the potential to affect the tax mix appreciably. Once reforms have been made to the design of individual tax bases, changes to the overall tax mix may be accomplished through decisions to increase or decrease the revenue from specific tax bases. All these changes should have the objective of improving the fairness of the overall tax mix, and should be considered in the context of economic constraints and on the assumption of revenue neutrality.

Tax Base Reforms and Tax Mix Options

A number of the recommendations we have already made to reform specific tax bases have tax mix implications (see table 33.4). Only those changes that could be enacted by the government of Ontario,

---

[4] It should be noted that the income bases for the personal income tax and the property tax are not strictly comparable. In the personal income tax row, the measure is taxable income as estimated by the Ministry of Finance, and in the property tax row the measure is census family income as provided by the Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

TABLE 33.3
Revenue Impact of Selected Tax Changes
Ontario, 1993–94

Tax	1993 rate	Rate change	Estimated full-year revenue impact[a] ($ millions)
Personal income tax	58% of BFT[b]	1 percentage point	260
	16.8% of TI[c]	1 percentage point on TI	900
Corporate income tax	9.5%; 14.5%; 15.5%	1 percentage point	140
Retail sales tax	8%	1 percentage point	870
Payroll tax	0.98%–1.95%	0.10 percentage point	140
Residential property tax[d]	$1890/household	$50/household	220
	4.0%[e]	0.10 percentage point	210

Sources: Fair Tax Commission calculations based on Ontario, Ministry of Finance, Fact Sheet of Economic Indicators, 12 October 1993; Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS); Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

a. Figures represent estimates of 1993–94 revenue for all taxes except property taxes, which are based on the 1993 calendar year.

b. Estimated payments for 1993 tax year. Prior to 1 July 1993 the personal income tax rate was 55 per cent; BFT = basic federal tax.

c. Maximum marginal rate (excluding surtaxes) expressed as a tax rate on taxable income (TI).

d. Excludes farm assessment and water and sewage charges.

e. Tax estimated as a percentage of average family income.

without corresponding changes in federal legislation, are included in this discussion. We comment later in this chapter on tax mix adjustments that require federal action.

At current rates, our recommendation to broaden the personal income tax base would increase revenues. The elimination of the lifetime exemption on capital gains would increase revenues by about $500 million annually, and the elimination of the marital and equivalent-to-married credits would generate an additional $200 million. Our recommendation on the age credit is not included in table 33.4 because we suggest that the amount involved be converted to a refundable tax credit.

Broadening the retail sales tax base to include services and some goods not currently taxed, and instituting a system of business input credits, would, at current rates, generate approximately $300 million in additional revenue. The elimination of the preferential rate for small businesses in the payroll tax would result in additional revenue of about $150 million per year.

Two other recommended changes do not enter our tax mix discussion because we assume that specific adjustments would accompany their implementation. The introduction of a new carbon tax would likely involve a rationalization of existing related taxes. Similarly, we assume that increased reliance on user fees and other charges directly related to the consumption of local public services by households and firms, such as sewer, water, and garbage collection and disposal, would generate revenues that come at present from municipal property taxes.

We recommend that the provincial government assume responsibility for funding education, social services, and children's services, and that these functions no longer be supported from *local* property taxes. This recommendation flows from our conclusion that these public services are not appropriately funded from the *local* residential property tax base. We further recommend that the province enact a uniform provincial tax to replace the local taxes on commercial and industrial property currently used to support education.

TABLE 33.4
Revenue Increases or Decreases Related to Commission's Major Tax Base Recommendations

Recommendation	Revenue increase ($ millions)	Revenue decrease ($ millions)
Personal income tax		
Eliminate lifetime exemption for capital gains	500	
Eliminate marital and equivalent-to-married credit	200	
Retail sales tax		
Broaden base to include services and institute business input credits	300	
Payroll taxes		
Eliminate preferential rates for small business	150	
Corporate income tax		
Eliminate manufacturing and processing preference	50	
Property tax – residential		
Eliminate property tax funding of education, social assistance, and assistance to children (net)[a]		3500

Sources: Sheila Block and Allan M. Maslove, "Ontario Tax Expenditures," in *Taxes as Instruments of Public Policy*, ed. Allan M. Maslove, Fair Tax Commission, Research Studies (Toronto: University of Toronto Press, forthcoming); property tax figures are Fair Tax Commission calculations based on information from the Ministry of Education and the Ministry of Municipal Affairs, Municipal Analysis and Retrieval System (MARS).

a. The aggregate property tax reduction is $4.6 billion. From this we subtracted $727 million attributable to the local levy for education and $373 million attributable to the residential portion of the property tax increase required to offset municipal grant reductions. Provincial portion of social assistance is not included in these tax mix calculations. This change, and required funding offsets, have already been announced by the provincial government.

The tax mix question that remains is whether the local residential property tax now used to finance education and social services should be converted to a provincial revenue source, or whether it should be eliminated, with the revenue being made up from other tax bases. We take the position that this portion of the residential property tax should be eliminated and replaced. We reached this conclusion primarily on the basis of two considerations that are discussed at length in part eleven of this report. First, on average the property tax is the most regressive tax in the Ontario tax system, and reducing its weight in the tax mix is an important step towards enhancing the fairness of the overall tax system. Second, the average distribution of property taxes masks wide variations among households with similar incomes and across municipalities. Given these problems, the residential property tax should be limited to financing municipal services on a benefits-received basis; it should not be used to raise revenues for more general purposes.

RECOMMENDATION 120

Ontario should reduce its reliance on residential property taxes.

Adjusting the Tax Mix

The residential property tax related to the funding of education and social services amounts to $4.6 billion in 1993. We recommend that local boards be granted limited capacity to levy additional residential property tax to support particular education programs supplemental to the provincially funded programs (recommendation 77). We estimate that this local levy could generate about $727 million annually (about 10 per cent of the current local property tax for education purposes). We also recommend changes in the system of grants to municipal governments (recommendations 111 and 112); these changes would result in a net decrease in grants of about $624 million per year, which local governments would presumably recoup by resort to their own property tax bases. The residential property tax share of this net grant reduction would be $373 million. The net decrease in residential property taxes that the provincial government would have to make up from other sources would then be $3.5 billion.

We considered four alternative tax sources (and combinations of them) to replace the residential property tax currently used to fund education and some social services. These sources were the provincial payroll tax, the corporate income tax, the personal income tax, and the retail sales tax.

The payroll tax offers considerable potential for additional revenues. As table 33.3 shows, relatively modest increases in the rate could generate substantial amounts of revenue because the base of this tax – all wages and salaries – is broad. Further, compared with the province of Quebec and many other non-Canadian jurisdictions, Ontario's current payroll tax rate is low, and in this sense there is room to increase reliance on this tax. However, we have already concluded that the payroll tax, in the long run, is borne by employees (chapter 22). That is of concern to us because the fairness of the tax is compromised. Unlike an income tax that falls on all sources of income, a payroll tax falls only on labour income. Accordingly, we are not prepared to recommend that reliance on the payroll tax be increased to the extent required (at least doubled) to make up for the property tax reduction.

We also concluded that the corporate income tax could not be the source for this additional revenue, but for a different reason. While the decision not to increase the payroll tax in the overall tax mix reflected our choice based on fairness considerations, the decision with respect to the corporate income tax reflects a judgment about constraints. Given the mobility of the tax base and of capital itself, any attempts to increase the tax rate to the extent required to generate any significant portion of the required revenues would be self-defeating. In our judgment, increased corporate taxes are not feasible, particularly for a subnational jurisdiction such as Ontario.

We are left with a choice between the personal income tax and the retail sales tax. Increasing revenues from each or from a combination of the two is, in our opinion, feasible. There is room to increase the retail sales tax rate. The current rate in Ontario is below that of several other provinces and, with implementation of the reforms we recommended in chapter 24, the retail sales tax would be able to generate significantly more in revenue than it currently does. There is also room to generate more revenue from the personal income tax, while respecting the principles we recommended in chapter 18 and the constraints discussed in this chapter and elsewhere. Taking into account the disincentive and potential mobility consequences of higher income tax rates, it is possible to design a tax rate schedule that will include more brackets than exist in the current system, with graduated rates throughout, and to maintain the combined federal and provincial marginal rate on the highest income bracket at less than 60 per cent.

Based on our fairness criteria, we opt for increased income taxes in preference to higher sales taxes. Even with the implementation of all the structural reforms we recommend in other taxes, the income tax is a fairer way to raise the required revenue. It is clearly more progressive than the sales tax, and for that reason advances our objective of a tax system that more clearly reflects ability-to-pay principles. In sum, the shift of a significant portion of the $3.5 billion needed to replace property tax revenues to the personal income tax would clearly enhance the fairness of the provincial tax system. A major portion of revenues (provincial and local combined) would be shifted away from the most unfair tax base onto the fairest tax base.

RECOMMENDATION 121

Ontario should increase its reliance on revenue from personal income taxes.

Our recommendations would result in additional revenues being generated from the retail sales tax ($300 million), the payroll tax ($150 million), and the corporate income tax ($50 million). The net amount that would have to be generated from increased personal income tax revenues would therefore be $3.0 billion, including revenues generated by the elimination of the marital and equivalent-to-married credits (see table 33.4). We are not including any revenue gain from the elimination of the capital gains exemption because it is doubtful that the estimated value in table 33.4 is sustainable over a long period. A high percentage of taxpayers with capital gains will have already taken advantage of the exemption.

RECOMMENDATION 122

Ontario should meet the additional requirements for funding resulting from reform of education finance and the assumption by the provincial government of responsibility for funding of services for children as follows:

Residential ($ billions)

Education property taxes		**4.600**	
LESS	**Local levy**	**0.727**	
	Grants offset (net)	**0.373**	
Property tax reduction			**3.500**
To be replaced by			
PIT rate changes		**3.000**	
Sales tax base		**0.300**	
Payroll tax changes		**0.150**	
Corporate income tax uniform rate		**0.050**	
Additional revenue			**3.500**

Commercial and industrial ($ billions)

Education property taxes		**3.095**	
LESS	**Grants offset (net)**	**0.251**	
Local property tax change			**2.844**
To be replaced by			
Provincial commercial and industrial tax			**2.844**

On the assumption that the Tax Collection Agreements are amended along the lines recommended in chapter 13, we have designed a schedule of income tax brackets and rates that would meet the requirement recommended above and, at the same time, incorporate the refundable credits recommended in chapter 16. Estimates of the impact on revenue and distribution of these proposals are presented in chapter 35. Also in chapter 35 we describe the likely impact of the proposed reform package on the economy.

Obviously, other combinations of rate schedules and refundable credits than we propose below would also meet the revenue target we have established. For example, with higher tax rates it would be possible to afford larger refundable credits than those recommended below. In addition, as noted in chapter 15, if the wider social assistance system is under consideration for redesign, shifts between direct assistance and tax benefit programs can be considered. However, keeping within the confines of the resources currently involved in the tax system, it is our view that the recommendations below are consistent with the fairness principles we have established. We also believe it is realistic in light of the constraints we have discussed.

RECOMMENDATION 123

If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, it should raise the revenue necessary to meet the tax mix objectives recommended by the Fair Tax Commission by establishing the following rate schedule and credit amounts:

- **brackets and marginal rates**

Taxable Income ($)	Rate (%)
10,000 and under	10
10,001–20,000	12
20,001–29,590	14
29,591–40,000	16
40,001–50,000	18
50,001–59,180	20
59,181–80,000	22
80,001–150,000	24
150,001–250,000	26
Over 250,000	28

- **a basic personal credit with the amount claimed equal to the federal amount and the credit rate equal to the lowest Ontario marginal tax rate.**

RECOMMENDATION 124

Refundable credit amounts should be as follows:

- **an Ontario tax assistance credit of $500 per adult family member up to family income of $18,000, and reduced at a rate of 8.3 per cent of income in excess of $18,000;**
- **an additional Ontario tax assistance credit of $300 for individuals aged 65 and over;**
- **a child tax credit of $600 for the first child and $500 for each additional child, up to a family income of $18,000 and reduced at a rate of 7.5 per cent of income in excess of $18,000;**
- **an additional credit of $400 for the first child in a single parent family.**

If Ontario establishes an income-tested child benefit which provides benefits to families with children regardless of the family's source of income, the child tax benefit should be eliminated and folded into this new program.

Our recommendations on the income tax rate schedule and the values of the refundable credits were based on 1993 incomes. Presumably, there will be a need to adjust these values over time to adjust for the effects of inflation. Currently, the federal government indexes its tax brackets and its credit values at the inflation rate (as measured by the Consumer Price Index) minus 3 per cent.

As for the marginal rate brackets, in theory they should be fully indexed for inflation. If Ontario were to index brackets fully, the common break points that we have established between the federal brackets and the proposed provincial brackets would be disrupted. The Ontario government must therefore consider the merits of full indexing at the cost of this lost correspondence (assuming the federal government will not return to full indexing), compared with a negotiated arrangement with the federal government to implement a common indexing formula.

For Ontario, considerations concerning the credits are somewhat different from those for the tax rate brackets. The level of credits should be set in relation to the needs of the recipients and the financial constraints faced by governments. Whatever levels are established, the government would want to ensure that the credits continue to meet their objectives over time. If benefits are not indexed, inflation will erode their values. An important objective of any benefit program should be to maintain their real values in the face of inflation. More broadly, their adequacy should be maintained as the circumstances of the target population change. If the credits were fully indexed, the real values would be maintained automatically, but adjustments for other changing circumstances would still require that these values be revisited from time to time. Alternatively, the government could adopt a policy to re-examine the credit values explicitly on an annual basis, and adjust them for both inflation and other changes.

We also assume that when credit values are reviewed, any adjustments made will take into account other benefits provided to low-income people. Finally, the benefits received through credits should not be lost through reduced social assistance levels.

This recommended tax mix is designed to be revenue neutral compared with the current Ontario system. It also does not take into account any tax changes requiring implementation at the federal level. Some changes are potentially large enough to affect Ontario's revenues to the extent that the tax mix issue would need to be revisited. These involve the changes to the taxation of capital income in the income tax (capital gains, dividends), the treatment of pension plan and RRSP contributions, and the introduction of a wealth transfer tax. Definitive recommendations on tax mix following these changes would depend on the revenue implications for Ontario. It is our view, however, that in the first instance the revenues from these additional reforms should be balanced through adjustments to personal income tax rates. Most of the changes that require federal action would result in higher income tax revenues, and, accordingly, compensating rate adjustments would be appropriate.

Part Thirteen
Aboriginals and Taxation in Ontario

34 Tax Considerations in Aboriginal Self-government

After years of discussion, the issue of aboriginal self-government has begun to receive serious consideration from both the provincial government and the federal government. In 1991 the Ontario government negotiated a statement of relationship between the province and aboriginal peoples that acknowledged self-government as a legitimate goal of First Nation communities. Constitutional recognition of the right to aboriginal self-government was also included as part of the package of constitutional reforms negotiated by the provincial governments and the federal government and put to the electorate in 1992 in a referendum. While the defeat of the proposed package of reforms in the Charlottetown accord has clearly put formal constitutional recognition of the right to self-government on hold, discussions continue between governments and aboriginal communities on issues of self-government.

The emergence of aboriginal self-government will likely give rise to a number of taxation issues involving both the aboriginal governments and the government of Ontario. Currently, however, attention tends to focus on disputes and grievances relating to the interpretation and administration of the aboriginal tax status. In part these disputes are based on misunderstandings between the aboriginal community and the non-aboriginal community of the other's perspectives.

In this chapter we discuss briefly the current administrative issues and legal disputes over the interpretation of the Indian tax status. While we try to contribute to the understanding of the issues at stake, we do not make any recommendations about their resolution. Ultimately, the most important of these disputes will be settled through interpretation of fundamental principles, such as the extent of the sovereign status of aboriginal peoples, rather than on the basis of tax fairness principles (or any other criteria for good taxation). For that reason, these questions are largely beyond the mandate of the commission. The tax issues that accompany self-government, however, may, at least in part, be usefully addressed by reference to tax principles.

Aboriginal Tax Status

Aboriginal leaders argue that they are a sovereign people within Canada and are therefore immune from taxation by all Canadian governments. Furthermore, they argue that this immunity extends to all aboriginal people (at present governments recognize only the status Indians, thus excluding Métis, Inuit, and non-status Indians), that it applies both on and off reserve, and that it covers any form of taxation, including licence fees and permit charges. To aboriginal people, the exemption is an inherent right stemming from their status as a sovereign people. The immunity from taxation by Canadian governments is recognized in treaties (among other declarations) and was to benefit Indians for "as long as the sun shines, the rivers flow, and the grass grows."

> First Nations did not give up their concept of sharing, or in the vernacular of today, taxation jurisdictions. No treaties mention it. In fact, at the time most of the treaties were entered into, there was no organized form of taxation in Canada. We take the position, accordingly, that at no time did our First Nations give up the right to govern ourselves, and at no time did we give up our jurisdiction in relation to taxation, a fundamental function of governing. (Mercredi 1991, 9)

This position is supported by the conclusions of the federal Royal Commission on Aboriginal Peoples (1993) that aboriginal peoples may not need any changes in the constitution to institute self-government. That right, they claim, was never relinquished.

Canadian governments, in contrast, take a narrower view, based on the Indian Act. Even the fact that governments refer to the aboriginal "exemption" implies a more narrowly defined special status than the aboriginal term, "immunity." In the Indian Act, status Indians are exempt from tax on

a) The interest of an Indian or a band in reserve or surrendered lands; and
b) The personal property of an Indian or band situated on a reserve. (Indian Act, section 87)

Status Indians are exempt from paying property tax on reserves, from sales tax and from many excise taxes when the good or service is to be consumed on a reserve, and from income tax when the income is deemed to be located on a reserve. The administration and interpretation of the breadth of the exemption is complicated by the lack of agreement on why the exemption or the immunity exists.

Many non-aboriginal people assume that the exemption is simply another tax expenditure intended to assist economic development in reserve communities. They claim it should be evaluated according to its success in achieving these goals, and, if found wanting, it should be changed or abolished. Others accept the argument that the exemption is a right of some sort, but interpret it very narrowly. They see the exemption as being rigidly limited to the reserve.

Clearly, from the aboriginal perspective of taxation immunity, the economic development rationale is the wrong focus for explaining their status. For them, a secondary but still important point is that a narrow interpretation of the exemption can hinder the development of reserves. For example, they argue that Indian corporations should be exempt from income tax. Because the Indian Act does not include corporations, Indian businesses must remain unincorporated in order to obtain the tax exemption, and this restriction denies them a significant tool of economic development.

Both facets of the aboriginal position were summarized in a submission we received from the United Chiefs and Councils of Manitoulin:

> As Native people, we never agreed to any form of taxation being imposed upon us. We never signed any treaties giving anyone the right to tax us. Nor did we ever give up our inherent right to self-government which includes the right of taxation. Accordingly, our First Nations retain exclusive jurisdiction over this matter and First Nations people are

exempt from tax as an aboriginal and treaty right which is protected under Section 35 of the *Constitution Act, 1982*.

Secondly, given the socio-economic conditions of Native people on our reserves and elsewhere, the imposition of taxation is grossly unfair. Governments should instead be working with First Nations to promote and enhance the Indian tax exemption as an incentive for increasing economic development and relieving the socio-economic conditions which prevail in our communities.

Specific conflicts reflect the debate over the rationale and scope of the immunity or exemption and also the vulnerability of the exemption to abuse, such as the resale of tax-free cigarettes on the black market.

Current Issues

Property Tax

While the exemption from property tax on reserves causes few problems, serious concerns arise over its extension to off-reserve property. According to the Department of Finance, "where property is purchased by the Crown with Indian moneys or moneys appropriated by Parliament for the use and benefit of Indians or bands, or is given to Indians or bands under a treaty or agreement, the property is deemed to be always situated on a reserve" (Canada Department of Finance 1993d, 9). The Ontario Assessment Act reinforces this interpretation in section 3(2), which indicates that any property held in trust for a band or body of Indians is exempt from property tax.

Individual Indians cannot receive the property tax exemption when they purchase lands off reserve. However, when a band purchases land it is deemed to be "held in trust" and is thus qualified for the exemption. Local residents often express concerns that individual Indians are living in band-owned properties off reserve tax free and that Indian bands are setting up businesses in their communities with an unfair advantage. Also, municipal governments are unable to enforce environmental standards or building codes, and they see their tax bases eroded.

In this context, it is worth noting our view of the municipal property tax as a benefit tax. On this basis all property should be subject to assessment and taxation. In the case of Indian-owned land, the provincial or federal government should make payments in lieu to the municipalities in recognition of the aboriginal exemption.

Sales and Excise Taxes

Disputes over the sales tax and excise tax exemptions are highly visible because of the number of transactions and the amount of money involved. Status Indians are exempt from sales and excise taxes for most goods bought for use on a reserve, though there is no exemption for alcohol.

The basic vulnerability of such a broad exemption to abuse is the most difficult issue to resolve; it is also the problem that provokes the most hostility among non-aboriginal people. Estimates suggest that millions of dollars per year in revenue are lost from the sale of tax-exempt cigarettes on the black market. These cigarettes are either smuggled through the reserves from the United States into Canada without bearing the appropriate tax or are purchased tax free because they are intended for consumption by status Indians. While specific measures have been taken, such as marking cigarette packages that have been subject to tax with a yellow strip, it is difficult to stop tax-free tobacco sales on the black market.

In other cases, problems arise from some merchants' abuse. For example, some vendors and suppliers seem to capture most of the benefit from the gasoline tax exemption by adding back as much as 90 per cent of the exemption to their prices at stations near reserves or on quantities shipped to reserve farmers. It has been noted by Ministry of Finance officials that the price of gasoline on reserves is only about 2 cents per litre cheaper than off reserves, while the Ontario tax that has apparently been removed is 14. 7 cents per litre.

Other vendors attempt to bolster government administration of the tax exemption with their own enforcement schemes. In some cases they refuse to honour the exemption from sales tax for status Indians they believe do not live on reserves, even if they have a federal identification card. Ministry officials apparently send reminders to these vendors to discontinue such practices. Still other vendors show little concern over granting the exemption whether people have identification cards or not. They simply give the exemption to anyone.

Beyond these deliberate acts that lead to frustration, there is also much real confusion about how to apply the exemption from sales and excise taxes. For example, car dealerships seem to use different standards to determine eligibility for the exemption. In some cases, the car must be delivered to a reserve, while in others a driver's licence with a reserve address must be shown. Again, aboriginal people are frustrated by this lack of consistency.

The introduction of the federal Goods and Services Tax has led to more problems. Indian community vendors refuse to collect the tax on behalf of the federal government, and individual status Indians are finding it difficult to obtain the exemption for reasons similar to those involving the retail sales tax.

Income Tax

Since income tax did not exist during the original drafting of the Indian Act, current discussions revolve around the applicability of the exemption to income. In 1983 the Supreme Court decision in *Nowegijick v. The Queen* established income as property to be exempt under the terms of the Indian Act. The decision also indicated that wages earned for work outside the reserve can be exempt from income tax if the location of the employer is on a reserve. If the cheque was mailed from a reserve, the income was considered exempt under the Indian Act. However, in 1992 the Supreme Court decision in the *Williams* case revisited the issue of income and the earner's location. The decision held that unemployment insurance benefits received by a status Indian were exempt from taxation even though the payments were made by Ottawa. The judges indicated that the exemption should apply because the previously earned income on which the payments were based would have been exempt. Thus, a simple reference to the address of the debtor is no longer sufficient to determine the exempt status of income.

The *Williams* case has opened the door to more disputes over the purpose of the exemption, which the federal government outlined as primarily to "preserve the entitlements of Indians to their reserve lands and to ensure that the use of their property on reserve lands is not eroded by the ability of governments to tax" (Canada Department of Finance 1993d, 10). In this particular case, the court allowed Williams an exemption even though the address from which the cheques were issued was not located on a reserve. However, the flip side of the decision is that the federal government has taken the position that in some cases the exemption will no longer apply. For example, Revenue Canada distributed a letter indicating that the income of many status Indians working off reserve will no longer be considered exempt. [1]

Ontario's Role in the Development of Aboriginal Self-government

While these current disputes and grievances tend to capture most of the headlines, another taxation issue will soon require the attention of aboriginal leaders and the provincial government. This issue relates to the emergence of First Nations self-government arrangements. It is likely that self-government will develop along several paths – land-based governments, agencies for the provision of specific goods and services, and perhaps new modes of aboriginal participation in existing federal and provincial institutions. Ontario may well turn out to be in the forefront of these developments, in part because of the Statement of Political Relationship signed by the provincial government and aboriginal leaders, which establishes the principle of government-to-government dealings between the two parties.

One form of Indian government that will emerge, and that may well be the dominant form, will be public government relating to current reserve territories plus any additional areas resulting from the settlement of land claims. These institutional arrangements will directly raise questions of taxation by these new governments of both aboriginal and non-aboriginal interests on these lands. Indian governments will, of course, continue to receive funding from the federal (and to a lesser extent the provincial) government, and for most communities these grants will constitute the majority of their public resources. However, if Indian governments are to succeed, it will be necessary for them to develop their own taxation sources as well.

As is the case with other governments exercising autonomy over particular areas, Indian governments could in principle tax their own citizens and non-residents with interests on Indian lands. The exis-

[1] Letter from Denis Lefebvre, assistant deputy minister, Revenue Canada Taxation, on the application of the Indian Act Tax Exemption, 29 December 1992.

tence of Indian government tax regimes will require that protocols be developed to coordinate their operation with the tax systems of the provincial and other non-aboriginal governments. Clearly one would want to avoid outcomes such as double taxation on the one hand, and, on the other, the complete avoidance of taxation because of location decisions or reporting gaps. A starting point for consideration of these issues is the model of the federal-provincial Tax Collection Agreements, and the interprovincial arrangements for the allocation of income.

The federal-provincial model may provide a guide for sorting out tax relationships between aboriginal and non-aboriginal governments, but it cannot be applied directly. The small size of aboriginal communities means that it is simply impractical for them to attempt to tax many bases directly, not only because of the mobility of their potential tax bases, but because of the overhead costs involved. In many cases, administration costs would likely exceed revenue collected. Moreover, in market transactions, formal distinctions between the two jurisdictions are often not made at all, and the paper trails that would be used to administer inter-jurisdictional tax coordination arrangements do not exist.

If the Indian government is to access these bases, tax harmonization agreements will be required with the federal or provincial government that already administers a comparable tax. In these cases the federal-provincial Tax Collection Agreements and allocation agreements become a useful model for aboriginal taxation. The principle that should be adopted from those accords is the recognition by each government of the taxing authority of the other, and the commitment implied in that recognition to coordinate tax systems where required.

In this context, there are two aspects to tax coordination. First, where an aboriginal government chooses to enter a tax field, the provincial and local governments should recognize that initiative and adjust accordingly. Second, where direct aboriginal taxation is not feasible, but there is still a desire by an aboriginal government to access the tax base, the province should be prepared to negotiate an administrative agreement to bring this into effect.

A brief consideration of possible arrangements in a few specific tax areas helps to illustrate these points. We consider them in ascending order of difficulty from the perspective of effective aboriginal government taxation.

The most straightforward tax for a First Nation government to implement would be a user fee tied to the consumption of specific services such as waste collection or water and sewage services. Because of the direct link between these taxes and the consumption of specific services, there really is no need for coordinating mechanisms with other governments.

Somewhat more complexity would be introduced with property taxes. In many cases, individual Indians do not hold land in fee simple. Land is regarded as belonging to the community, and land required for private uses such as housing is, in effect, leased to the occupant. In these cases, annual lease fees could be regarded as analogous to property taxes. Provincial and municipal governments do not tax these lands under the Indian exemption.

There may, however, be a tax collection role that the provincial or the municipal government could play to assist the Indian government. These established governments could provide assessment services where required, and, in some cases, could serve as the agency to administer the tax on behalf of the aboriginal government. It is not hard to imagine that for many communities, especially the smallest ones, this arrangement would involve much lower administration costs. Perhaps the greatest difficulty would be political. First Nation communities may be reluctant to enter into any arrangement that could create a perception that the tax was being levied by and paid to a non-aboriginal government.

Similar issues could arise with respect to payroll and general sales taxes. In theory, there is no reason why an aboriginal government could not levy these taxes if their structures were similar to the corresponding taxes in the surrounding jurisdictions and the rates were the same or lower. In practice, however, such taxes are impractical for very small jurisdictions to administer. Tax collection agreements with a neighbouring jurisdiction that already administers such taxes would seem to be a logical solution.

Finally, if Indian governments were to enter the field of income taxation, collection agreements would clearly be required, in this case with the federal government as well as the government of Ontario. Moreover, recognition of aboriginal taxing authority in this area may also provide the means by which existing tax disputes can be resolved. The membership of an aboriginal person in a First Nation and the authority of that nation to exercise taxing authority would clearly be recognized. Membership in a First Nation community could serve a similar function to the "province of residence on 31 December" rule for the interprovincial allocation of income with respect to non-aboriginals.

To summarize, clarification of the taxing authority of First Nation governments, and the recognition of this authority by other governments, can facilitate the aboriginal self-government process. In addition, it can help to sort out many of the tax disputes that currently occupy so much time and attention. Further, the readiness of Ontario to assist First Nation governments in the development of administrative mechanisms to enable them to collect their own taxes where feasible, and to collect taxes on their behalf in other areas, would be a concrete statement of goodwill and support to First Nation governments. While it is premature to specify details, we believe that a statement by the Ontario government indicating its willingness to work towards such arrangements is warranted.

RECOMMENDATION 125

Ontario should declare its readiness to negotiate tax harmonization accords with aboriginal governments and to help develop administrative arrangements to facilitate taxation by aboriginal governments.

Impact and Implementation

35 Tax Fairness and the Economy

Our overriding objective in formulating our recommendations was to enhance fairness in the distribution of the tax burden among taxpayers in Ontario. To this end, we have made many recommendations for changes to specific elements of the tax system. We have addressed issues in the design of existing taxes and proposed new taxes that we believe will contribute to the fairness of the overall tax system. We have also recommended a substantial shift in the tax mix involving a significant reduction in revenue from the residential property tax and an increase in revenue raised from personal income taxation. In addition, we have proposed many changes to the personal income tax system designed to improve the distribution of the tax burden within that tax base. These changes include modifying the rate structure, removing several non-refundable credits, and restructuring Ontario's refundable credits. In this chapter we present estimates of the impact of these proposed changes on taxpayers in different income brackets, as well as on the Ontario economy.

Impact on People

Our estimates of the impact of these changes on census families[1] in Ontario are derived from special calculations using Statistics

---

[1] Refers to a husband and a wife (with or without children who have never married, regardless of age), or a lone parent of any marital status (with one or more children who have never married, regardless of age), living in the same dwelling. For census

Canada's Social Policy Simulation Database and Model. This model allowed us to estimate the impact of both property and income tax changes on families in Ontario. We did not model any of our recommended tax changes that require changes in federal tax laws. For example, recommended changes in the tax treatment of capital gains and dividends and our proposal for a new national wealth transfer tax are not accounted for in this analysis. The specific changes we considered for this modelling exercise are limited to those changes Ontario can pursue on its own. These changes are listed in table 35.1.

Overall Impact of Tax Mix and Income Tax Changes

Although there would be no impact on the total tax revenue collected by governments, the impact of these proposed changes would be significantly progressive. They would reduce the amount of income, property, and sales tax paid by families with incomes up to about $40,000, and they would increase the amount of tax paid by families with incomes in excess of $50,000. Families with incomes in excess of $90,000, whose average income is $150,000, would pay on average an extra $1950 in tax. This would amount to a 1.6 per cent decline in their disposable income. The net impact would be to increase taxes on this highest income group in total by about $890 million and to redistribute this revenue downward, targeting especially those with incomes below $30,000 (table 35.3).

purposes, persons living in a common-law type of arrangement are considered as now married, regardless of their legal marital status; they accordingly appear as a husband-wife family in most census family tables. An unattached individual is regarded as a census family in our analysis.

TABLE 35.1
Summary of Proposed Changes

Item	Recommendations
1. Ontario tax reduction, Ontario property tax credit, and Ontario sales tax credits	Eliminate. Replace with: a) New Ontario tax assistance credit $500 per adult per year $300 supplement for adults aged 65 and over (maximum amount of credit paid up to $18,000 family income; credit reduced at 8.3 per cent for family income above $18,000) b) New Ontario child credit $600 for first child $500 for each additional child $400 supplement for single parent family (maximum amount of credit paid up to $18,000 family income; credit reduced at 7.5 per cent for family income above $18,000)
2. Ontario portion of marital credit, equivalent-to-married credit, age credit, and pension income credit	Eliminate
3. Tax mix shift	a) Reduce property tax by $3.5 billion b) Increase income tax by $3.0 billion c) Revenue increases from other tax changes of $0.5 billion
4. New income tax rate structure	a) Eliminate Ontario surtax on high incomes b) New Ontario basic exemption: - amount claimed = federal exemption - credit rate = 10% (lowest provincial rate) c) New income tax rate structure (see table 35.2 and recommendation 123)

TABLE 35.2
Proposed Income Tax Rate Structure with and without Property Tax Changes, 1993

Taxable income ($)	Rate with tax mix change (%)	Rate without tax mix change (%)
10,000 and under	10	7
10,001–20,000	12	9
20,001–29,590	14	12
29,591–40,000	16	14
40,001–50,000	18	16
50,001–59,180	20	18
59,181–80,000	22	20
80,001–100,000	24	22
100,001–150,000	24	24
150,001–250,000	26	24
Over 250,000	28	26

TABLE 35.3
Estimated Impacts of Proposed Changes by Income Group Resulting from Changes to Income, Property, and Sales Taxes, 1993 (Census Families)

Total income group ($)	Total Ontario tax impact ($ millions)	Average dollar impact ($)	% change in disposable income
10,000 and under	236	580	9.6
10,001–20,000	641	690	4.9
20,001–30,000	290	440	1.9
30,001–40,000	21	40	0.1
40,001–50,000	-9	-20	-0.1
50,001–60,000	-35	-90	-0.2
60,001–70,000	-39	-130	-0.2
70,001–90,000	-25	-70	-0.1
Over 90,000	-887	-1950	-1.6
Total	192[a]	40	0.1

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

a. Overall amount of tax to be raised through recommended changes to other taxes. See table 33.4.

Note: Negative sign indicates decline in disposable income/increase in tax; otherwise indicates increase in disposable income/decline in tax.

TABLE 35.4
Estimated Impact of Tax and Tax Credit Changes on Ontario Families, 1993
Average Dollar Change in Taxes Paid

Total income group ($)	Married couple, no children	Married couple, with children	Single parent families, all	Unattached non-elderly individual	Unattached elderly individual
			$		
10,000 and under	970	2100	1510	380	520
10,001–20,000	1080	1610	1530	520	400
20,001–30,000	570	1100	910	140	-450
30,001–40,000	-50	330	370	-200	-630
40,001–50,000	-110	150	350	-280	-510
50,001–60,000	-310	80	150	-350	-1280
60,001–70,000	-280	0	-190	-430	-1260
70,001–90,000	-350	60	80	-500	-910
Over 90,000	-2450	-1500	-4250	-4140	-2160
Total	-200	-90	680	130	150

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Note: Negative sign indicates decline in disposable income/increase in tax; otherwise indicates increase in disposable income/decline in tax.

The New Rate Structure

The largest single tax change we are proposing is to reduce the residential property tax by $3.5 billion. Approximately $3 billion of this amount would be shifted to the personal income tax and the remainder would be generated by changes to the retail sales tax, payroll taxes, and other small tax changes (see chapter 33). The higher levels of income tax will of course be offset by the reduction in the property tax burden (part of which will be reflected in tenants' rents) faced by residents in Ontario as a result of the tax mix change. Because the property tax is regressive and the income tax system is progressive, the combined effect of these changes will be to shift the burden of taxation from people with lower and middle-range incomes towards people with higher incomes and a greater ability to pay.

TABLE 35.5
Estimated Impact of Tax and Tax Credit Changes on Ontario Families, 1993
Per Cent Change in Disposable Income

Total income group ($)	Married couple, no children	Married couple, with children	Single parent families, all	Unattached non-elderly individual	Unattached elderly individual
			%		
10,000 and under	17.6	29.3	22.8	6.4	9.3
10,001–20,000	6.7	9.7	10.7	3.8	3.0
20,001–30,000	2.4	4.5	3.7	0.6	-2.0
30,001–40,000	-0.2	1.0	1.2	-0.7	-2.0
40,001–50,000	-0.3	0.4	0.9	-0.7	-1.3
50,001–60,000	-0.7	0.2	0.3	-0.8	-2.6
60,001–70,000	-0.5	0.0	-0.4	-0.8	-2.3
70,001–90,000	-0.5	0.1	0.1	-0.8	-1.5
Over 90,00	-1.9	-1.3	-2.7	-2.7	-1.7
Total	-0.4	-0.1	2.2	0.6	0.8

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Note: Negative sign indicates decline in disposable income/increase in tax; otherwise indicates increase in disposable income/decline in tax.

We recommend renegotiation of the federal-provincial Tax Collection Agreements to permit Ontario to control its own rate structure. Within this new framework we recommend that Ontario increase the number of tax brackets and establish its own rate structure. In recommending this change in rate structure, we are guided by the desire to ensure that middle-income earners not face an increase in their marginal tax rates. The effective Ontario marginal tax rate currently is 22 per cent at incomes of about $63,000. The new tax structure we propose would keep the same rate between $59,180 and $80,000. Table 35.2 shows our recommended rate structure required to generate an increase of $3 billion in income tax revenue, compared with the rate structure that would be required without the tax mix changes.

TABLE 35.6
Estimated Change in Tax Credit Benefits for Ontario Families, 1993: Total Cost

Total income group ($)	Married couple, no children	Married couple, with children	Single parent families, all	Unattached non-elderly individual	Unattached elderly individual	All
			$ millions			
10,000 and under	10	11	54	45	3	122
10,001–20,000	45	71	139	71	46	372
20,001–30,000	78	97	81	12	-12	255
30,001–40,000	-5	48	28	0	-4	67
40,001–50,000	-6	23	12	0	0	28
50,001–60,000	-1	24	5	0	0	27
60,001–70,000	-2	24	4	0	0	26
70,001–90,000	0	49	8	0	0	57
Over 90,000	-1	76	5	0	0	80
Total	117	422	336	128	32	1035

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Note: Negative sign indicates decline in disposable income/increase in tax; otherwise indicates increase in disposable income/decline in tax.

At this lower end of the income spectrum there would be significant reductions in taxes paid. Families with incomes below $10,000 would experience an average drop of $580 in the taxes they pay each year. This decline would result in a 10 per cent increase in their disposable income. Families with incomes in the $10,000 to $20,000 range would experience an average decline of $690 in the amount of tax they pay annually, resulting in a 5 per cent increase in their disposable income. These decreases in taxes paid and increases in disposable income are significant for these low-income families. Families in the middle-income ranges, $40,000 to $90,000, would experience minor changes in the amount of taxes they pay and in their disposable incomes.

Impact by Family Type

This shift in the tax burden to higher-income groups is accomplished through the combined effects of the proposed changes. In some cases specific changes were proposed to shift government tax relief from one group to another, or within a group downward to lower-income families in that group. For example, the elimination of the Ontario portion of the federal non-refundable age credit would shift Ontario's current tax relief efforts for seniors from support of higher-income elderly families to lower-income elderly families because the new refundable credit would go to all low-income seniors, including those who don't pay income tax. The changes we have proposed for the restructuring of the Ontario refundable tax credits would increase disposable income for low-income families with children to a relatively greater extent than for families without children. For the reasons we have discussed in chapter 16, these shifts are desirable from the point of view of both tax fairness and social policy.

Single parents as a group would derive the greatest benefit from these tax changes. On average, single parents in Ontario would experience a decrease in their tax burden of $680 per year (table 35.4), increasing their disposable income by 2.2 per cent (table 35.5). The tax and credit changes for single parents with incomes of less than $20,000, almost all of whom are women, would, on average, result in an increase in after-tax income of approximately $1500 per year. For single parents with incomes in the $10,000 to $20,000 range this means an 11 per cent increase in their disposable income. Given the high rate of poverty among single parents and the importance attached to reducing child poverty, this outcome is highly desirable. Single parent families in the highest income group, whose average income is almost $200,000, would experience a net increase in their tax payable of $4250 per year and a decline in their disposable income of 2.7 per cent.

Low-income couples with children would also experience a large reduction in the taxes they pay and a corresponding increase in their disposable income (table 35.4). The reduction in the overall tax burden for couples with children affects all income classes except those with incomes over $90,000. Couples without children experience a net increase in the tax burden of about $185 million, but this comes from an increase on those childless couples with incomes in excess of

$50,000, while childless couples with incomes below $30,000 experience a reduction in taxes and an increase in disposable income.

Unattached elderly individuals are net beneficiaries. As a group their combined tax decrease and credit increase amount to $81 million. Single elderly people at the lowest income levels – below $20,000 – would experience an increase in their disposable income, but those with incomes above $20,000 would experience an increase in their taxes and small percentage declines in their disposable income. Changes to the tax relief provisions for the elderly combine to produce this result, most notably the elimination of the special provisions in the Ontario property tax credit that provide a richer supplement to elderly people at higher income levels. Moreover, many unattached elderly individuals are not large beneficiaries from the property tax reduction.

Impact of Proposed Refundable Tax Credit Changes

We are presenting the impact of all the proposed changes together because we see the need to treat these proposals as part of a package. The restructuring of Ontario's refundable tax credits is a crucial part of the package.

Despite the fact that the recommendations are integrated in a single package, however, it is useful to look at the costs of the revised credit structure and how the benefits from our proposed new credit system are distributed. Table 35.6 shows the difference in total spending between our proposed credit structure and the old credit structure. The net difference between the two is $1.04 billion. In other words, revising the refundable credits in the way we have proposed would require Ontario to spend this amount more on refundable credits. It is important to keep in mind, however, that our proposal is, in total, revenue neutral and that it involves no net new spending by Ontario. The additional revenue required to increase the value of the credits is generated through recommended changes in income tax rates and through other recommended changes in the tax system. Single parents are the largest beneficiaries of the changed credit system, along with families with children (table 35.7).

TABLE 35.7
Estimated Average Change in Benefits as a Result of Restructured Tax Credits, 1993, for Ontario Families

Total income group ($)	Married couple, no children	Married couple with children	Single parent families, all	Unattached non-elderly individual	Unattached elderly individual	All
	$ per family					
10,000 and under	590	1200	1160	140	130	300
10,001–20,000	620	1410	1290	230	120	400
20,001–30,000	420	950	970	60	-160	380
30,001–40,000	-30	310	530	0	-190	130
40,001–50,000	-50	120	320	0	-30	60
50,001–60,000	-10	120	240	0	-10	70
60,001–70,000	-20	130	200	0	0	80
70,001–90,000	0	210	420	0	0	160
Over 90,000	0	260	320	0	0	180
Total	130	300	830	110	60	230

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Note: Negative sign indicates decline in disposable income/increase in tax; otherwise indicates increase in disposable income/decline in tax.

Impact on Poverty Rates

The package of recommended changes would contribute to the alleviation of poverty in Ontario. Table 35.8 presents the estimated percentages of families in Ontario currently below the low-income cut-off (LICO) level and shows what the incidence of poverty would have been if our proposed changes had been in place in 1993. Overall, the rate of poverty (percentage of families below the LICO) would have been about 1 per cent lower. This figure represents a decrease of about 50,000 in the number of Ontario families below the LICO, about 7 per cent of the current total. The largest proportional improvement occurs among single parent families; the incidence of poverty for this group declines by more than 2 per cent.

TABLE 35.8
Estimated Incidence of Poverty with and without Commission Recommendations in Place, 1993

	% of families currently below low-income cut-off	% of families below low-income cut-off after commission reforms
Married couple, no children	4.7	3.8
Married couple, with children	6.9	6.0
Single parent families, all	31.5	29.3
Unattached non-elderly individual	28.3	27.3
Unattached elderly individual	20.0	19.0
All families	15.9	14.8

Source: Fair Tax Commission estimates based on Statistics Canada Social Policy Simulation Database and Model (SPSD/M).

Impact on the Economy

In formulating our recommendations to increase the fairness of the tax system in Ontario, we were aware of the need to consider their economic impact. This section presents the estimated impact of our recommended tax mix changes on selected provincial economic indicators, on selected labour market indicators, and on the provincial government's fiscal situation.

We analysed the impact of our recommendations on the Ontario economy from 1995 until 2001. The analysis is based on the assumption that the entire package will be in place in 1995 and was carried out for the commission by the Policy and Economic Analysis Program (PEAP) at the Institute for Policy Analysis at the University of Toronto. PEAP used the FOCUS-ONTARIO model of the province's economy. The results of the analysis are expressed as differences from what has otherwise been forecast for the Ontario economy from 1995 to 2001. Readers interested in PEAP's long-range economic forecast for the province may refer to "The Macroeconomic Impacts of Harmonizing the Ontario Retail Sales Tax with the Federal GST: Simulations with the FOCUS-ONTARIO Model" in the volume of the Fair Tax Commission's Research Series entitled *Issues in the Taxation of Individuals*.

The FOCUS-ONTARIO model was used to analyse the economic impact of the major tax revenue shifts that result from our recommendations, including:

- a decrease of $3.5 billion in revenue from residential property tax;
- an increase of $3.0 billion in revenue from the personal income tax;
- coordination of the retail sales tax and the Goods and Services Tax at a rate of 8 per cent, which results in a revenue increase of $300 million;
- elimination of the graduated rates in the payroll tax, which results in a revenue increase of $150 million; and
- elimination of the manufacturing and processing rate in the corporate income tax, which results in a revenue increase of $50 million.

These changes do not reflect all our recommendations, but only those expected to have a significant impact on the economy. For example, our recommendation 115 to replace the education portion of the commercial and industrial property tax with a provincial commercial and industrial property tax is not included in the analysis because, from a macroeconomic perspective, there is no change in net revenue. We also asked that the modelling reflect only those changes that Ontario can make unilaterally, and not those that require changes to federal taxes. Thus, the impact on the economy of the proposed national wealth transfer tax and measures that change the base of the personal income tax are not included.

Overall, the recommendations that were modelled have a marginally positive impact – right through to 2001 – on the Ontario economy, the Ontario labour market, and the Ontario government's fiscal position, in particular the provincial deficit.

TABLE 35.9
Estimated Impact on the Ontario Economy and Government Finances of the Commission's Recommendations

	1995	1996	1997	1998	1999	2000	2001
Economic Effects	Percentage difference from the base case						
Real GPP	0.3	0.5	0.7	0.8	0.8	0.8	0.8
Consumption	-0.5	-0.5	-0.5	-0.3	-0.3	-0.3	-0.2
Investment	1.6	2.7	2.5	2.7	2.6	2.5	2.4
Exports	0.2	0.3	0.4	0.5	0.5	0.5	0.5
Labour market effects							
Unemployment rate	-0.1	-0.2	-0.1	-0.2	-0.1	0.0	0.0
Labour productivity	0.1	0.2	0.5	0.5	0.6	0.7	0.8
Consumer Price Index							
(Ontario)	-1.1	-1.2	-1.4	-1.6	-1.7	-1.8	-1.9
	$ billions difference from the base case						
Provincial government balance	0.2	0.3	0.4	0.5	0.5	0.6	0.6

Source: Institute for Policy Analysis, University of Toronto, FOCUS-ONTARIO Model.

Economic Effects

The FOCUS-ONTARIO model estimates that our recommendations will have a small positive impact on Ontario's gross provincial product (GPP), the value of all goods and services produced in the province in a given year. The results are summarized in table 35.9. In real terms – that is, after factoring out inflation – the GPP would be higher than the level otherwise projected by 0.3 per cent in 1995, by 0.5 per cent in 1996, by 0.7 per cent in 1997, and then by 0.8 per cent in each of the years from 1998 to 2001. Because the Ontario economy is such a large component of the Canadian economy, the national gross domestic product (GDP) is also predicted to increase above the otherwise expected level as a result of our recommendations. In real terms, the national GDP is predicted to be between 0.1 and 0.3 per cent higher than otherwise expected in each year from 1995 to 2001.

Our recommendations result in a lower level of consumption than would otherwise occur. This reduction is largely attributable to the fact that the application of Ontario's retail sales tax to a number of goods and services that are currently exempt increases total sales tax revenue, even after accounting for input credits for business. This results in a reduction in consumer demand for these products. In each year from 1995 to 1997, consumption is predicted to be lower by half a per cent than otherwise expected, and in each year from 1998 to 2000 consumption will be lower by 0.3 per cent.

Although consumption would be somewhat lower than would otherwise be the case, investment is predicted to be higher than otherwise expected. In particular, investment in machinery and equipment is predicted to be 2.3 per cent higher in 1995 than would otherwise be the case, 3.8 per cent higher in 1996, and 3.6 per cent higher in each year from 1997 to 2001. This positive impact is largely attributable to the removal of the retail sales tax from business inputs. A steadily growing positive effect on investment in non-residential construction is forecast as a result of our recommendations. This category of investment is predicted to be 1.2 per cent more than otherwise expected in 1995, growing to 3.1 per cent more in 1998 and 1999, and 2.9 per cent more in 2001.

Finally, exports are predicted to increase slightly above the otherwise expected level, largely as a result of the application of input credits that would remove the retail sales tax now embedded in the cost of exported goods.

Labour Market Effects

The tax reforms we recommend are predicted to have a slight positive impact on the unemployment rate in the province and to result in a slightly higher level of labour productivity than otherwise expected. The unemployment rate is predicted to be between 0.1 and 0.2 percentage points lower than it would otherwise be and labour productivity is predicted to be higher, although by less than 1 per cent annually.

Impact on the Ontario Government's Balance of Revenue and Expenditure

Our recommended changes to the tax mix are structured to be revenue neutral. However, the economic growth that is predicted as a result of our recommendations is assumed to lead to increases in the Ontario government's tax revenue. This increase in revenue will lead to a lower than otherwise expected deficit. Results from the model show that in 1995 the provincial government's deficit will be $200 million less than otherwise expected, and by 2001 the deficit will be $600 million lower than expected.

Inflation

Our recommendation to remove funding for education from the property tax will have the effect of reducing residential property taxes and, thus, the cost of housing included in the Consumer Price Index (CPI). CPI measures increases in the price of a "basket" of commonly consumed goods and services. Property taxes are included in the CPI as a component of housing costs. As a result of the reduction in property taxes, the CPI for 1995 is predicted to be 1.1 per cent lower than otherwise in 1995, with an even lower level predicted in subsequent years. Thus, the inflation rate would experience a one-time reduction of 1.1 percentage points in 1995 and would be reduced marginally in subsequent years.

36 Local Government

In part eleven of our report, we present an analysis of the issues facing local government finance. We develop a framework for local government finance reform with a view of the property tax as a local benefit tax as its centrepiece. And we propose a comprehensive package of reforms consistent with that framework.

Taken together, we believe that these reforms will both improve significantly the fairness of the system of local government finance and create the opportunity for Ontario to increase significantly the progressivity of provincial and local taxes combined.

This chapter deals with the implications of these changes for Ontario's institutions of local government, school boards and municipalities.

Education Finance Reform

Our recommendations on the financing of education would transform the financial base for elementary and secondary education in Ontario. Locally determined property taxes currently account for approximately 60 per cent of these educational costs. Taken together, our recommendations would reduce that share dramatically. Commercial and industrial property taxes and business occupancy taxes currently levied at the local level for school board purposes would be eliminated. The local levy on residential property for education would be limited, probably to no more than 10 per cent of total education spending. Assuming that, overall, half the potential local levy of approximately $1.4 billion is actually exercised by local school boards, residential taxes for education would be, on average, approximately 16 per cent of their current levels.

The proposed changes have profound implications, both for the provincial government and for local school governance.

Funding Adequacy

The implementation of a financing system that is largely independent of the size of the local property tax base places enormous pressure on the provincial funding allocation formula. It must reflect adequately the differences in expenditures required to provide an accepted standard of educational services to different student populations in different communities. The proportion of total education spending in Ontario that is determined by the provincial funding formula will increase substantially. Equity in funding does not mean equality in funding. It means funding that is sensitive to recognized differences in the costs of achieving provincially mandated educational objectives with different student populations in different communities.

The current system has survived not because it has done a reasonable job of reflecting the local costs of achieving Ontario's educational objectives, but because its failure to do so has no direct impact on what actually takes place at the school board level. Revenue reform without funding reform would impose huge penalties on school boards that have had to rely heavily on local property tax revenues to offset the deficiencies of the current provincial funding approach. An effective funding allocation system is critical to the success of the package of reforms proposed in our report. To proceed with revenue reform without a dramatically improved funding allocation system would be disastrous for the education system because it would simply replace one set of inequities with another.

The proposed changes also have important implications for provincial education programming decisions. In the current system, with its technically open-ended local property tax revenue base, there is no direct relationship between the programs and standards mandated by the provincial government and the amount of money it allocates for education. With local property taxes available to pick up the slack, the provincial government over the period from 1974 to 1993 has established progressively higher (and more costly) standards for education at the same time as it has been reducing its share of the costs. In effect, the various ministries that have been responsible for education have had an independent source of revenue from which to draw to pay for ministry programs and policies. Because that source of revenue, the local property tax, does not go through the provincial consolidated revenue fund, it has traditionally been insulated from the impact of provincial spending restraint initiatives. With the provincial government more fully responsible for the fiscal impact of its program decisions, far more discipline will be introduced into the system at the provincial level.

Our recommendation to increase the provincial government's share of education funding is not without precedent. The Ontario Committee on Taxation (Smith Committee) in 1967 recommended that the provincial share of total education funding be increased to 60 per cent, a goal that was in fact achieved briefly in the early 1970s. The lack of any limit on the use of local tax sources to support educational programming made it possible for the provincial government to let its financial commitment to education erode with relatively limited consequences for what actually went on in Ontario's elementary and secondary classrooms. In effect, the provincial government was able to draw on local property tax revenues to support the educational system without acknowledging that fact.

The limit we have proposed on local access to the property tax base for education funding is intended to bind in two ways. On the one hand, it is intended to restrict the ability of local school boards to impose higher local taxes to support higher local spending levels. On the other hand, it is intended to force the provincial government to be more realistic in its approach to funding education by cutting off its back-door access to local property tax revenues.

Education Governance

In our hearings and in other consultations with the public, the only consistent objection that was raised to the idea of shifting the funding base for education from local property taxes to provincial revenue sources concerned the potential impact of such a move on the effectiveness of school boards as local democratic institutions. School trustees and other active participants in the education governance system argued that the elimination of local funding for education would make the system unresponsive to local conditions. They pointed out that school boards, if they cease to be responsible for levying taxes for most of their spending, will no longer be accountable to their electorates for their actions.

We share this belief in the importance of local governance in ensuring that the education system is appropriately responsive to local needs and conditions. In recommending a limited local discretionary levy on residential property, we also accept the need to provide some local resources in response to local conditions. We do not believe, however, that providing a fair funding system for education in Ontario will destroy the foundation for democratic decision making in the education sector.

Can there be effective local representation without taxation? Some might suggest that local accountability arises from a local funding base. However, Ontario does not maintain school boards simply for the purpose of overseeing the spending of locally raised property taxes. If that were the case, that responsibility could just as easily, and much more efficiently, be exercised by municipal governments. Democratic accountability of school boards is and should be based on the educational services they deliver. In other words, the foundation for democratic accountability in the education sector should be services, not local taxes.

Issues related to education governance were raised repeatedly by participants in our public consultations. Much of the attention was focused on the fact that most parts of Ontario are served by more than one school board. Extensively publicized conflicts between public and separate school boards over facilities, highly visible overlaps in student transportation services, the obvious duplication inherent in each board's central administrative facilities, an electoral system that results in dozens of trustees seeking office in some electoral districts, and the sheer complexity of the entire system as experienced by the average person have combined to create a negative impression of governance and administration in education. Rightly or wrongly, school boards have become symbols for many people of waste, duplication, and inefficiency in the provision of government services.

Participants in our hearings made a wide range of proposals: abolition of school boards entirely; replacement of school boards with committees drawn from municipal councils; further consolidation of school boards into larger administrative units; reduction of the number of trustees; mandatory sharing of school facilities; and the creation of unified school boards under which all school systems in a given geographical area would operate.

Local School Governance in Ontario

Elementary and secondary education in Ontario has a long history as a local undertaking. The earliest local governments in many parts of the province were school boards, not municipalities. The last major educational reform in Ontario in the 1960s produced a dramatic reduction in the number of school boards (from more than 3000 to fewer than 200 by 1969) and greatly increased provincial financial support and influence (Ontario 1985, 17). Despite these changes, local governance remains an important structural feature of Ontario's public education system. The constitutionally protected status of the Roman Catholic separate school system in Ontario tends to reinforce the local character of the system as a whole.

The system of local governance in education has come under great stress in recent years. Questions emerged in our public hearings about its responsiveness to changing economic circumstances, about our ability to afford the duplication of services and facilities that is inevitable in parallel systems, and about the overlap in responsibilities inherent in a system that is funded and controlled both centrally and locally. At the same time, the idea that the best decisions are made by people who are responsible to the community in which services are delivered continues to be a fundamental principle of our political culture. The problem of finding new forms of governance consistent with changing economic circumstances, educational needs, and basic political values is extremely difficult.

School Governance Reform in Other Jurisdictions

This problem is mirrored in countless other jurisdictions around the world. Many variations have been tried in recent years to make school governance more inclusive, more responsive, more accountable, and more cost-efficient. Few jurisdictions now govern their school systems entirely from the centre without any measure of local control by democratically elected bodies. Most recent reforms have concentrated on school-based governance and have called into question the role or even the continued existence of a middle tier of governance corresponding to the school boards in Ontario.

A representative sample of recent reforms shows the variety of models used by different jurisdictions attempting to decentralize school decision-making powers. In Canada, various jurisdictions (Edmonton is a well-known example) have devolved responsibility for school budgeting and management to individual schools. Quebec was the first province to link this devolution to the creation of mandatory democratic decision-making bodies at the local level. Parental representation is required on school committees that determine annual educational program plans, discipline codes, pupil placement and guidance, and various extracurricular and ancillary programs (including school-based day care). The school boards retain responsibility for capital planning, resource allocation, the school calendar, and standards for evaluation and promotion. However, in order to strengthen the voice of parents at the school board level, two non-voting parent commissioners sit on each school board.

In the New Zealand reform of 1989, most powers were transferred from regional education boards to school-based boards of trustees composed largely of elected parent representatives. The regional boards were closed down within a year or so. Some observers felt that the move was too hasty and produced unanticipated effects such as a massive privatization of many of the school support services formerly operated by the regional boards. The impact of such reforms has been to remove the buffer of regional governing bodies and to strengthen central control of policy.

In England and Wales, a similar reform was embedded in the British Education Reform Act of 1988. It too served a centralizing purpose, as was illustrated by the simultaneous introduction of a highly prescriptive national curriculum and a regime of frequent nationwide testing. The erosion of regional government was expected to occur as and when local populations desired it. School-based councils dominated by parents were mandated and given the power, among other things, to opt out of Local Education Authority control and to relate directly to the national Department of Education and Science. A small number of schools have taken advantage of this option, but a new white paper published in 1993 is designed to increase this number.

In the Chicago School Reform of 1989, significant powers and funds were transferred from the central school board to local school-based councils dominated by parents and community members. School-based councils assumed responsibility for hiring principals and setting the school budget. The school board has remained in place, with a significantly reduced administrative staff complement and budget, to sustain such system-wide functions as allocating funds for the promotion of equity, collective bargaining, and services whose provision is subject to economies of scale. Between the board and the school councils are area councils based on "families" of schools. They consist of school parent/community representatives who hire one official to monitor individual school performance and to ensure that the local elementary school programs are well coordinated with the local secondary school programs. Comparable reforms have taken place in many US jurisdictions such as New York, Rochester, Philadelphia, Cincinnati, Denver, and Dade County, Florida. Many of these jurisdictions share decision-making power more equally between teachers and parents.

In France over the past 25 years, decision-making powers in a highly centralized system have been devolved to school-based councils consisting of parents, teachers, administrators, community representatives, and senior students. A weak middle tier of governance was exercised through municipal and regional bodies that were responsible for the maintenance of physical plant. Over the period, however, the demand to expand the mandate of this middle tier by decentralizing decision-making power away from Paris has led to a multi-tiered education governance model into which universities and other post-secondary institutions are also beginning to be incorporated.

The role of the middle tier, corresponding to our school boards, is noteworthy. All these reforms (with the exception of that in France) began with the intention of eliminating the middle tier or reducing its power. However, except in New Zealand, the middle tier has survived and is seen to be playing a valued role in providing services that cannot be delivered efficiently at the school level. In France, the role of regional governance in educational decision making is now expanding as policy makers increasingly strengthen the links between regional planning and community development on the one hand, and education programming and infrastructure on the other.

The trend towards school-based governance and concern about costs and duplication suggest that financial reform will add to the pressures for change in education governance.

School-based governance reforms have generally not been rooted in concerns related to financial management, although this was a factor in New Zealand and in Britain. Typically their stated objective was to improve the performance of the public school system with respect to its fundamental educational purposes. While it is not our mandate to develop such a statement, it would inevitably include excellence in the quality of service delivered, equity in its availability to students, responsiveness to differences in the needs and capabilities of students, and effectiveness in building the groundwork for the educated workforce Ontario requires to succeed in a modern economy.

School-based governance models are based on two propositions: that the most important determinant of the school system's ability to succeed is what goes on within the walls of the local school; and that the stakeholders in a system with multiple purposes, operating in a diverse society, are best represented in a governance system that is more flexible and more responsive than the traditional municipally based governance system, such as Ontario's. Other things being equal, these considerations might point towards the replacement of regionally or municipally based governance with school-based governance.

At the same time, most of the jurisdictions discussed above have retained some form of regional democratic structure, whether they originally intended to or not. This suggests that there are a number of functions that cannot be performed effectively at the local school level or at the centre.

Constitutional Questions

In Ontario, reform of education governance must take into account constitutional and legal rights to separate (Roman Catholic) education and to instruction in the French language. The traditional linking of these entitlements to funding and governance has complicated the education governance system in Ontario. Democratically elected public and separate school boards have operated in parallel throughout Ontario's history. Two developments in the 1980s have both increased the complexity of the system and given it more visibility. The extension of support for separate education to grade 13 expanded the role of the separate boards and, by giving rise to conflicts among boards, heightened their public profile. At the same time, the recognition of entitlements to instruction in French or English carried with it the establishment of independently elected governing bodies in some parts of Ontario. It is in those areas of the province that public concerns about duplication and inefficiency are most acute.

Revenue Reform and Governance Reform

We believe our recommendations concerning education finance could serve as a catalyst, eliminating some of the obstacles that might otherwise stand in the way of education governance reform. If the financial resources available to a particular school no longer depend on the local property tax base to which the board responsible for the school has access, the educational stakes associated with governance reform are significantly reduced. The task is to find a new model for governance that responds to concerns about cost and duplication, is sensitive at a system-wide level to changing demographic and other realities, respects legal and constitutional rights, and is consistent with the changes we have proposed for the education financing structure.

A model that has some basis for a fair balance among the various pressures on the governance system would include both school-based and regional governance structures. School-based governance would have to be designed to take into account the need to coordinate elementary and secondary school programs. The regional elected bodies would be responsible for the provision of common functions and the delivery of common services within the region, for the strategic planning of infrastructure and educational programs, and for the promotion of educational equity within their communities. In such structures, school-based governance structures would retain their constitutionally protected identities (public/separate, English/French). The regional bodies, in contrast, could be unified, with appropriate protections built in for minority rights.

Municipal Finance Reform

Our recommendations call for a system of local government finance in Ontario in which municipal governments exercise increased power over taxation policy. They would wield this authority within a provincial policy framework that is clearly defined and rooted specifically in principles of tax fairness. Those principles would also provide an alternative basis for continued progress in the rationalization of the provincial-municipal financial relationship. We recommend changes in the funding of certain services and in the basis for allocating provincial financial support to local government. Local governments would take on more financial responsibilities with respect to services of local benefit, which are appropriately funded from local benefit taxes. The provincial government would take on more financial responsibility with respect to services of provincial benefit, which are appropriately funded from general provincial revenue sources and better related to ability to pay.

Our proposed municipal financial system would recognize the fact that the property tax is actually two taxes: a tax on the housing occupied by residents of the municipality; and a tax on property used by businesses operating in the municipality. Municipalities would have the power, within broad limits, to exercise taxation policy by establishing rates for each of these taxes independently of each other. We also propose that municipalities rely much more heavily on user charges for sewer, water, and solid waste services.

Clarifying Provincial and Municipal Roles

Our recommendations answer a long-standing grievance on the part of municipal governments by making them responsible for the spending of a much larger proportion of the money they raise from the property tax. School board funding from local property taxes would be dramatically reduced to the limited discretionary levy on residential property.

Although the provincial government might wish to make administrative arrangements with municipalities for the collection of the proposed provincial tax on commercial and industrial property, it would be levied explicitly as a provincial tax. Elimination of the business occupancy tax, with its associated administrative problems for municipal governments, would also simplify and rationalize the local taxation system.

This reformed system has important implications for the local political system. By making explicit policy differences in local taxation that are currently buried in the assessment system, our proposals will make differences in tax rates between types of property obvious to taxpayers. These differences will clearly play a role in the local political agenda.

Our proposals with respect to exemptions from taxation will have a similar effect. The provincial government would assume full responsibility for the costs to local governments of exemptions from local taxation that it considers to be appropriate. And assistance offered by municipalities to local taxpayers would have to be offered on the expenditure side of the local budget rather than through tax exemptions.

Our recommendations with respect to provincial grants policy and the allocation of financial responsibility for programs between the provincial government and municipal governments follow this same direction. In particular, we recommend that the provincial government continue with its reform of social assistance financing and assume full responsibility for financing of services to children. We also propose that the province reduce its grants to municipal governments for services of local benefit by $700 million (for a net impact of $624 million after allowing for provincial assumption of full funding for children's services). The limited success of the Provincial/Local Relationship Review (the recent provincial initiative known as disentanglement, abandoned in 1993) in arriving at trade-offs between financial and program responsibilities underlines the difficulties in achieving reform in this area.

We believe, however, that the approach we recommend could give significant new impetus to this area of reforms because it responds to a number of the lessons from that experience. First, reform of the local government finance system is impossible unless education finance issues are addressed at the same time. Education currently accounts for more than half of property taxes. Reforms that address the municipal side only are addressing less than half the issue, as it is perceived by taxpayers. Second, revenue reform must proceed in tandem with expenditure reform. Not all the problems of local government finance are on the expenditure side. As a result, meaningful reform cannot take place on a revenue-neutral basis. Third, reform cannot be successful if it proceeds on the assumption, either implied or explicit, that all local governments are the same. Local governments are extremely diverse, with vastly different administrative and political capabilities, and they have different capacities to participate in a reformed financial and administrative structure.

Local Government Structure

There are 832 municipal governments in Ontario. Of 793 lower-tier (local) municipalities, nearly 25 per cent have populations of less than 1000. Almost 75 per cent have populations below 5000. Only 2 per cent have populations of more than 100,000. More than 80 per cent of Ontario's population is located in the largest 15 per cent of lower-tier municipalities. Many municipalities perform relatively limited functions and have little capacity for administration or for delivering programs.

In addition, many of these municipalities are heavily dependent on grants from the provincial government. In 1991, over 100 of 832 municipalities were more than 50 per cent dependent on provincial grants. This makes them disproportionately vulnerable to cutbacks in provincial grants. Although some provision can be made to protect grants to the most vulnerable of these municipal governments, this approach itself underlines the differences between smaller and larger municipalities. The structural changes in the Ontario economy and the recessions of the early 1980s and the early 1990s have also had a significant impact. The loss of a major manufacturing operation to recession or restructuring is an important problem, wherever it takes place. In a small municipality, such a loss could effectively eliminate its industrial tax base.

Municipal governments are also experiencing political pressures related to efficiency similar to those faced by school boards. Duplication and inefficiency as well as competition and lack of coordination – between the provincial and local government, among neighbouring municipalities, and between lower-tier and upper-tier municipalities – which might have been tolerated in better economic circumstances give rise to political controversy in these more difficult times.

Even without financial reform, Ontario's diverse system of municipal government is under great pressure. Our recommendations increase the pressure in two respects. First, expanding the taxation responsibilities of municipal governments will add responsibilities to local governments, some of which effectively lack the capacity to carry out the responsibilities they currently have. Second, our proposals to reform local government finance will have a different impact in some smaller municipalities than they do on the system as a whole. We have proposed that the provincial government reduce grants for services of local benefit as a partial offset for the removal of education and children's services from local property taxes. If the provincial government had done this in 1991 by eliminating operating grants for services of local benefit (general government, police,

TABLE 36.1
Impact on Residential Property Taxes of Commission Recommendations
Selected Ontario Municipalities

Municipality	Percentage change	Municipality	Percentage change
Cities		Sudbury	-34%
Barrie	-44%	Thunder Bay	-38%
Burlington	-45%	Timmins	-37%
Cambridge	-40%	Toronto	-43%
Chatham	-32%	Windsor	-38%
Cornwall	-37%	Towns	
Etobicoke	-45%	Halton Hills	-46%
Guelph	-45%	Markham	-55%
Hamilton	-37%	Milton	-49%
Kingston	-39%	New Liskeard	-43%
London	-42%	Oakville	-46%
Mississauga	-50%	Orangeville	-36%
Nepean	-42%	Pickering	-47%
North Bay	-35%	Picton	-26%
North York	-45%	Townships	
Oshawa	-40%	Augusta	-48%
Ottawa	-36%	Horton	-15%
Owen Sound	-37%	McKellar	-25%
Peterborough	-39%	Montague	-18%
Scarborough	-43%	Mersea	-54%
Sault Ste Marie	-39%	Stephen	-37%

Source: Fair Tax Commission calculations based on Ontario, Ministry of Municipal Affairs, Analysis and Retrieval System (MARS), and Ministry of Education administrative data.

Note: Assumes all school boards exercise option of local levy at 5 per cent of total education spending. Assumes elimination of all operating grants for roads, transit, environmental services, and other local services and full provincial funding for children's services.

fire, inspections, transportation, sewer, water, solid waste, recreation, and planning and development), assuming responsibility for children's services, and instituting the education funding reforms, the net effect in 748 municipalities would have been to reduce residential property taxes by an average of $793. The combined impact of our proposed changes to education finance and municipal grants for selected municipalities is summarized in table 36.1.

However, in 45 municipalities the impact of the grants cuts would more than offset the education tax reductions, and residential taxes would increase by an average of $126 per household. While the municipalities in which taxes would increase represent less than 0.5 per cent of the households in the province, the data demonstrate the special problems posed by finance reform in small, grant-dependent municipalities.

There are three options. First, do not proceed with financial reform because of its impact on these small municipalities. Second, recognize small, grant-dependent municipalities as a separate category of local government that should have a different relationship to the provincial government. Third, proceed with reform of the structural problems in local government that lead to the problem in the first place.

The first option – allowing these differential impacts to block reform – makes no sense. We are convinced that the local government financial system is in serious trouble. The problems that continue to build because the system has not been rationalized are greater than the problems associated with implementing the reforms.

With regard to the second and third options, we note that efforts at structural change for municipal government have foundered repeatedly in the past 20 years because of strong resistance from rural Ontario. The severity of the financial situation facing Ontario as the economy is restructured may provide a renewed impetus for changes such as county restructuring – amalgamating lower-tier municipalities within a county area and increasing the power of the county government – or it may be time for the provincial government to recognize explicitly that in some parts of Ontario the division of power and responsibility between the provincial government and local government, and the corresponding structures of local governance, will have to be different from the norm in the rest of the province.

The structure of local government – both for education and for municipal services – is in need of renewal. The additional pressures on that structure posed by the financial reforms we recommend should be welcomed as opening up new opportunities to make progress towards that end. The alternative, allowing opposition from the existing institutional structure to block any attempt at reform, will perpetuate the gross unfairness of the existing system.

37 Federal-Provincial Fiscal Relations

In the course of our work, we identified many areas in which our recommendations bear on the relationship between Ontario and the federal government. In some areas, our recommendations call for an expansion of the provincial role set out in federal-provincial agreements. In other areas, we address potential benefits from increased harmonization of provincial and federal taxation policies. In still other areas, we make recommendations for changes in federal tax policy, in recognition of the fact that action by Ontario on its own would be impractical or undesirable.

These areas of federal-provincial concern suggest a need for a rethinking of Canada's system of federal-provincial tax coordination. The need for coordinated changes in tax structures also raises broader questions of federal-provincial fiscal relations. In chapters 6 and 7, we noted with concern the evolution of the federal-provincial fiscal relationship over the past 15 years from one characterized by cooperative federalism to one characterized by federal government efforts to withdraw from previous cost-sharing commitments and to shift fiscal responsibilities for programs in provincial jurisdiction to the provincial governments. Ultimately, issues of tax sharing and tax harmonization cannot be divorced from larger considerations of fiscal arrangements in a federal system. In this chapter, we review our recommendations with implications for the federal-provincial relationship and explore the broader issues they raise for fiscal relations.

Areas of Concern

There are four major areas in which our recommendations involve the federal government. First, a number of recommendations involving the personal income tax require the federal government to change its income tax. For Ontario to take action by itself would be either administratively unfeasible or self-defeating, in the sense that taxpayers could easily arrange their affairs to take advantage of provisions that were more favourable at the federal (and other provincial) level. These provisions include the treatment of the capital gains exclusion and dividends, the taxation of alimony and child support payments, and tax support for registered pension fund and RRSP contributions. To accomplish other reforms in its own income tax, Ontario first must conclude a new tax collection agreement with Ottawa.

Second, we conclude that attempts to use the provincial corporate income tax to accomplish economic policy goals different from those inherent in the corresponding federal tax are unlikely to be sufficiently effective to justify their revenue costs and the added complexity and compliance costs for corporate taxpayers.

Third, we recommend that the Ontario retail sales tax be coordinated in a unified national sales tax structure with the federal Goods and Services Tax (in concert with other provinces).

Finally, we recommend a wealth transfer tax on the basis that it would make a significant contribution to a fairer tax system, but conclude that potential problems of compliance require that an effective wealth tax be implemented only at the national level.

In general, our conclusions have been driven by two considerations that circumscribe Ontario's policy flexibility. The first is the mobility of tax bases, particularly those involving capital and income from capital. Ontario is a province with a small open economy; tax policy cannot ignore either the real mobility of capital or "paper mobility"— the ability to transfer ownership or income from investments outside the province for tax purposes.

The second consideration underlying our conclusions is that the Canadian federation is an integrated economic and political system. This system strengthens the mobility of capital and other economic resources, as well as constraining what a provincial government can do to meet these challenges. These constraints on provincial action serve a positive purpose. Unrestricted interprovincial mobility of people, goods, and services is an important aspect of a strong national economy. The barriers that result from provincial regulatory and procurement actions have, in recent years, received considerable attention; fortunately, governments have largely avoided using provincial tax systems for such purposes. Unrestricted mobility has implications particularly for policy in areas such as personal income taxation (capital gains exclusion, child support payments) and the proposed wealth transfer tax.

Ultimately these specific recommendations relate to larger concerns about:

- tax harmonization, and
- the determination of the fiscal balance between Ottawa and the provinces through revenue sharing and the allocation of revenue and expenditure responsibilities between the federal and provincial governments.

Tax Harmonization

Our recommendations, if implemented, would increase the degree of harmonization in the tax system between the federal and provincial governments. We recommend explicit harmonization of the Ontario retail sales tax (RST) with the federal Goods and Services Tax (GST) through the development of a unified national sales tax structure. With respect to the corporate income tax, we recommend unilateral changes that would bring Ontario's corporate tax closer to the federal tax. In addition, we call for federal-provincial action on a common corporate tax structure. In the area of the personal income tax, our recommendations could be interpreted as calling for somewhat less harmonization. Although this is true for rate structures, our recommendations, in a larger sense, call for greater provincial input into the already harmonized personal income tax system rather than for a decrease in the degree of harmonization. Finally, our wealth tax recommendation is actually a proposal for a harmonized federal-provincial or interprovincial wealth tax.

A more harmonized federal-provincial tax system raises a number of issues. For a provincial government, tension exists between maintaining an independent tax and agreeing to greater harmonization. The former provides the government with more potential (at least in theory) to use the policy levers inherent in the tax area, while the latter offers the advantages of reduced compliance and administrative costs and, probably, more certain revenue flows. One way to ease this tension is to create more cooperative mechanisms for harmonization than have typically existed in Canada. Tax harmonization in Canada has effectively required the harmonizing province to surrender its authority in the relevant tax field to the federal government. This has certainly been true with the personal and corporate income tax collection agreements. Only recently, and to a limited extent, has the federal government allowed participating provinces to deviate from its standard structure in any meaningful way.

Our recommendations relating to harmonization suggest a new model that provides for more meaningful input from provincial governments. The recommendations for revisions to the personal income tax collection agreement and RST/GST harmonization, for example, take this direction. Moreover, we have suggested two specific forms this increased provincial participation could take. First, a greater degree of joint decision making in tax policy formation would include issues such as the determination of the base of the tax. At a minimum, the provinces should be informed and consulted when the federal government considers such issues. One might even go further to argue for consensus among the participating provinces before any changes are instituted.

Second, joint participation in tax administration should be considered. Different options are possible. As a minimum, a province could have input into the federal audit practices carried out in its jurisdiction. At the other end of the range, a federal-provincial tax administration agency could serve both levels of government and be politically independent of them.

Federal-Provincial Fiscal Balance

Our recommendations also raise the question of the allocation of taxing authority in the federation and the sharing of revenues that accompanies such an allocation. One of the principal fiscal concerns in a federation – and one central to our recommendations – is vertical balance: the relationship between the revenue capacities of the federal and provincial levels of government to their expenditure responsibilities. Historically, the federal government's capacity to raise revenue has been greater, relative to its expenditure responsibilities, than that of the provinces. This has led governments to establish mechanisms to transfer revenues from Ottawa to the provinces. There is reason to believe that this fiscal balance problem between the federal and provincial levels of government will worsen in coming years. In a study for the commission, Dungan (n.d.) projected that Ontario's debt will grow dramatically faster than the federal debt over the remainder of this century, and possibly beyond. Other analysts have predicted similar trends in the federal-provincial fiscal balance (Ruggeri, Van Wart, Robertson, and Howard 1993).

Stated in its simplest terms, one can approach the balance between revenues and expenditures at the federal and provincial levels in three ways. First, expenditure responsibilities within the federation could be determined according to certain criteria, and then tax sources could be allocated to one of the two levels of government (or shared between them) so that each level would have sufficient revenue-raising capacities to meet its expenditure commitments.

The second way is to reverse this order. Taxing powers could be allocated first, according to a set of criteria. For example, one might determine that those tax bases most likely to be mobile between provincial jurisdictions should be allocated to the national level of government, and the less mobile bases be allotted to the provinces. Expenditure responsibilities could then be determined in light of the fiscal capacities of the two levels of government.

In the third way, one might decide to capture the benefits of the "ideal" allocation of both revenues and expenditures, and reconcile any resulting fiscal imbalances through a system of grants or transfers between the levels of government – specifically from the federal to the provincial level. The form of these transfers and the formulas for determining their amounts would then be determined.

This sketch is, of course, simplistic. Grants are paid from the federal government to the provinces for reasons either unrelated to or only indirectly related to vertical fiscal balance. For example, some grants (such as equalization payments) are intended mainly to address fiscal capacity imbalances among provinces, as distinct from an imbalance between the provinces as a group and the federal government. The same taxes will not yield (in per capita terms, for example) equivalent revenues in all provinces if these provinces differ from one another in terms of wealth or income. Thus, a "have" province will more easily be able to provide a package of public services than a "have-not" province. Federal transfers to the have-not provinces provide one way to improve regional balance in terms of fiscal capacity. The provision of grants such as these is related to vertical balance, but is distinct from it.

Nor does the determination of expenditure and revenue allocations typically emerge as dryly and mechanically as the above sketch suggests. Certainly, over time we have witnessed fairly major changes in the Canadian federation, especially on the revenue side. In recent years, provinces have accounted for a larger share of income taxes, and Ottawa has become more prominent in the taxation of consumption. In addition, grant programs have changed regularly since Confederation. Often these changes are prompted by particular fiscal pressures that developed at one or both levels of government. Sometimes they relate to the introduction of major new initiatives involving both levels; medicare is a prime example. Sometimes they emerge from competitive activities of the federal and provincial governments in their attempts to provide packages of public goods and services that appeal to voters (Breton 1993).

The fiscal components of federalism in Canada are currently in a period of stress and may be revised significantly in the coming years. Since the early 1980s federal transfers to the provincial governments have been cut back. As we noted in chapter 6, from Ontario's perspective the restraints applied to the Established Programs Financing and Canada Assistance Plan transfers were especially troublesome. The tax structure changes we recommend would add other dimensions to the rethinking of revenue sharing.

From our perspective, two main questions emerge:

- What changes in the allocation of taxing powers might be contemplated, and what consequent adjustments might follow?
- What changes in the system of federal grants to the provinces might be contemplated?

The two questions are related, although the first is more directly relevant to the Fair Tax Commission.

Two of our recommendations raise the issue of the allocation of taxing powers directly, and a third raises it indirectly. If Ontario refrains from attempting to structure its corporate income tax differently from the federal tax, should the tax ultimately be levied only at the federal level? If the provinces harmonize their sales taxes with the federal GST, should there ultimately be only one general sales tax, and, if so, at what level? If there is to be a national wealth transfer tax, should this tax be levied by the federal government or collectively by the provinces?

Any of these three changes could involve revenues of sufficient size to prompt, in response, consideration of the reallocation of other taxes between the two orders of government. In fact, two recent studies developed models for such reallocations, though they reached different conclusions from each other (Ip and Mintz 1992; Ruggeri, Howard, and Van Wart 1993).

Such major reallocations of taxing authority are difficult to negotiate. They involve federal and provincial governments seeking to protect or increase their shares of limited total revenues (the adage about there being only one taxpayer applies here). They involve provincial governments that do not necessarily have common objectives in tax negotiations because the same tax can be of different value to different governments, depending on the structure and wealth of their economies.

A government's particular objectives and its capacity to use tax provisions as policy instruments affect the importance it ascribes to access to different tax bases. A good example relates to the conduct of provincial fiscal policy. To the extent that Ontario attempts to moderate swings in economic activity within the province (Auld 1993), tax levers have been important instruments in those initiatives. If Ontario were to withdraw from tax sources that are sensitive to economic conditions, it would lose some of its capacity to conduct its own stabilization policy. If the shift went the other way, Ottawa would lose some of its capacity to practise stabilization for the national economy.

Finally, the political costs governments face when they levy taxes are not the same for all taxes.

Considerations such as these begin to suggest the complexities involved when issues of taxing authority are addressed directly. They also suggest that more factors than taxing authority may have to be involved in order to find solutions to which all governments can subscribe.

Achieving vertical balance in the federal-provincial fiscal system may also require reconsideration of the grant or transfer programs from the federal to the provincial level. An alternative to joint occupancy of a tax base is to assign the taxing authority to the federal level and to adjust revenues by way of grants. Clearly the willingness of a province to agree to such an arrangement will depend on factors such as the amount it stands to receive, the certainty of this revenue source over time, the increases it can expect to receive over time, and any conditions attached to the grant. From the federal perspective, Ottawa's willingness to bear all the political costs of raising the tax revenue may depend on the portion of the revenue it keeps for its own programs and whether it is able to gain political visibility through leverage over any programs delivered by the provincial governments.

The recent history of federal grants to the provinces is not encouraging, at least from the perspective of provinces such as Ontario. As described in chapter 6, the federal government has cut back considerably (relative to expected amounts) on the major transfer programs from which Ontario receives funds. If closer tax cooperation is to emerge between the federal government and the provinces, with revenue balances adjusted even partially through grant programs, it is essential that the provinces have reason to be more confident in the stability of these grants. Although it is beyond our purview to provide specific recommendations, it is important to point out that progress in the area of tax coordination cannot proceed without addressing these broader components of fiscal federalism as well.

38 Implementation and Transition

Our recommendations for fair tax reform touch on virtually every aspect of taxation in this province. We are proposing a complete overhaul of the system for financing education, with a significant shift in funding from local residential property taxes to provincial personal income taxes. We are advocating a series of changes in the design and administration of Ontario's personal income and sales taxes that will fundamentally alter the relationship between the provincial government and the federal government in the area of taxation. We are proposing that the federal government close a gap in Canada's taxation system and introduce a national tax on transfers of substantial holdings of wealth. We are recommending that Ontario abandon market value reassessment as its local government finance policy and proceed with a package of reforms to rationalize and simplify local government finance while retaining the flexibility needed to make reform possible. We are recommending that Ontario rationalize its energy and road use taxes to make them more effective in achieving goals relating to the environment and to transportation infrastructure. We are recommending that the taxation policy process be opened up and made more accessible, so that periodic reviews such as that conducted by the Fair Tax Commission become less important. The focus on issues of fairness will be better maintained as taxation policy develops and changes from year to year.

A list of recommendations of this breadth presents a variety of implementation challenges for government. Some of our recommendations affect the internal operations of government. Other recommendations call for changes that rationalize the existing structure of the tax system, but do not have a significant overall impact on the taxes that individual taxpayers pay. The central recommendations of our report will, however, have a significant impact on the kinds of taxes people pay, on the way those taxes are distributed among individual taxpayers, and on the relationships between the provincial government and both local governments and the federal government.

Implementation of our key recommendations for education finance reform and for a more progressive mix of taxes in Ontario will result in a shift of approximately $3.5 billion from residential property taxes to other taxes, primarily personal income taxes. Replacement of local non-residential property taxation for education purposes with a provincial commercial and industrial property tax levied at a uniform rate across the province will result in substantial tax increases in some areas and substantial tax decreases in others as Ontario replaces a system of taxation that is fundamentally irrational. Assessment reform in both the residential and the non-residential sectors will produce its own shifts in taxation within municipalities, as properties that have been undertaxed relative to their value in current use see tax increases, and properties that have been overtaxed see tax reductions.

Local government finance reform raises important questions about the relationship between the provincial government and our institutions of local government. These questions must be addressed carefully and with sensitivity.

Many of the changes we have proposed in personal income taxation, wealth taxation, and sales taxation can only be made in the context of a reformed fiscal relationship between Ontario and the federal government.

We took seriously the minister of finance's request that we develop workable solutions to Ontario's tax fairness problems. In our report we have repeatedly drawn attention to potential changes that are clearly justified on fairness grounds, but are impractical given the economic and political constraints Ontario faces. We recognize that change itself creates problems of fairness that must be addressed. However, we do not believe that the old maxim, "an old tax is a good tax," can be taken as an excuse for inaction in the face of demonstrable unfairness. We also recognize that our recommendations raise difficult questions about Ontario's relationship with the federal government and about the role and structure of local government. These questions will inevitably provoke opposition to many of our proposed changes in taxation. While we believe strongly in the need for an effective federal government and in the importance of local government institutions, we also believe that institutions and their interrelationships should facilitate, not constrain, fair tax reform.

Special attention must be paid to questions of transition arising from the implementation of our recommendations for three reasons. First, fairness in transition is an important element of fairness in taxation. In our economy, people and institutions are constantly adjusting to change. Those adjustments are not always easy, nor do they take place without cost. The bigger the change that must be absorbed, the more difficult the adjustment will be. To be implemented fairly, tax reform must give taxpayers adequate notice of change and enough time to adjust their financial affairs to take its impact into account.

Second, as a practical matter, a reform that does not address issues arising from transition cannot be implemented successfully. Without careful attention to transitional issues from the beginning, it is difficult to shift the debate over tax reform initiatives from their immediate impact to the fairness goals of the reforms. Debates about impact are almost always dominated by those who expect to experience tax increases, because any change is more concrete to them than to those who stand to gain. In such a debate, advocates of reform are easily drowned out.

Third, many of the recommendations put forward in our report will enhance the fairness of the tax system as a whole only if they are implemented in coordination with other recommendations. For example, implementation of our recommendation to eliminate the equivalent-to-married credit in the income tax system without implementing other recommended changes to Ontario's refundable credit system would make the system less fair than it is now. Implementation of assessment reform, without at the same time permitting municipalities to vary tax rates on residential and non-residential property, would produce huge tax shifts that accomplish no fairness objective whatsoever. In education finance reform, it is essential that reforms in funding allocation and revenue proceed in parallel, and that the revenue reforms be implemented as a package.

There are three major areas of our recommendations in which particular attention must be paid to transitional arrangements and to implementation strategies: changes with federal-provincial implications, including changes to Ontario's tax credit system; education finance reform and associated changes in the tax mix; and local government finance reform, including residential and non-residential property assessment reform.

Changes with Federal-Provincial Implications

Some of the income tax changes proposed in this report can be implemented by Ontario within the framework of the current income tax collection agreement with the federal government. The major proposed change, the shift in tax mix from the local residential property tax to the income tax, can be implemented by increasing the proportion of Basic Federal Tax levied in Ontario. Our proposed rationalization of Ontario's refundable tax credits into simplified child and adult components requires changes in only one element of the income tax that is already under Ontario's control. It is therefore possible to implement these recommendations at the earliest opportunity.

Other proposed reforms could only be implemented with federal cooperation. The ease with which federal cooperation could be obtained varies with the nature of the change proposed. Our proposals with respect to the personal income tax rate schedule and the refundable tax credits (the married, equivalent-to-married, age, and disability credits) could be implemented within the framework put forward by the federal government in its June 1991 discussion paper, *Personal Income Tax Coordination: The Federal-Provincial Tax Collection Agreements* (Canada Department of Finance 1991). Our proposals with respect to the child care expense deduction and the deduction for disability-related medical expenses would require a change to the tax collection agreement that goes beyond the federal discussion paper to give Ontario control over its own tax expenditures. Our proposals to tighten the limits on contributions to pension plans and RRSPs eligible for tax assistance and to change the form of assistance from a deduction to a credit would require the federal government to change its own approach. Finally, because our proposals to change the tax treatment of child support and alimony, to eliminate the exclusion of 25 per cent of capital gains from income, and to change the basis for taxation of dividend income affect the base of the personal income tax, they could only be implemented by the federal government.

Other proposed changes also require either federal-provincial negotiation or federal action. We have concluded that a wealth transfer tax would enhance the fairness of the tax system in Ontario, but administrative problems we find insoluble mean it could only be implemented successfully at the national level. Our objections to the federal government's proposal to disallow deductions from corporate income tax for payroll taxes above an arbitrary level can only be resolved through federal-provincial negotiation. Our proposal that the Goods and Services Tax and the retail sales tax be replaced by a common national multi-stage sales tax framework also requires negotiation among the provincial governments and the federal government. We suggest that the changes which require federal-provincial agreement be negotiated as part of a broader initiative by Ontario to renew federal-provincial fiscal arrangements.

RECOMMENDATION 126

Ontario should proceed with proposed changes in the structure of its income tax credit system at its earliest opportunity.

RECOMMENDATION 127

Ontario should develop a coordinated strategy for negotiating with the federal government on:

a) changes in the personal income tax collection agreement;
b) reform in the tax treatment of child support and alimony;
c) reform in the tax treatment of income from capital;
d) sales tax harmonization;
e) wealth transfer taxation; and
f) a framework agreement on the income tax treatment of federal, provincial, and local taxes paid by corporations.

These changes should be part of general negotiations on federal-provincial fiscal arrangements.

Education Finance Reform

Reform of Ontario's system of education finance is a central recommendation of the Fair Tax Commission. It addresses the most significant fairness problem raised by participants in our public consultation process.

At the same time, the recommendations with respect to education are the most sensitive and the most carefully balanced of all our recommendations dealing with local government finance. It is essential, therefore, that our recommendations be considered and implemented as an interrelated package. In particular, our recommendation for a funding allocation model based on cost and student needs must be implemented at the same time as our recommendations for an end to funding education through local property taxes. Implementation of revenue reform without funding allocation reform would lead to the conclusion that the reform initiative was little more than a disguised version of commercial and industrial assessment pooling. Proceeding on the expenditure side without addressing the fairness issues on the revenue side would be interpreted as a provincial power grab combined with further downloading of costs onto local governments.

In addition, because the centrepiece of the proposed reforms is a shift from residential property taxes for funding education to provincial general revenues, it is critical that a mechanism be in place to ensure that reductions in property taxes on residential rental property are passed on from landlords to tenants in the form of reduced rents. To proceed with reform without such a mechanism in place would be grossly inequitable to tenants, who would pay increased income taxes but have no guarantee of reductions in their rents resulting from the other half of the tax mix change.

Similarly, our proposal for local discretionary levies on residential property would not be feasible without changes to enable municipalities to establish residential and non-residential tax rates independently of each other. A local levy designed as we have proposed would not be possible in the current system, which requires that the residential tax rate be 85 per cent of the non-residential tax rate.

RECOMMENDATION 128

Ontario should implement the recommended changes in education expenditure allocation and in the sources of revenue for education as a package.

An education finance reform package must also include a mechanism to ensure that property tax reductions on residential rental property are passed on to tenants and must enable municipalities to set tax rates on residential and non-residential property independently.

Our proposals for education finance reform and the associated changes in tax mix would have the most significant impact on individual taxpayers in Ontario. Residential property taxes would decline by an average of 42 per cent across the province. Much of that increase would be made up by increases in personal income taxes, but because the distribution of residential property taxes among families is so different from the distribution of personal income taxes, substantial changes would result in the taxes paid by individual households.

Whatever the transitional arrangements are to cushion the impact on individual taxpayers, it is essential that the framework for education finance be put in place at the beginning of any transitional period. The education finance framework proposed by the commission is not consistent with the current system. The current system is driven almost entirely by differences in local financial resources. The proposed system is driven almost entirely by differences in student population characteristics and needs. To attempt to phase in the transition from one framework to the other would itself create a whole new set of transitional problems. It would create substantial inequities among school boards at the beginning of the transition period that would disappear by the end. It would make it difficult to shift the focus of the system to student equity. It would give rise to opposition from school boards suspicious that those parts of the package which are consistent with the traditional position of the Ministry of Education and Training would be implemented, while those parts which run counter to this view would fall by the wayside.

Most important, without the new framework in place, it would be impossible to manage the transitional impact on individual taxpayers.

RECOMMENDATION 129

Ontario must introduce a complete framework for education finance at the beginning of the transition to a new funding system.

This framework should include the expenditure allocation model, the shift in commercial and industrial taxation responsibility from school boards to the province, legislative authority for the discretionary local levy on residential property, and the shift in primary funding responsibility for education from school boards to the provincial government.

Our research models show that the combination of education finance reform and cuts in provincial grants for local municipal services would reduce property taxes substantially in almost every municipality in Ontario. With tax increases limited to a small number of municipalities and affecting a very small number of households, transitional arrangements for residential taxpayers could be limited to special assistance targeted to those municipalities.

In the non-residential sector, local taxes for education would be replaced by a provincial tax levied at a uniform effective rate across the province. Because effective rates of tax for education on non-residential property vary widely across the province, the shift to a uniform rate of tax will result in substantial increases in taxes in some municipalities and substantial reductions in taxes in others. These shifts should be phased in over a five-year period, as follows. Local non-residential property taxes would be frozen at their pre-reform levels. The provincial non-residential property tax would shift gradually from the pre-existing rate of tax levied as a local tax to a uniform rate of tax across Ontario. In the first year, the provincial tax would be 80 per cent of the pre-reform local tax plus an additional amount levied at a uniform effective rate province-wide, with the rate set initially to maintain revenue at an inflation-adjusted pre-reform total. In the second year, the tax would be 60 per cent of the pre-reform level plus an amount raised at a uniform effective rate province-wide. In the third year, the tax would be 40 per cent of the pre-reform local tax, with the remainder levied at a uniform effective rate province-wide. In the fourth year, 20 per cent would be based on pre-reform local taxes, with the remainder from the uniform effective rate tax. In the fifth year, all provincial commercial and industrial tax revenue would be raised from the uniform effective rate of tax.

Provincial commercial and industrial property tax revenues in total would be determined by the provincial government in the context of our other recommendations as well as general provincial policies on the appropriate mix of taxes on business.

RECOMMENDATION 130

The education portion of the residential property tax (other than the limited local discretionary levy) should be eliminated at the beginning of the phase-in period.

The shift from local non-residential property taxes for education to provincial commercial and industrial taxation at a uniform rate should be phased in over a five-year period.

Assessment Reform and Municipal Finance

Assessment reform poses the most difficult transitional problems in local government finance reform. There is no consistent system of assessment in place either for the same types of property between municipalities or for different types of property within municipalities. As a result, in developing recommendations for a consistent system across the province, we attempted to avoid imposing uniformity where there was no overriding public policy reason for uniformity and where local governments should be able to exercise independent policy discretion.

Our recommendation that residential and non-residential tax rates be established independently is an essential component of our assessment reform package. Quite apart from the questionable logic behind requiring that there be a fixed relationship between tax rates levied on different bases, the experience of the past 20 years shows that the tax shifts dictated by province-wide uniformity would doom our proposals to the same fate as the proposals in the 1970s for province-wide market value reassessment.

Our recommendations with respect to the sharing of costs of regional, district, and metropolitan municipalities and counties among local (lower-tier) municipalities and for establishing a new basis for provincial equalization payments to municipalities are also linked to assessment in reform. Current cost-sharing and equalization formulas based on the total of residential and non-residential assessment in use at present cannot work properly in a framework in which local municipalities are able to exercise taxation policy flexibility.

RECOMMENDATION 131

Prior to the beginning of the transition period for assessment reform, Ontario should implement policy changes dealing with local tax policy flexibility; with sharing the costs of regional, district, and metropolitan municipalities and counties among local municipalities; and with the establishment of a new basis for distributing provincial equalization grants among municipalities.

Because our proposals on changes in the tax mix take into account a net reduction of approximately $624 million in provincial grants to municipalities, it would make sense to phase these changes in on the same schedule as the reforms in education finance.

Even with reforms that eliminate the need for changes in the mix of taxes at the local level between the residential property tax and the non-residential property tax, assessment reform will generate substantial shifts in taxation at the local level. This effect is not a feature of the shift from the current system to unit value and rental value for residential and non-residential property, respectively. The current system is so irrational that the implementation of any consistent assessment system, however defined, would produce substantial tax shifts. That irrationality will also make it difficult for individual taxpayers to anticipate the impact of reform.

We know from the data that some general shifts are likely to take place. Multiple unit residential rental property is currently overassessed and overtaxed relative to owner-occupied residential property on the basis of market value. While the change from market value to unit value is likely to reduce the size of these shifts resulting from one-class assessment and taxation of residential property, it will not change their direction. This fact reinforces the need to ensure that property tax reductions are passed on by landlords to tenants.

Industrial property is overtaxed relative to commercial property in the current system. Although data were not available to enable us to model the impact of rental value reassessment, it is likely that rental value reassessment would result on average in tax increases in the commercial sector and tax reductions in the industrial sector. In addition, business occupancy tax rates in the industrial sector are higher on average than rates in the commercial sector. Transition in the business sector will have to be handled carefully given the inevitability of these general shifts and the fragile state of the provincial economy.

Transitional arrangements for assessment and local government finance reform must ensure that concerns about fairness in transition are actually met and that the necessary measures are even-handed among different types of taxpayers and institutions. The Property Tax Working Group addressed criteria for transitional arrangements in its recommendation 48 (Property Tax Working Group 1992, 134–35). We endorse the relevant criteria spelled out in that recommendation as follows.

RECOMMENDATION 132

Transitional and implementation measures for local government finance reform should be consistent with the following criteria:

a) Transition should take place over a defined period of time; it should not be linked to an event such as the sale of property (in the case of assessment) or subsequent decision by a particular local government.
b) Transition should, to the extent possible, be weighted towards the beginning of the transitional period to ensure that momentum for reform is maintained.

The same transitional measures should apply to all classes of property.

Because it will be necessary to phase in the introduction of a uniform provincial tax rate on commercial and industrial property in any case, it would simplify the overall transition to a new system of local government finance if the transition to a new assessment system for non-residential property coincided with transition to the uniform effective rate of provincial commercial and industrial taxation. This combination would eliminate the need to adjust local assessments using equalization factors for provincial commercial and industrial taxation purposes and would allow both sets of impacts to be managed in a single transitional process.

From the point of view of transition, it would be an advantage to implement education finance reform and commercial and industrial assessment reform at the same time.

RECOMMENDATION 133

Ontario should, if possible, implement the reform of education finance and of commercial and industrial assessment at the same time.

For assessment reform, implementation and transition involve two steps. First, the government will have to develop the administrative procedures and models for the new system so that it can be implemented in the field. Second, a reformed assessment system will have to be phased in.

For the first step, it would be helpful to conduct a pilot reassessment study to develop and test procedures and to train the assessors who will be responsible for implementation. As part of our research program, staff in Halton Region became involved in studies of the impact of commercial and industrial taxes and of the impact of residential property taxes on household income. In addition, a community group formed to study alternatives to market value assessment concluded that unit value assessment in the residential sector and rental value in the non-residential sector were the best options for reform available to them and recommended that the impact of such changes be subjected to detailed study. Given the fact that the local community has already participated in our work and has indicated support in principle for the ideas put forward, Halton would appear to be an ideal candidate for a pilot study. Because Halton includes a variety of different types of residential areas, a diverse commercial and industrial sector, and a substantial rural area, it would also provide a representative cross-section of the kinds of assessment problems that are likely to arise across Ontario.

Once the first phase has been completed, implementation could proceed, either simultaneously across the province or staged from area to area. If a staged approach is chosen, it would make sense to start in those parts of the province where assessment systems are most out of date – in the large regional municipalities in the Toronto area, many of which have not been reassessed at all, and in other large urban areas where reassessment either has not taken place or has been implemented on only a class-by-class basis.

One way to phase in reassessment is to maintain two assessment rolls for the transition period, with municipalities drawing a steadily increasing share of their revenue requirements from the new, reformed assessment roll and a steadily declining share of their revenue requirements from the old assessment roll.

The shift from the business occupancy tax to the non-residential property tax could be addressed in the same way. The business occupancy tax for the transition period would be the statutory percentage of business taxes levied on the old assessment roll. The business occupancy tax would simply not apply to taxes levied on the new assessment roll. The phase-in schedule for the elimination of exemptions from local property taxes should be coordinated with the phase-in schedule for assessment reform more generally.

As an alternative to a gradual phase-in, reassessment could be implemented at once, after a period of advance notice to give people time to adjust to the coming change. A transitional fund could be maintained for a period of time to cushion extremely large tax shifts or to deal with situations of individual hardship.

RECOMMENDATION 134

In the transition period for assessment reform, the old and reformed assessment rolls should be maintained in parallel. Over a fixed transition period, municipalities would raise a portion of their revenue requirements from the old assessment roll and a portion from the new assessment roll, with the proportions mandated to shift towards the new roll throughout the transition period.

Business occupancy taxes would be phased out by linking them to the old assessment roll only.

Other aspects of our proposals for local government finance reform either would not have a direct impact on local taxpayers or would produce relatively small changes in local taxes. As a result, the transition problems are not nearly as significant. In implementing all our proposed changes, however, special attention should be paid to the impact of changes of general application on particular geographical areas, types of municipalities, or types of taxpayers. The government should be open to considering special transitional measures to deal with unusual impacts.

Transitional Measures for Local Government Finance Reform in Perspective

We have dealt at great length and in great detail with the problems of transition in local government finance reform. It is critical, however, that our emphasis on these problems be kept in perspective. The most important element in a successful strategy for transition and implementation of tax reform is public support for the goals of the reform. Based on what we heard in our public consultation program and the widespread support generated by the report of the Property Tax Working Group, we are confident there is a broad consensus in Ontario concerning the seriousness of the problems in our system of local government finance, the root causes of those problems, and the appropriate general directions for reform.

We have been impressed by the extent to which this consensus is shared among various interests in the local government finance system and the interested public. We have also been impressed by the extent to which the emerging consensus about directions for reform is both multi-partisan and non-ideological. We believe, therefore, that the time is right for dramatic and decisive action on the problems that beset our local government finance system.

Implementing a Comprehensive Reform of Local Government Finance

Our recommendations for a new system of local government finance in Ontario touch on every aspect of the local government financial system. At present there is no agency of the provincial government that has either the responsibility for the preparation of a coordinated response or the authority to oversee its implementation. Because the provincial government intersects with local government at so many points within the provincial government structure, our recommendations affect a large number of government ministries and agencies.

Education finance policy is the mandate of the Ministry of Education and Training; municipal finance policy issues with respect to taxation and user fees are the responsibility of the Ministry of Municipal Affairs; and most other policy areas are divided among the ministries that operate conditional grants programs, including Transportation, Community and Social Services, Health, Natural Resources, Environment and Recreation, and Culture and Tourism. Assessment is the responsibility of the Assessment Division of the Ministry of Finance.

Because local taxation policy is bound up in assessment, the Ministry of Finance is responsible for that policy as well, although no provincial agency appears to have explicit responsibility for this area. Responsibility for capital financing policy is equally diverse, with different ministries apparently working at cross purposes. As a result, most ministries have staff who specialize in some aspect of local government finance, but there is no ministry that exercises responsibility for the overall picture.

Coordination at the political level is no more effective than it is at the bureaucratic level. Different ministries with responsibilities in the area of local government finance report to cabinet through different cabinet committees. In 1993, for example, none of the committees of cabinet even included in its membership all the major ministries with responsibilities related to local government finance. The Ministry of Finance reports through the Cabinet Committee on Economic Development; the Ministry of Education and Training through the Cabinet Committee on Social Policy; the Ministry of Municipal Affairs through the Cabinet Committee on Environment Policy; the Ministry of Transportation through the Cabinet Committee on Environmental Policy; the Ministry of Community and Social Services through the Cabinet Committee on Social Policy; and the Ministry of Environment and Energy through the Cabinet Committee on Environmental Policy. This splintering at the political level makes the coordination of proposed changes that affect the provincial-local relationship extremely difficult.

Given the importance of considering and implementing these recommendations in a coordinated and integrated fashion, the institutional obstacles to policy coordination pose a very serious problem. Issues of local government finance should be coordinated in one ministry. This ministry would ideally draw responsibilities and resources from all the ministries whose functions currently intersect with those of local government, and would also draw heavily on the expertise that exists in the local government sector itself.

We see no reason why this recommendation should result in any addition to the provincial staff commitment to local government finance issues. What is needed is a consolidation and a focusing of resources currently devoted to this area throughout the Ontario public service. Such a consolidation would also provide the opportunity to bring together the various administrative databases in use throughout the government to facilitate coherent decision making. As we noted in chapter 11, the quality of the data available for public policy analysis in Ontario is, in many areas, woefully inadequate.

RECOMMENDATION 135

Ontario should locate all of the functions related to local government finance in one ministry.

Consolidated Recommendations

Complete recommendations are found below, numbered sequentially, and identified by chapter and page reference in the text.

Chapter 11 *Page*
Improving Accountability in the Tax System

1 Ontario should apply the rule of budget secrecy only to the details of tax changes that might enable an individual to derive financial gain through prior knowledge. *215*

In general, the process of budget policy making should be carried out under the same restrictions as those applicable to other policy questions requiring cabinet decisions.

2 Public multi-group presentations to, and discussions with, the provincial minister of finance should be a regular part of the Ontario tax policy process and form the basis of Ontario's budget considerations. The list of participants and any formal presentations made in such discussions should be made public by the minister. *216*

3 Ontario should establish a central agency responsible for: *217*

- maintaining all government databases related to provincial or local public finance,
- ensuring consistency and comparability of those databases, and
- publishing information about public finance in Ontario.

Access to provincial data sources should be provided to outside researchers and the public, subject to the personal privacy provisions of the Access to Information Act and any federal/provincial agreements with respect to confidentiality.

4 Programs should be delivered through the tax system only if they satisfy the following criteria: *221*

a) The rules for determining eligibility for the subsidy are so simple and easy to apply that application for the subsidy can be built into a tax-filing process based on self-assessment by taxpayers.
b) The program can be administered effectively by the Ministry of Finance rather than the government department normally responsible for the policy area.
c) There is a high degree of certainty the program will not be abused.
d) It is appropriate for the subsidy to be delivered on an infrequent basis in conjunction with the filing of tax returns and the payment of tax refunds.
e) Where monitoring and auditing are considered necessary, appropriate provisions are built into the design of the program.
f) The potential for costs to escalate in an open-ended program can be addressed effectively in the design of the tax expenditure program.
g) The tax expenditure program can be designed so that it does not affect the operation of the general rules governing the tax system.

If there is doubt as to whether a program should be delivered directly or through the tax system, it should be delivered directly.

5 To ensure that the benefits from tax expenditures in the income tax system do not increase with income, tax expenditures should be delivered in the form of a tax credit rather than a tax deduction. *222*

To ensure that tax expenditures are fully equivalent to grants, they should generally be taxable. They should also generally be refundable and therefore paid whether or not the taxpayer has taxable income.

6 All tax expenditures should be dealt with in the government's budget-making process in the same way as direct spending programs designed to achieve the same objectives. *223*

a) Information on tax expenditures should be made available to pre-budget roundtables and consultations.
b) The relevant government department should be involved in the design and review of each tax expenditure program.

7 a) Tax expenditure programs should be monitored to ensure that they continue to satisfy criteria for delivery through the tax system as opposed to the direct expenditure system. *224*
b) Ontario should include tax expenditures in annual program reviews. In addition, tax expenditures should be subject to periodic in-depth evaluations on a rotating basis on the same basis as expenditure programs.
c) Legislation should be introduced to expand the authority of the provincial auditor to audit tax expenditures on a basis that mirrors the process for direct expenditures.

d) Corporations should be required to disclose the benefits received from all tax expenditure provisions in the same way that benefits received from direct spending programs are disclosed.

e) Ontario should publish an annual tax expenditure account. This account should include:

- the objectives of each tax expenditure;
- its statutory basis;
- an estimate of revenue forgone;
- a description of the relationship between the tax expenditure and corresponding direct expenditure programs; and
- summary tables showing the distribution of benefits from the tax expenditure among different categories of beneficiaries.

The purpose of the account is to draw attention to tax expenditures and encourage analysis of whether policy objectives are being met or whether other approaches would be more effective and efficient.

8 Ontario should earmark taxes for specific government programs only where: *231*

- the benefits from the service can be attributed to individuals;
- redistribution is not an objective in providing the service;
- public policy does not require that the service be provided as a right;
- efficiency and public accountability would be enhanced; and
- there is a clear relationship between the earmarked fee or tax and the service to be funded.

Ontario should not create the impression that taxes are earmarked by using names that describe an expenditure program rather than the base of the tax. Ontario should therefore change the name of its Employer Health Tax.

Chapter 12
Paying Other People's Taxes: Problems of Compliance

9 Ontario should seek the agreement of the federal government to establish and strictly enforce rules applicable to corporate expenditures which provide employees with personal benefits such as meals expenditures. Where possible, the personal element of such expenditures should be attributed as income to those who derive the private benefit. *239*

Where it is not practical to attribute benefit to individuals, the corresponding deductions by the business incurring the expense should be limited.

The same limits should apply to business expense deductions, whether they are claimed by a corporation or by an individual claiming deductions from income from self-employment.

Ontario should seek the agreement of the federal government to disallow any deduction for business entertainment.

10 Ontario should improve compliance by: *244*

a) simplifying rules and administrative procedures to make compliance with tax laws easier for taxpayers;
b) increasing rates of audit and penalties to increase the risk associated with non-compliance;
c) making the public aware of the enforcement of tax compliance;
d) improving cooperation among tax authorities within the provincial government and among levels of government to enforce tax compliance;
e) emphasizing cooperative efforts with other levels of government in identifying underground economic activities; and
f) devising special enforcement, reporting, and withholding requirements to address compliance problems in particular areas of the underground economy.

Chapter 13
Strengthening Ontario's Role in Income Tax Policy

11 Ontario should seek amendments to the federal-provincial Tax Collection Agreements that permit it to: *254*

a) levy its tax directly on the income base rather than the "tax-on-tax" arrangement currently in place;
b) determine the number of income tax brackets and the rates applicable to them independently of the federal government; and
c) define and determine the value of its own tax credits independently of the federal government.

12 Ontario should seek amendments to the federal-provincial Tax Collection Agreements that allow both levels of government to determine tax expenditures independently by: *254*

a) ensuring they are in the form of tax credits rather than deductions, exemptions, or exclusions from the base; and/or
b) empowering the provincial government to define an "adjusted income" base that would enable it to add items back into its base that the federal government chooses to exclude.

13 Ontario should seek amendments to the federal-provincial Tax Collection Agreements that give it a role in income tax policy and administration by: *255*

a) providing for direct input by the provincial government into the audit and enforcement activities of the federal government involving Ontario taxpayers; and
b) institutionalizing formal consultation in advance of any federal decision affecting the definition of the income tax base.

Chapter 14
Equality of Women and Men

14 To continue the recognition in the tax system of the economic independence of men and women, the individual should be retained as the unit of taxation in both the federal and provincial income tax systems. *267*

15 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the marital credit and redirect the funds through a reformed credit system. *271*

16 Ontario should seek the agreement of the federal government to abolish the deduction for child support and alimony payments in the personal income tax. These payments should not be taxable in the hands of the recipient. *276*

Chapter 16
The Role of the Tax System in Social Policy

17 Ontario should consolidate the adult components of the Ontario property and sales tax credits and the Ontario Tax Reduction program into a new and simplified Ontario Tax Assistance Credit. The credit should be refundable, delivering its maximum benefit to adults below a specified family income level and declining as income rises. *302*

18 The current system of tax-delivered assistance to families with children through the Ontario Tax Reduction and the sales tax credit should be rationalized into an Ontario child tax credit. The credit would be refundable and provide a declining benefit as family income rises. *306*

19 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, the equivalent-to-married credit should be eliminated and replaced with a supplement to the child tax credit that would provide benefits to single parent families. *306*

20 If Ontario establishes an income-tested child benefit program which provides benefits to low-income families regardless of the source of their income, Ontario should not implement the child tax credit proposed in recommendation 18. The assistance to families with children currently delivered through the tax system, through the Ontario Tax Reduction and the sales tax credit, should be eliminated and the additional revenue used to augment the benefits delivered under the child benefit program. *307*

21 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the child care expense deduction and use the revenue recovered in direct program spending for child care. *310*

22 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the disability tax credit and replace it with a flat rate, taxable benefit payable to all persons with disabilities. *318*

23 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the credit for disability-related medical expenses and the deduction for attendant care. In their place, Ontario should establish a program outside the tax system to subsidize the cost of attendant care or medical expenses for persons with a disability. *321*

24 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the age tax credit and replace it with a seniors tax credit. This credit should be refundable and provide a declining benefit as family income rises. *324*

25 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the pension income credit. The revenue recovered by eliminating this credit should be used to increase the value of the seniors tax credit. *327*

26 The maximum retirement benefit eligible for tax assistance through the deduction for contributions to registered pension plans and Registered Retirement Savings Plans in the personal income tax and the deduction of contributions in the corporate income tax is currently 2.5 times the average industrial wage. Ontario should seek the agreement of the federal government to reduce this limit to 1.5. This lower limit should be phased in by freezing the pension maximum and corresponding contribution limits at current levels until the maximum pension and corresponding limits are equivalent to 1.5 times the average industrial wage. Thereafter, contribution limits should be indexed to maintain the ratio. *332*

27 Ontario should seek the agreement of the federal government to convert the deductions for contributions to registered pension plans and RRSPs in the personal income tax and corporate income tax to tax credits. Withdrawals from plans should continue to be taxed as ordinary income. *333*

Chapter 17
Taxation of Dividends and Capital Gains

28 Ontario should discuss with the federal government the effectiveness and fairness of the dividend tax credit with a view to eliminating or restructuring the credit, subject to appropriate measures to ensure that small business income is subject to the same amount of tax whether it is earned directly through self-employment or a partnership, or indirectly through a Canadian-controlled private corporation. *343*

29 Ontario should seek the agreement of the federal government to end the exclusion of 25 per cent of capital gains from taxable income. Similarly, all capital gains should be included in corporate income for corporate income tax purposes. *348*

30 Ontario should seek the agreement of the federal government to abolish both the $100,000 general lifetime exemption for capital gains and the special $500,000 lifetime exemptions for farming and small business assets. If the federal government does not agree to make the changes at the federal level, Ontario should make the changes in the Ontario income tax. *350*

Chapter 18
The Income Tax Rate

31 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should adopt a personal income tax rate schedule with the following features: *358*

- a basic personal credit determined by multiplying the lowest Ontario personal income tax rate by the basic personal amount in the federal personal income tax;
- a rate schedule that is graduated over the middle-income range;

- a top marginal rate which would result in a combined federal/provincial top marginal rate of no more than 60 per cent and which would apply to annual taxable income in excess of $250,000; and
- no more than 10 tax brackets.

Chapter 19
Taxation of Wealth

32 Ontario should seek the agreement of the federal government and the other provinces to establish a national wealth transfer tax. This tax should be fully comprehensive and should apply to gifts as well as transfers at death. The tax should exempt spousal transfers. It should have a generous exemption level but should contain no credit for capital gains taxes on deemed dispositions. *393*

33 If a wealth transfer tax is implemented which generates additional revenue for the Government of Ontario, Ontario's probate fee should be levied as a user fee at a flat rate, rather than as a percentage of the estate. *393*

Chapter 20
Corporate Taxation in a Fair Tax System

34 Ontario should maintain effective rates of tax on business at approximately their current levels relative to other jurisdictions, given the evidence with respect to: *411*

- effective tax rates in competing jurisdictions,
- the impact of effective tax rates on business location decisions, and
- the shifting of corporate taxes to employees, consumers, and investors.

35 It would be desirable in principle to change the composition of taxes on business by increasing taxes based on profitability and decreasing taxes that are not sensitive to profit. However, the fact that the corporate income tax base can move from country to country in response to statutory tax rate differentials means that it is unlikely that increased revenue could be raised *412* through higher corporate income tax rates. The Ontario government should consider the potential for tax base mobility when setting corporate income tax rates.

36 Ontario should seek agreements with the federal and provincial governments to minimize interprovincial tax competition. Agreements should provide for such measures as: *416*

- consolidated taxation in which the tax-paying unit would include all the Canadian members of a corporate group; and
- minimum provincial corporate tax rates.

37 National and subnational jurisdictions face constraints in their ability to tax the income of multinational corporations. While respecting those constraints in establishing its own policy, Ontario should urge the federal government to play an active role in promoting initiatives, such as international tax agreements, to ensure that the income of multinational corporations is taxed fairly. *416*

38 Ontario should not attempt to use its corporate tax system as a mechanism for delivering incentives that are more generous than those offered in the federal system. Corporate tax deductions in Ontario which are either in addition to federal deductions or accelerated compared with federal deductions should be eliminated. *426*

39 In addition to the criteria applicable to tax expenditures generally, tax expenditures designed to further general economic development goals should meet the same criteria that apply to economic development programs delivered outside the tax system: *426*

a) Subsidies should be focused on desired activities or behaviours, not on sectors, types of companies, or size of businesses.

b) The activities or behaviours targeted must be defined and measured easily.
c) The incentives given should be large enough to result in changed corporate decisions.
d) The subsidy programs must be simple to understand and transparent for both companies and the administrative authorities.
e) To limit the potential for abuse, tax incentives in the form of non-refundable credits should not be tradable among firms but rather should be restricted to the recipient company.
f) All subsidy programs should be reviewed in depth with potential recipient firms for their likely impact on behaviour before they are introduced.

40 Ontario should eliminate the bias in the corporate income tax against income generated in service industries by removing the preferential rate for profits from manufacturing and processing. *435*

Chapter 21
Taxation of Small Business and Cooperatives

41 Ontario should maintain a tax rate lower than the general corporate tax rate for the first $200,000 of small business income. The small business rate should be adjusted periodically to ensure equal tax treatment of small business income received by individuals that has been earned through either an incorporated or an unincorporated business. *458*

42 Ontario should retain the exemption and graduated set of flat rates for the Ontario capital tax in its current form. *460*

43 Ontario should encourage the federal and provincial governments to consider the ownership and governing structure of cooperatives when developing tax policy, programs, and legislation. *465*

Programs should be structured so that:

a) the requirements can be met as easily by cooperatives as by other enterprises, and

b) the benefits are equally available to cooperatives and other enterprises.

44 Ontario should amend the worker ownership component of the Ontario Investment and Worker Ownership Program to permit employees to operate a worker-owned enterprise as a cooperative. *467*

45 Ontario should ensure that property held by not-for-profit housing cooperatives be assessed on the same basis, whether they own or lease the land. *468*

Ontario should amend the Land Transfer Tax Act to ensure that it is not applied to the value of the building of a newly developed housing cooperative when the land and the building originate with different corporations.

Chapter 22
Payroll Taxation

46 Ontario should eliminate the graduated rate structure for its existing payroll tax and replace it with a uniform rate of tax based on all remuneration. *478*

47 Ontario should establish a new method of calculating remuneration for payroll tax purposes for owner-managers of corporations and self-employed individuals. For owner-managers of corporations, remuneration above an exemption level up to a threshold amount, whether in the form of salary or dividends, should be fully taxable. Above this threshold amount, a portion of remuneration would be excluded from the base as an allowance for the owner-manager's return on capital. For self-employed individuals, a portion of remuneration above the threshold amount would be excluded from the base as an allowance for the return on capital included in earnings. *482*

48 Ontario should seek the agreement of the federal government to make payroll taxes fully deductible for corporate income tax purposes. *484*

Chapter 23
Resource Taxation

49 The Ontario Mining Tax should be changed from its current format as a tax on profits to one on cash flow, which would: *497*

a) allow for the immediate deduction of all capital and operating expenditures;
b) provide for any expenditures not deducted in the current period to be carried forward with an investment allowance for deduction in future periods; and
c) exclude any further deduction for depreciation or interest.

Since these features allow full credit for returns on processing assets, there would be no justification for the processing allowance provided for in the current tax format.

50 The resource allowance in the Ontario corporate income tax should be restricted to the lesser of resource taxes actually paid and 25 per cent of resource profits. *500*

51 In establishing rates of tax on cash flow in the mining industry, Ontario should monitor closely world economic conditions in the province's key mineral sectors to ensure that Ontario generates the maximum revenue possible from the underlying value of the mineral resources consistent with the need to maintain the long-term viability of the industry. *512*

Ontario should set the initial rate of the tax on cash flow to generate a long-term revenue yield – after allowing for any additional incentives for exploration, research, and environmental costs – equivalent to the yield of the current tax on profits.

52 A mining tax based on a cash flow format should not provide for: *512*

a) exemptions for cash flow below a threshold or on any basis; or
b) tax holidays for new mines or on any other basis.

53 Ontario should explore further the potential role for a tax on cash flow in enhancing Ontario's return from its forestry wealth. *519*

54 Ontario should increase its reliance on auctions of forest-harvesting rights to recover the public value of forest products until such time as a cash flow tax can be introduced. *519*

55 Regeneration costs borne by the forestry operation should be deductible from the cash flow base. Regeneration costs borne by the government should be a charge against cash flow prior to the application of the tax. *520*

56 Ontario should revise the system of area charges for forestry to reflect the cost of holding forest land out of alternative uses such as recreation and to reflect costs of administration and forest maintenance. *522*

Chapter 24
Retail Sales Tax

57 Ontario should broaden the base of the retail sales tax to include all goods and services with limited exemptions. *535*

58 Ontario should exempt all business inputs from the retail sales tax. *537*

59 Ontario should replace its current single-stage sales tax, levied only at the final point of sale at the retail level, with a multi-stage sales tax levied on all transactions with full credit for tax paid on business inputs. *538*

60 Given the existence of a comprehensive sales tax at the federal level, Ontario should harmonize its retail sales tax with a national sales tax modelled on the federal Goods and Services Tax. This would involve accepting the basic structure of the GST as a multi-stage sales tax or value-added tax, with the following provisions: 544

a) an exemption for health care services, financial services, education services, child care services, personal care services, legal aid, resale of homes, and residential rents; and

b) zero-rating for basic groceries, prescription drugs, medical services, transportation services, and public transit services.

In negotiating its participation in a national sales tax system, Ontario should:

- examine approaches to making prepared foods purchased in convenience and grocery stores taxable; and
- explore the options for including financial services in the tax base.

61 Ontario should require joint administration of the harmonized sales tax, which would provide for: 545

a) joint establishment of all aspects of sales tax policy, with the exception of rates;

b) establishment of tax rates by each government independently;

c) formal provincial involvement in the administration of the tax. This involvement would be accomplished through recognition of a clearly specified provincial role in the administration of the joint tax; provincial administration of the joint tax; or establishment of an independent federal/provincial agency for the administration of the joint tax.

62 Ontario should not increase retail sales tax rates on selected luxury items or introduce a distinct excise tax on luxury items. 549

Chapter 25
The Role of Taxes in Protecting the Environment

63 Ontario should increase its reliance on tax-related economic instruments directed towards pollution control. Ontario should establish pollution taxes on substances selected from generally recognized pollutants or lists of recognized pollutants, such as: *559*

- the Primary List of substances for ban or phase-out maintained by the Ontario Ministry of Environment and Energy;
- the Ministry of Environment and Energy Secondary List; or
- the National Pollutant Release Inventory.

Such pollution taxes should apply to all discharges, whether into water (including sewers), land, or air. Such taxes should increase with the quantity of pollution and vary with the risks associated with the discharge of each substance.

In determining the appropriate mix of tax, regulation, and other instruments, Ontario should consider the extent to which the tax can be applied directly to the activities generating the pollution and the potential impact of each type of measure on industrial activity.

64 Ontario should introduce a tax on all fossil fuels consumed in the residential, commercial and industrial, and transportation sectors based on the carbon content of fossil fuel energy inputs. For the largest sources of carbon dioxide emissions, carbon dioxide emission limits should be negotiated and established through regulated limits. The tax should apply to those sources only if they fail to meet agreed emission limits within the established timetable. *563*

65 To maintain incentives for fuel conservation and to reflect the higher environmental costs associated with transportation use, Ontario should retain a rate of tax on transportation fuels higher than on energy consumed in other sectors. *566*

66 Ontario should extend the Tax for Fuel Conservation to light trucks and vans and then adjust the rates to provide a stronger incentive to purchase fuel-efficient vehicles. *568*

67 Ontario should establish a new system of vehicle registration based on mileage, vehicle inspection results, and other vehicle characteristics related to road use, such as weight. Fees raised from this system should replace a portion of the revenue currently raised from transportation fuel taxes. Until this system is implemented, transportation fuel taxes should remain at their current levels. *571*

68 Ontario should introduce an environmental tax on all ozone-depleting substances used in the province, whether new or recycled. The government should ensure that the tax closely complements the province's existing and emerging regulatory framework. *574*

Chapter 26
Environmental Charges for Water and Sewer Services and Solid Waste

69 User fees should be applied for water and sewer services, based on levels of consumption and costs of providing the service. Such fees should apply to all sectors that consume these services. *582*

Fees for water and sewer services should include a fixed amount to account for the costs of capital replacement, and a variable amount that reflects consumption.

To improve efficiency and to provide incentives for resource conservation, the user fee system should incorporate such features as peak-load pricing, seasonal pricing, and surcharges for hard-to-treat industrial, commercial, and institutional waste.

User fee systems should include such options as reduced, flat, or constant unit rates up to a minimum level of consumption, subsidized rates for basic service, and exemptions for low-income consumers to ensure that higher fees for sewer and water services do not bar low-income families from access to those services.

70 Ontario should expand the application of user fees for both residential and non-residential solid waste. *585*

71 User fee rates for solid waste in the residential sector should reflect all costs associated with the collection and disposal of solid waste, including the environmental costs generated by waste collection and disposal. *588*

Fees should vary with the amount of waste generated. Where possible, fees for residential solid waste should increase with weight.

To ensure broad access to solid waste collection and disposal services, user fee structures should provide for reduced rates for basic service, and special reduced rates for low-income consumers.

72 Ontario should establish a regulatory and fee framework to ensure that prices charged for solid waste collection and disposal in the industrial, commercial, and institutional sector provide incentives for waste reduction. *591*

73 Ontario should introduce a broad-based system of environmental excise taxes on food and beverage containers. These taxes should be fully refundable for containers returned for reuse and partially refunded for containers returned for recycling. *593*

Chapter 28
Paying for Services: Property Taxes in a Fair Tax System

74 The provincial government should assume responsibility for the funding of education to a provincial standard, allocating funds to school boards based on per student cost, student needs, and community characteristics which affect education costs, such as poverty and language. *677*

75 Ontario should replace the local residential property tax as a source of core funding for education with funds raised from provincial general revenues. *681*

76 Ontario should eliminate the local education levy on commercial and industrial property. *681*

77 Ontario should permit school boards to raise funds to support local discretionary spending through a local levy on the residential property tax base. The amount of this local levy for each board should be restricted to a fixed percentage – not greater than 10 per cent – of the total amount of provincial funding provided to that board. *685*

78 Ontario should assume full responsibility for funding general welfare assistance and provincially mandated services to children. *686*

79 a) To ensure that municipal governments do not eliminate property tax savings resulting from reform in the funding of education and social services by raising municipal tax rates, those tax rates should be subject to provincial regulation during a transitional period. *687*

b) Ontario should establish a base year municipal tax rate, which excludes taxes attributable to services no longer funded from property taxes, and should limit municipal tax rate increases to a provincial standard increase, subject to appeal. In addition, municipal governments should be required to disclose on their tax bills any increases in tax relative to this revised base year tax rate.

80 Ontario should require that municipalities levy user fees for sewer and water services. Assessment-based charges for water and sewer services should be replaced by metering of all consumption. Flat rate water charges should not be permitted. *690*

81 By the funding of pilot projects and other means, Ontario should encourage municipalities to levy user fees for waste collection. *690*

Chapter 29
A New Basis for Property Taxation

82 Residential assessment of individual properties for local taxation purposes should be based on the following factors: *704*

- size of building,
- dimensions of lot, and
- type of building.

Weighting factors used in combining the factors of size of building and dimensions of lot for each type of building should be designed to ensure that the resulting assessments reflect variations in the value of properties in their current use, as shown in their rental value.

Weighting factors would be permitted to vary, based on location, subject to the following requirements:

- Without differential weighting factors based on location, it would be impossible to achieve assessments which reflect value in current use.
- Assessment areas could not be smaller than geographically contiguous areas which carry the same zoning designation for planning purposes.

83 Residential tenants should be made aware of the assessment and corresponding property taxes that apply to the property they occupy and that are reflected in their rents. Municipalities should be required to send property tax notices to all tenants, informing them of all taxes applicable to their units. *707*

Administrative mechanisms should be developed to ensure that landlords are able to pass on increases in property tax and that tenants receive full credit in their rents for any reductions in property tax that result from reform of local government financing.

Local government finance reforms affecting residential rental property should not be implemented until such a mechanism has been developed.

84 All recreational vehicles and trailers located permanently in a campground or trailer park should be assessed as residential property. Location would be considered permanent if the mobility of the vehicle or trailer is impaired. Vehicles and trailers located in a campground or trailer park for more than 30 days and not assessed should be subject to a monthly fee. The fee should be established by the provincial government to approximate the local taxes that would apply if the structure were a permanent dwelling, pro-rated to a monthly amount. *708*

Fees would be collected by the operator and remitted to the local municipality or local roads board.

85 Non-residential property should be assessed on the basis of the rental value of the property – the price that would be paid for property of that class and type for the right to employ the property in its current use. *711*

86 Statutory assessment rates should apply to non-residential properties whose value in current use is difficult to determine. *713*

Railway, pipeline, and electrical transmission rights of way should be assessed at provincial standard unit rates which are updated on a regular basis as assessed values generally are updated.

Church sanctuaries and cemeteries should be assessed at a standard unit rate.

87 Vacant land should be assessed based on the preponderant use of property in the area. Vacant land includes surface parking lots zoned for other purposes and unused rights of way. *714*

Chapter 30
Municipal Taxation Policy

88 All residential property should be assessed on the same basis whether the property is occupied by an owner or a tenant. *717*

89 Non-commercial cottage and recreational property should be assessed as residential property and be subject to local municipal taxes on exactly the same basis as other residential property. *719*

90 Local levies for education should apply to all properties assessed and taxed for municipal purposes as residential property, including non-commercial cottage and recreational property. *720*

91 Ontario should allow municipal governments to establish their own rates of tax on non-residential property, subject to a minimum rate of tax established by the provincial government. *723*

92 The farm residence and one acre of land should be assessed and fully taxed as residential property. *724*

93 Wetlands, managed forests, and farming property other than the farm residence and one acre should be assessed as non-residential property based on its value in current use, established using available provincial data on soil quality and productivity, and should be subject to local non-residential property taxes. *724*

94 The business occupancy tax should be abolished as a separate form of taxation of non-residential property. Municipal governments should have explicit powers to replace the revenue forgone from residential or non-residential property taxes. *727*

95 To replace the relief provided for vacant non-residential properties in the current non-residential and business occupancy tax systems, the local non-residential tax rate should be reduced by 40 per cent for property that is vacant. *728*

96 Ontario should develop general legislation regarding exemptions from local property taxes and should repeal the exemption provisions of existing private legislation. *742*

Property should be exempt from local taxation only if it is determined that the owner should not be required to pay for local services or if there is a public policy rationale for linking a subsidy directly to the amount of property tax paid on the property.

Exemptions should be based on the nature of the use of a property rather than on the characteristics of the owner of the property.

Municipal governments should not have the power to exempt property from taxation.

97 Crown land should continue to be exempt from local property taxation, but should be subject to full payment by the province in lieu of all local property taxes, based on the assessment of similar property. Roads and highways should not be subject to taxation or to payments in lieu of taxes. *742*

98 The exemption from local property taxation for "property held in trust for a band or body of Indians" should be restricted to reserve lands and other lands for which municipal services are not provided. *743*

99 Public hospitals and public educational institutions should continue to be exempt from local property taxation. Formula payments in lieu of taxes based on the number of beds or the number of students should be eliminated and replaced by full payment in lieu of taxes by the province based on the assessment of similar property. *743*

100 The exemption from local property taxation for Children's Aid Societies should be continued. The provincial government should make payments in lieu of taxes for Children's Aid Societies. *743*

101 The property of lower-tier (local) municipalities and school boards located within their geographic jurisdiction should be exempt from local property taxes. Property of upper-tier municipalities (regional, district, and metropolitan municipalities and counties), other than roads, highways, and public transit rights of way, should be subject to local property taxes. *743*

102 The local property tax exemptions for public libraries and agricultural and horticultural societies should be restricted to property owned and operated by a municipal government or an agency of a municipal government and located within the municipality. *744*

103 The local property tax exemptions should be eliminated for property owned, occupied, and used by: the Boy Scouts Association; the Canadian Girl Guides Association; private reform schools and orphanages; charitable organizations for the relief of the poor; the Canadian Red Cross Society; and the St. John Ambulance Association. *744*

104 The local property tax exemptions for churches, cemeteries, and religious and educational seminaries should be eliminated. *744*

105 The local property tax exemption for battle sites should be eliminated. *744*

106 Other local property tax exemptions should be limited to property owned and used by institutions of provincial interest or importance. The provincial government should make full payments in lieu of taxes for all such exempt property. *744*

107 The following transitional rules should apply to the repeal of existing exemptions from property taxation: *745*

a) After advance notice of one year, there should be a phase-in period of up to five years to permit taxpayers to adjust.
b) Exemption policies should only be changed following the introduction of assessment based on value in current use for commercial and industrial properties and unit value assessment for residential properties.
c) Special statutory assessment rates should be established for exempt properties for which it is impossible to determine a value in current use, such as the portion of church property used as a sanctuary.
d) Properties such as cemeteries which are supported by fixed endowments based on tax exempt status should continue to be exempt. New cemeteries established after the change in policy should be taxable.

108 The special local property tax exemption for mining buildings and machinery located underground should be eliminated. Any building, machinery, or equipment that would be taxable if located on the surface should be taxable if located underground. *747*

109 The exemption from local property taxation for up to 20 acres of forestry land attached to a farm (a wood lot) should be eliminated. Such property should be assessed and taxed based on its value in use as a wood lot. *747*

110 Provided a unit value residential assessment system is adopted, in which assessments of individual properties of the same type and in the same geographic area vary only with differences in physical dimensions, exemption from local property taxation for modifications to property for the accommodation of elderly or disabled residents should be eliminated; any appropriate assistance should be provided through direct spending programs. *747*

Chapter 31
Making the Local Financial System Work Better

111 Ontario should limit provincial grants and subsidies to municipal governments in areas of local jurisdiction to: *757*

a) areas in which the province wishes to increase local spending because such spending generates spillover benefits outside the local area or in the province generally; and
b) areas in which it is considered appropriate that the province guarantee the availability of a basic level of service, regardless of local fiscal capacity.

Grants intended to increase levels of local spending on programs that generate benefits for people who live outside the local area (spillover benefits) should be designed to provide assistance for spending above minimum levels rather than matching funding from the first dollar spent.

112 Ontario's subsidy programs for municipal governments should be targeted to deal with factors that limit the ability of municipalities to provide access to adequate local services at reasonable cost. These programs should focus on particular local services; should be based on factors such as climate, geography, and density of population; and should be designed to respond to emergency situations, such as the closure of a business vital to the local revenue base. *758*

To ensure that assistance is available only to offset excessive local tax burdens required to fund minimum standard services, subsidies under such programs should vary based on local fiscal capacity – the ability of the municipality to raise revenue to pay for those programs while imposing a reasonable burden on local taxpayers.

Local fiscal capacity should be measured separately for the residential and non-residential sectors. For the non-residential sector, local fiscal capacity should be measured using assessment, adjusted by equalization factors so that it is measured on the same basis throughout Ontario. For the residential sector, local fiscal capacity should be measured based on residential property taxes paid by residents of the municipality as a proportion of the total income of all households in the municipality.

Subsidies should equalize the impact on household incomes in the municipality of residential property taxes required to support a particular service, after allowing for local revenue from the application of a standard effective rate of tax on commercial and industrial properties and after allowing for revenue from the taxation of residential property used by non-residents.

113 Each local (lower-tier) municipality's share of county, regional, district, or metropolitan (upper-tier) costs should be based on its share of total residential and non-residential assessment. *762*

Residential and non-residential assessment would be measured on a consistent basis throughout the upper-tier area. The share of each lower-tier municipality would be determined as follows:

a) The weighted average rate of tax on residential property in the upper-tier area in the previous year would be calculated by dividing total residential property taxes levied for upper-tier purposes by all municipalities in the upper-tier area by total residential assessment in the upper-tier area.

b) The weighted average rate of tax on non-residential property in the upper-tier area in the previous year would be calculated by dividing total non-residential property taxes levied for upper-tier purposes by all municipalities in the upper-tier area by total non-residential assessment in the upper-tier area.
c) Residential assessment would be multiplied by the weighted average rate of tax on residential property as calculated above.
d) Non-residential assessment would be multiplied by the weighted average rate of tax on non-residential property as calculated above.
e) The share of each municipality would be calculated by adding the figures obtained in (c) and (d) above and dividing by total residential and non-residential property taxes for upper-tier purposes in the upper-tier area in the previous year.

Once the share of each lower-tier municipality is determined in this fashion, lower-tier municipalities would determine the mix of residential and non-residential property taxes used to raise the required revenue in accordance with their own taxation policies.

114 Development charges for education should be eliminated, and the infrastructure costs associated with education should be funded from provincial general revenues. *769*

Municipal development charges should not apply to infrastructure development that is related solely to the total population of the municipality, irrespective of its location within the municipality, and should apply only to costs that would not be recovered from increased property taxes on the new development.

Chapter 32
Provincial Property Taxation

115 Ontario should establish a provincial property tax on commercial and industrial property, levied at a uniform effective rate across the province, to replace the revenue raised by the local education levy on non-residential property and the education share of the business occupancy tax. *776*

116 The provincial commercial and industrial tax should be levied on the assessed value of commercial and industrial property as established for municipal taxation purposes and equalized to a common base across Ontario. *778*

117 The provincial commercial and industrial property tax should apply to all non-residential property which is used for a business purpose. Property owned by a non-profit organization and used for a non-profit or charitable purpose should be exempt from the provincial commercial and industrial property tax. *779*

118 Provincial policy towards the taxation of farming should be reformed as follows: *781*

a) Farming property should be exempt from the provincial commercial and industrial property tax pending a broader review of the economics of the farming industry in Ontario and the policy objectives of government with respect to the farming industry.

b) The Farm Tax Rebate Program should be abolished.

119 The rate for the provincial commercial and industrial tax should be set to generate approximately the same amount of revenue as is currently raised for education at the local level from the business occupancy tax and the non-residential property tax. *782*

Chapter 33
Reducing Reliance on Regressive Taxes

120 Ontario should reduce its reliance on residential property taxes. *802*

121 Ontario should increase its reliance on revenue from personal income taxes. *804*

122 Ontario should meet the additional requirements for funding resulting from reform of education finance and the assumption by the provincial government of responsibility for funding of services for children as follows: *804*

Residential ($ billions)

Education property taxes		4.600	
LESS	Local levy	0.727	
	Grants offset (net)	0.373	
Property tax reduction			**3.500**
To be replaced by			
PIT rate changes		3.000	
Sales tax base		0.300	
Payroll tax changes		0.150	
Corporate income tax uniform rate		0.050	
Additional revenue			**3.500**

Commercial and industrial ($ billions)

Education property taxes		3.095	
LESS	Grants offset (net)	0.251	
Local property tax change			**2.844**
To be replaced by			
Provincial commercial and industrial tax			**2.844**

123 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, it should raise the revenue necessary to meet the tax mix objectives recommended by the Fair Tax Commission by establishing the following rate schedule and credit amounts: *806*

- brackets and marginal rates

Taxable Income ($)	Rate (%)
10,000 and under	10
10,001–20,000	12
20,001–29,590	14
29,591–40,000	16
40,001–50,000	18
50,001–59,180	20
59,181–80,000	22
80,001–150,000	24
150,001–250,000	26
Over 250,000	28

- a basic personal credit with the amount claimed equal to the federal amount and the credit rate equal to the lowest Ontario marginal tax rate.

124 Refundable credit amounts should be as follows: *807*

- an Ontario tax assistance credit of $500 per adult family member up to family income of $18,000, and reduced at a rate of 8.3 per cent of income in excess of $18,000;
- an additional Ontario tax assistance credit of $300 for individuals aged 65 and over;
- a child tax credit of $600 for the first child and $500 for each additional child, up to a family income of $18,000 and reduced at a rate of 7.5 per cent of income in excess of $18,000;
- an additional credit of $400 for the first child in a single parent family.

If Ontario establishes an income-tested child benefit which provides benefits to families with children regardless of the family's source of income, the child tax benefit should be eliminated and folded into this new program.

Chapter 34
Tax Considerations in Aboriginal Self-government

125 Ontario should declare its readiness to negotiate tax harmonization accords with aboriginal governments and to help develop administrative arrangements to facilitate taxation by aboriginal governments. *820*

Chapter 38
Implementation and Transition

126 Ontario should proceed with proposed changes in the structure of its income tax credit system at its earliest opportunity. *864*

127 Ontario should develop a coordinated strategy for negotiating with the federal government on: *864*

a) changes in the personal income tax collection agreement;
b) reform in the tax treatment of child support and alimony;
c) reform in the tax treatment of income from capital;
d) sales tax harmonization;
e) wealth transfer taxation; and
f) a framework agreement on the income tax treatment of federal, provincial, and local taxes paid by corporations.

These changes should be part of general negotiations on federal-provincial fiscal arrangements.

128 Ontario should implement the recommended changes in education expenditure allocation and in the sources of revenue for education as a package. *866*

An education finance reform package must also include a mechanism to ensure that property tax reductions on residential rental property are passed on to tenants and must enable municipalities to set tax rates on residential and non-residential property independently.

129 Ontario must introduce a complete framework for education finance at the beginning of the transition to a new funding system. *867*

This framework should include the expenditure allocation model, the shift in commercial and industrial taxation responsibility from school boards to the province, legislative authority for the discretionary local levy on residential property, and the shift in primary funding responsibility for education from school boards to the provincial government.

130 The education portion of the residential property tax (other than the limited local discretionary levy) should be eliminated at the beginning of the phase-in period. *868*

The shift from local non-residential property taxes for education to provincial commercial and industrial taxation at a uniform rate should be phased in over a five-year period.

131 Prior to the beginning of the transition period for assessment reform, Ontario should implement policy changes dealing with local tax policy flexibility; with sharing the costs of regional, district, and metropolitan municipalities and counties among local municipalities; and with the establishment of a new basis for distributing provincial equalization grants among municipalities. *869*

132 Transitional and implementation measures for local government finance reform should be consistent with the following criteria: *870*

a) Transition should take place over a defined period of time; it should not be linked to an event such as the sale of property (in the case of assessment) or subsequent decision by a particular local government.
b) Transition should, to the extent possible, be weighted towards the beginning of the transitional period to ensure that momentum for reform is maintained.

The same transitional measures should apply to all classes of property.

133 Ontario should, if possible, implement the reform of education finance and of commercial and industrial assessment at the same time. *871*

134 In the transition period for assessment reform, the old and reformed assessment rolls should be maintained in parallel. Over a fixed transition period, municipalities would raise a portion of their revenue requirements from the old assessment roll and a portion from the new assessment roll, with the proportions mandated to shift towards the new roll throughout the transition period. *873*

Business occupancy taxes would be phased out by linking them to the old assessment roll only.

135 Ontario should locate all of the functions related to local government finance in one ministry. *875*

APPENDICES

Ontario
Executive Council
Conseil des ministres

Order in Council
Décret

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council, orders that:

Sur la recommandation du soussigné, le lieutenant-gouverneur, sur l'avis et avec le consentement du Conseil des ministres, décrète ce qui suit :

WHEREAS a comprehensive examination of the present tax system in Ontario is necessary to determine what factors contribute to and enhance the fairness of the tax system;

NOW THEREFORE, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council orders that a Commission to be known as the Fair Tax Commission be established to advise and report to the Treasurer of Ontario and Minister of Economics on the design and implementation of a more equitable tax system in Ontario and to examine and report on the following issues:

The distribution of the tax burden among income groups in Ontario and on changes that would increase the fairness of the tax system as it affects individuals;

Options for ensuring that corporations pay an appropriate share of the tax burden and on the changes that would increase the fairness of the tax system as it affects business;

The distribution of tax powers between the federal, provincial and local governments and the changes that would improve the fairness of these distributions;

The effectiveness and fairness of using the tax system to deliver economic incentives to individuals and businesses; and

Any other matters, as directed by the Treasurer of Ontario and Minister of Economics, that will enable Ontario to achieve its overall objective of improving the fairness of the tax system.

AND THAT the final report of the Commission shall be delivered to the Treasurer of Ontario and Minister of Economics by the end of December, 1993 unless another date is determined in consultation between the said Treasurer and the Commissioners.

O.C./Décret 2853/90

AND THAT not fewer than five or more than nine Commissioners of the Fair Tax Commission shall be appointed by order of the Lieutenant Governor in Council.

AND THAT the Treasurer, in consultation with the Commissioners, may establish Working Groups to provide the Treasurer and the Commissioners with advice, analysis and recommendations on specific tax issues and questions and carry out specific tasks as outlined in the Terms of Reference provided by the Treasurer in consultation with the Commissioners to each Working Group.

AND THAT, to provide full-time administrative support and research coordination to the Commission, a Secretariat is established with a staff consisting of such seconded civil servants, contract staff appointed under the *Public Service Act* and consultants as the Treasurer, in consultation with the Commissioners, deems necessary subject to the approval of the Management Board of Cabinet for staff complement and rates of remuneration.

AND THAT the Commission shall carry out consultations with interested organizations and individuals to obtain their views and concerns on improving the fairness of the tax system, in such manner as the Commissioners, in consultation with the Treasurer, deem appropriate.

AND THAT, in the expenditure of funds and the purchase of goods and services, the Commission shall adhere to the Management Board of Cabinet Directives and Guidelines.

AND THAT the release of all advertisements, public notices, working papers and other research by the Commission, its Commissioners or Working Groups shall be carried out in consultation with the Treasurer.

AND THAT all Government Ministries, Boards, Agencies and Commissions shall assist the Commission to the fullest extent.

AND THAT administrative services to the Commission and its Secretariat shall be provided by the Ministry of Treasury and Economics as the Treasurer deems necessary.

Recommended ____________________
Treasurer of Ontario and
Minister of Economics

Concurred ____________________
Chair

Approved
and Ordered December 20, 1990
Date

____
Lieutenant Governor

Ontario
Executive Council
Conseil des ministres

Order in Council
Décret

On the recommendation of the undersigned, the Lieutenant Governor, by and with the advice and concurrence of the Executive Council, orders that:

Sur la recommandation du soussigné, le lieutenant-gouverneur, sur l'avis et avec le consentement du Conseil des ministres, décrète ce qui suit :

1. Paragraphs 4, 5 and 6 of Order in Council 2853/90 made the 20th day of December, 1990 are revoked and the following substituted therefor:

AND THAT not fewer than five or more than ten Commissioners of the Fair Tax Commission shall be appointed by order of the Lieutenant Governor in Council.

AND THAT the Commissioners shall establish Working Groups to provide the Treasurer and the Commissioners with advice, analysis and recommendations on specific tax issues as outlined in the Commission's Terms of Reference provided by the Treasurer.

AND THAT, to provide full-time administrative support and research coordination to the Commission, a Secretariat is established with a staff consisting of such seconded civil servants, contract staff appointed under the *Public Service Act* and consultants as the Commissioners deem necessary subject to the approval of the Management Board of Cabinet for staff complement and rates of remuneration.

2. Subject to the amendments herein made, the said Order in Council is, in all other respects, confirmed.

Recommended ______ Treasurer of Ontario and Minister of Economics

Concurred ______ Chair

Approved and Ordered January 31, 1991
Date

______ Lieutenant Governor

O.C./Décret 184/91

Appendix B
Consultants

The following individuals, organizations, and firms undertook research projects or assisted with the consultation program and other aspects of the commission's work.

Action for Social Justice
Alpha Consulting Inc.
F.J. Anderson
Douglas A.L. Auld
David Ben
Richard M. Bird
Albert Breton
Caledon Institute of Social Policy
Grant Cameron
Canadian Centre for Policy Alternatives
The Canada Consulting Group
A. Marguerite Cassin
Duanjie Chen
Harold Chorney
David Conklin
Bev Dahlby
James B. Davies
Kathleen M. Day
Deloitte & Touche
Donald N. Dewees
G. Bruce Doern
Donegan Consulting
Andrew Donelle
Arthur Donner
Doris Marshall Ltd.
Daniel J. Dudeck
Peter Dungan
Lorraine Eden
Morley D. English
Brian Erard

Ernst & Young
Lionel D. Feldman
Ed Finn
Jeremy J. Fox
Paul K. Frits
W. Irwin Gillespie
Katherine Graham
John Grant
Leslie Green
Morley Gunderson
David Halchansky
Budd Hall
Douglas G. Hartle
John G. Head
Douglas A. Holland
Samie Husain
Joseph Gault & Associates
Jonathan R. Kesselman
Harry M. Kitchen
KPMG Peat Marwick Thorne
Kathleen A. Lahey
Fred Lazar
Evert A. Lindquist
Linda Mackenzie-Nicolas
Maureen A. Maloney
Dian Marino
Dale Martin
Kenneth J. McKenzie
Alex Michalos
Jack Mintz
Peggy B. Musgrave
Richard A. Musgrave
Lynne Newman
Nirv Centre Communication & Computer Service
Kevin O'Grady
Lars Osberg
Leo Panitch
Rick Williams Research & Consultants
Schlesinger & Associates
Enid Slack
Carl Sonnen
Mark Sproule-Jones
Marc St. Louis
Statistics Canada, Analytical Studies Branch
Taddle Creek Software Inc.
T.D. Cooke Advanced Economic Research
Wayne R. Thirsk
Universalia Management Inc.
Viewpoint Research
François Vaillancourt
John Whalley
Jeremy Williams
Stanley L. Winer
Michael Wolfson
Frances R. Woolley

Appendix C
Working Groups and Advisory Groups

Eight working groups were appointed by the treasurer (now the minister of finance) to examine particular tax policy issues over a 12- to 18-month period. The groups were composed of individuals from a variety of backgrounds who shared their perspectives and collective expertise in developing recommendations to the minister in a number of tax policy areas. Members of the working groups participated as individuals rather than as representatives of organizations.

The working groups were supported by staff from both the Fair Tax Commission secretariat and a number of ministries within the Ontario government. The working groups reported directly to the minister, and their reports, along with other types of material, were used by the commission in its deliberations. (A more detailed discussion of the working groups is found in chapter 2.)

Two advisory groups were appointed by the Fair Tax Commission to provide advice to the commission in the areas of the taxation of cooperatives and tax expenditures. These groups were composed of tax practitioners and other experts and were supported by staff from the Ontario government and, in the case of the advisory group on cooperatives, by staff from a municipal-level government and the cooperatives sector.

Positions and affiliations identify an individual's status at the time he or she was asked to join the group. An asterisk (*) denotes members or staff advisers who withdrew during the working group process owing to professional appointments or other reasons.

Corporate Minimum Tax Working Group

Members

David Burn
Vice-president, Taxation
Northern Telecom

Duncan Cameron
Professor of Political Science
University of Ottawa

Maureen Cavan
Consultant
ABC Canada

Ken Delaney
Acting Research Director
United Steelworkers

Moira Hutchinson
Co-ordinator
Taskforce on the Churches and Corporate Responsibility

Andrew Jackson
Senior Economist
Canadian Labour Congress

Kathleen Lahey
Professor, Faculty of Law
Queen's University

Tom McDonnell (Chair)
The McDonnell Consulting Corporation

Jack Mintz
Professor, Business Economics
University of Toronto

Joyce Mongeon
Chair, Royal Connaught Hotel

Lorne Motton
Vice-president, Finance
Co-operators Group Ltd.

David Pell
Development Initiatives Inc.

George Penna
Vice-president, Taxation
Noranda Inc.

Michael Shapcott
Co-ordinator
Rupert Hotel Coalition

Jack Steer
Financial Consultant and Director
Eastern Construction Company Ltd.

Mary Turner
Tax Partner
Deloitte & Touche

Bob Westlake
Comptroller, Taxation
Sears Canada Inc.

Chris Woodward
Vice-president and Chief Accountant
Toronto Dominion Bank

Government Staff Support

Chris Hill
Sectoral Policy
Ministry of Industry, Trade and Technology

Ann Langleben
Taxation Policy Branch
Ministry of Treasury and Economics

Steve Orsini
Taxation Policy Branch
Ministry of Treasury and Economics

David Parr
Corporate Tax Branch
Ministry of Revenue

Environment and Taxation Working Group

Members

Beth Savan (Co-chair)
Professor of Environmental Studies
University of Toronto

Paul Emond (Co-chair)
Professor of Environmental Law
Osgoode Hall

John Carlos
Director of Taxation
Dupont Canada, Inc.

Janine Ferretti
Executive Director
Pollution Probe

Sam Gindin
Research Director
Assistant to President
Canadian Auto Workers

Joan Huzar
Past President (as of May 1992)
Consumers' Association of Canada (Ontario Division)

Philip Jessup
Director, Urban CO^2 Reduction Project
International Council for Local Environmental Initiatives

Andrew Muller
Professor of Economics
McMaster University

Joy Neill
President
Northwest Chambers Association

Owner/operator
Jellien Nurseries

David Rehor*
Vice-president and Controller
Ford Motor Company of Canada, Limited

Wayne Samuelson
Director of Political Education and Legislative Affairs
Ontario Federation of Labour

Alison Stirling
Health Promotion Consultant
Ontario Prevention Clearing House

Dona Stewardson
Executive Committee Member
Ontario Federation of Agriculture

Michelle Swenarchuk
Executive Director and Counsel
Canadian Environmental Law Association

Special Mention

Jack Gibbons
Senior Economic Adviser
Canadian Institute for Environmental Law and Policy
(Participated on behalf of J. Ferretti at numerous full-group and subgroup meetings)

Staff Support

Peter Burns
Buildings Branch
Ministry of Housing

Janet Dawson
Taxation Policy Branch
Ministry of Treasury and Economics

Peter Deschamps
Tax Revenue and Grants Program
Ministry of Revenue

Jack Donnan
Fiscal Planning and Economic Analysis Branch
Ministry of the Environment

Kayla Estrin
Research Section
Premier's Council on Health, Well-being, and Social Justice

Sid Friesen
Policy Analysis Branch
Ministry of Agriculture and Food

Russ Houldin
Office of Economic Policy
Ministry of Treasury and Economics

Al Nausedas
Central Agency Co-ordination
Ministry of Natural Resources

Larry Poon
Rail Office
Ministry of Transportation

Steven Shrybman
Cabinet Committee on Environment Policy

Duncan Taylor
Policy Development and Coordination Division
Ministry of Energy

Joan van Kralingen
Office of the Minister of Mines
Ministry of Northern
Development and Mines

Peter Victor*
Assistant Deputy Minister
Ontario Ministry of the
Environment

Bunli Yang
Policy Development and
Coordination Division
Ministry of Energy

Low Income Tax Relief Working Group

Members

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 and Actuary
Royal Insurance Canada

Mary Pat MacKinnon (Chair)
Steering Committee Member
Child Poverty Action Group

Andy Mitchell
Program Director
Social Planning Council of
Metropolitan Toronto

Mona Monkman
Director, Financial Management
Corporation of the City of
Mississauga

George Monticone
Counsel
Advocacy Centre for the Elderly

Peter Oliphant
Chartered Accountant
Oliphant & White

Marge Reitsma-Street
Associate Professor
School of Social Work
Laurentian University

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

Government Staff Support

Grace Bogart
Taxation Policy Branch
Ministry of Treasury and Economics

Harry Busse
Benefits Administration
Ministry of Revenue

Agatha Garcia-Wright
Policy Development Division
Ministry of the Attorney General

Zsuzsanna Lonti
Labour Market and Adjustment Policy Branch
Ministry of Labour

David Mercer
Policy Development Section
Ministry of Community and Social Services

Kostas Plainos
Taxation Policy Branch
Ministry of Treasury and Economics

Property Tax Working Group

Members

Beverley Allen
Director of Legislation and Finance
Ontario Public School Boards Association

Grant Andrews
Associate Director / Business Affairs
Durham Region Roman Catholic Separate School Board

Elizabeth Behrens
Regional Councillor
Town of Oakville

Wendy Bell
Former Mayor
Town of Marathon

Audrey Birt
Director, Taxation and Water Revenue
Finance Department, City of Toronto

Doris Brick
Reeve
Township of Ennismore

Ken Brooks
Executive Director, Legal Assistance
Town of Wallaceburg

Charles Caldwell
Mayor
Town of New Liskeard

John Calvert
Research Officer
Canadian Union of Public Employees

Paul Carroll
Superintendent of Business and Operations
Huron County Board of Education

Danielle Chartrand
Director of Property
Department of Housing and Property
City of Ottawa

Donald Clune
Chairman
Metropolitan Separate School Board

Grant Collins
Past President
Bruce County Federation of Agriculture

Audi Dharmalingam (Co-chair)
President
Urban Alliance on Race Relations

Ron Ditchburn
Manager, Property Tax
CN Real Estate

Louise Eason
Acting Commissioner of Finance,
Regional Municipality of Peel

Andy Faas*
Executive Vice-president
National Grocers Company

Iain D. Fraser
President
AEC Group Ltd.
Valuations Inc.

Peter Goldthorpe
Director of Information and Legislative Services
Ontario Home Builders' Association

Linda Grayson
Associate Director of Education, Operations
Toronto Board of Education

Jim Gubinczki
Treasurer
City of St Thomas

James Head
First Vice-President
Ontario Teachers' Federation

Florence Henderson
Ontario Teachers' Federation

Grant Hopcroft
Controller
The Corporation of the City of London

Garth Jackson
President
Canadore College of Applied Arts and Technology

Ruth Lafarga
Citizen
Former trustee of Durham Board of Education

Terry Mangan
Ontario Teachers' Federation
Deputy General Secretary
Ontario English Catholic Teachers Association

Malcolm McCarthy
Director
Peterborough Two Tier Property Tax Committee

Ross McKee
Director of Revenue
City of Waterloo

Dick McIntosh
Consultant to the Metro Toronto Public School Boards
Former Superintendent of Business and Plant
East York Board of Education

Donald McIver
Chief Economist
Sun Life of Canada

Roland Montpellier
Supervisor of Revenue
Sudbury District Roman Catholic Separate School Board

Allan Morrill
Assessment Manager
Falconbridge Limited

Katherine Packer
Citizen
Member of Upper Stoney Lake Cottagers' Association

Joe Pantalone
Councillor
Municipality of Metropolitan Toronto

Robert Poirier
Supervisor
Separate School Panel, Ottawa-Carleton French Language School Board

Robert Richards
Deputy Chief Administrative Officer
Municipality of Metropolitan Toronto

Elaine Rowe
Manager
Public Education Assessment Review Department
Metropolitan Toronto School Board

Arthur St. Jean
Trustee
Association franco-ontarienne des conseils d'écoles catholiques

Andrew Stewart
Citizen with interest in tenants

David Stewart
Director
Property Tax and Insurance
Cambridge Leaseholds Limited

Ron Sudds
Business Superintendent
Northumberland and Newcastle Board of Education

Myron Swartz
President
Building Owners Association

Jack Switzer
Citizen
Former chairman of Atikokan Board of Education

Peter Tomlinson
Director of Economic Development
Planning and Development Department
City of Toronto

Reno Viswasam
Citizen
Director
Royal Management Group

Paul Whitehead
Trustee
Ontario Separate School Trustees Association

Margaret Wilson (Co-chair)
Secretary-Treasurer
Ontario Teachers' Federation

John Woods
Deputy City Treasurer
Finance Department
City of Toronto

Observers

Ruth Baumann
Executive Assistant
Ontario Teachers' Federation

Fiona Chapman
Trustee
Toronto Board of Education

Ted Cook
Economist
Canadian Tax Foundation

Hugh Craigen
Assessment Manager
Waterloo Roman Catholic
Separate School Board

Lynn Delvaux
Chief Accountant
Peel Board of Education

Lionel Feldman
President
Lionel D. Feldman Consulting

Sam MacKinlay
Executive Director
Task Force on the Funding of Public Education
Metro Public School Boards

Charlotte MacFarlane
Researcher
Association of Municipalities of Ontario

Earle McCabe
Deputy Executive Director
Ontario Separate School Trustees Association

Peter Meneguzzi
Deputy Director of Education
Administrative Services and Treasurer
Metropolitan Separate School Board

Patrick Slack
Executive Director
Ontario Separate School Trustees' Association

Paul Wealleans
Supervisor
Assessment and Taxation Research
City of Toronto Finance Department

Government Staff Support

Oussama Al-Dimashk
Municipal Finance Branch
Ministry of Municipal Affairs

James E. Doris
School Business and Finance Branch
Ministry of Education

Gerry Hinbest
Policy and Planning Section
Ministry of Education

Shirley Hoy
Assistant Deputy Minister
Ontario Women's Directorate

Brian Kozman
Housing Policy Branch
Ministry of Housing

Lucy Magnus-Burke
Intergovernmental Finance Policy Branch
Ministry of Treasury and Economics

John Nywening
Provincial/Municipal Relations Unit
Ministry of Community and Social Services

Michael O'Dowd
Assessment Policies and Priorities Branch
Ministry of Revenue

Walter Wasylko
Education Expenditure and Financial Analysis Section
Ministry of Education

Retail Sales Tax/Goods and Services Tax Working Group

Members

Andrew Aitkens
Director of Research and Communications,
One Voice, The Canadian Seniors Network

Peter Bleyer
Action Canada Network

Robin Boys
Vice-president Planning
Shoppers Drug Mart

Lucienne Bushnell
Vice-president, Issues and Policies
Consumers' Association of Canada (Ontario)

Graham Cudlipp
Vice-president, Finance, and Secretary
Economical Mutual Insurance Company

Irene David (Chair)
Partner, Ernst & Young

Michael Doyle
Director of Education, Training and Health and Safety Fund
United Food and Commercial Workers International Union

Virginia Davies
Tax Counsel
Bank of Montreal

Bob Hebdon*
Senior Research Officer
Ontario Public Service Employees Union

Katrin Horowitz*
President
Planning Initiatives

Jacqui MacDonald
Managing Director
Bridgehead Inc.

Lorraine Michael
Ecumenical Coalition for Economic Justice

William Molson
Owner, Frida Craft Stores

Alan Wilson
Partner, Price Waterhouse

Mel Watkins
Professor of Economics and Political Science
University College
University of Toronto

Thomas Wilson
Professor of Economics
University of Toronto

Carolann Wright*
Community Health Outreach Worker
Women's Health in Women's Hands

Darla Youldon
Canadian Pricing Manager
John Deere Limited

Government Staff Support

Alex Athanassakos
Northern Policy Planning and Analysis Section
Ministry of Tourism and Recreation

John Godlewski
Taxation Policy Branch
Ministry of Treasury and Economics

Chris Goethel
Small Business Development Branch
Ministry of Industry, Trade and Technology

Burke Williams
Retail Sales Tax Branch
Ministry of Revenue

Tax Treatment of Real Estate Gains Working Group

Members

Penny Bethke
Executive Director
Labour Council Development Foundation

Patrick Boyle
Partner
Fraser & Beatty

Cheryl Craig
Owner
Cheryl Craig Careers
Member, Board of Directors
Ontario Chamber of Commerce

Mitsi d'Souza
Case worker
Centre for Equality Rights and Accommodation

Philip Dewan
President and CEO
Fair Rental Policy Organization of Ontario

Jim Flood
Director of Government Relations
Ontario Real Estate Association

Peter Goldthorpe
Director of Information and Legislative Services
Ontario Home Builders' Association

Michael Kainer
Partner
Sack, Goldblatt, Mitchell

Bruce Lewis
Partner
Lewis & Collyer

Robert MacKenzie
President
MacKenzie and Associates

Robert Poirier
Broker
Royal LePage Real Estate Services
Secretary
Federation of Agriculture (Glengarry County)

Ted Robinson (Chair)
Commissioner
Planning and Development Department
City of Ottawa

Leslie Robinson
Law Reform Director
Metro Tenants' Legal Services

Sheldon Silver
Partner
Goodman & Goodman

Lawrence Smith
Professor of Economics
University of Toronto

Marion Steele
Associate Professor of Economics
University of Guelph

Fiona Stewart
Co-ordinator
Affordable Housing Action Group

Government Staff Support

Anne Guthrie
Taxation Policy Branch
Ministry of Treasury and Economics

George Hough
Housing Policy Branch
Ministry of Housing

Barbara LaVasseur
Assistant Deputy Minister's Office
Ministry of Consumer and Commercial Relations

Wealth Taxation Working Group

Members

Isabella Bakker
Department of Political Science
York University

Gordon Bale
Faculty of Law
Queen's University

Joseph Berman
Berman Family Foundation

Diane Bull
Ontario Public Service Employees Union

Robert Couchman
Donner Canadian Foundation

William Crawford (Chair)
Ernst & Young

James Davies
Department of Economics
University of Western Ontario

George Eaton
Department of Economics
Atkinson College
York University

Larry Enkin
Coppley Group (Cambridge Clothes)

Leo Ferens
Price Waterhouse

Wolfe Goodman
Goodman and Carr

Joan Gullen
Family Service Centre of Ottawa Carleton

Jo-Ann Hannah
CAW-TCA Canada

Kathy Henry
Ontario Federation of Agriculture

Laurie Masters
DDI Seamless Cylinder
International Inc.

Ted Reeve
United Church of Canada

Government Staff Support

Sunita Doobay
Legal Services Branch
Ministry of Revenue

Serge Imbrogno
Industrial and Technology Policy Branch
Ministry of Industry, Trade and Technology

Catherine MacNaughton
Legal Services Branch
Ministry of Revenue

Len Roozen
Policy Analysis Branch
Ministry of Agriculture and Food

Sam Samanta
Strategic Planning and Financial Services
Ministry of the Attorney General

John Whitehead
Taxation Policy Branch
Ministry of Treasury and Economics

Diana Wright
Taxation Policy Branch
Ministry of Treasury and Economics

Women and Taxation Working Group

Members

Charles Black
Vice-president, Insurance Operations
Canadian Life and Health Insurance Association

Marlene Gilbert
Director of International Taxation
Northern Telecom

Nathan Gilbert
Executive Director
Laidlaw Foundation

Marg Harris
Provincial Board Director
Middlesex District
Federated Women's Institute of Ontario

Tina Head
Labour representative

Carmencita Hernandez (Chair)
Past chairperson
Ontario Coalition of Visible Minority Women

Frances Hogg
Chair
Strategic Planning Task Force
YWCA of Metropolitan Toronto

Kathleen A. Lahey
Professor, Faculty of Law
Queen's University

Julie Y. Lee
Lawyer
Osler, Hoskin & Harcourt

Joanne E. Magee
Assistant Professor, Taxation
Department of Administrative Studies
Atkinson College
York University

Janet E. Maher
Ontario Women's Action Coalition

Maryka Omatsu
Lawyer

Mary Anne Palangio
Chartered Accountant
Deloitte & Touche

Thomas E. G. Warner
Coalition for Lesbian and Gay Rights in Ontario

Jean R. Woodsworth
Retired social worker
Past president, One Voice, The National Seniors Network
Chair of Issues, Committee of One Voice

Paul Zarnke
Executive Director
Family Service Association of Toronto

Government Staff Support

Ruth Abbott
Employment Services Section
Ministry of Community and Social Services

Kamman Cheung
Taxation Policy Branch
Ministry of Treasury and Economics

Marion Crane
Guaranteed Income and Tax Credit Branch
Ministry of Revenue

Muriel Deschênes
Economics Unit
Ontario Women's Directorate

Barbara Holman
Policy Development Division
Ministry of the Attorney General

Diana Wright
Taxation Policy Branch
Ministry of Treasury and Economics

Advisory Group on Taxation of Cooperatives

Members

Jerry Andrijiw
Board Member
Credit Union Central of Ontario

John Black
Member-at-large

Joseph Brooks
Vice-president
Finance, Gay Lea Foods Co-operative Ltd.

Dennis Deters
Senior Vice-president, Human Resources
The Co-operators Group Ltd.

Elizabeth Dorsman
Tax Manager
The CUMIS Group Ltd.

Patricia Fenton
President
Parent Co-operative Preschools International

Mary Lou Morgan
Worker Ownership Development Foundation

Albert Perras
Consultant
L'alliance des caisses populaires de l'Ontario ltée.

Gary Rogers
Director of Taxation
Credit Union Central of Canada

Richard Tyssen
Manager, Program Delivery
Co-operative Housing
Association of Ontario

David Westbrook
Treasurer, Chief Financial Office
Co-operators Data Services
Limited

Resource Staff

George Alkalay
Policy Advisor
Ministry of Financial Institutions

Jackie Hawken
Metro Region Human Resources
Manager
The Co-operators Group Ltd.

Hermien Pluimers
Co-operators Data Services Ltd.

Tax Expenditures Advisory Group

Members

Irwin Gillespie
Professor
Department of Economics
Carleton University

John O'Grady
John O'Grady Consulting Ltd.

John Stacey
Director of Tax Services
Deloitte & Touche

Sharon Sutherland
Professor
Department of Political Science
Carleton University

Government Staff Support

Steve Dorey
Economic Forecasting Branch
Ministry of Treasury and
Economics

Anne Evans
Fiscal Planning Policy Branch
Ministry of Treasury and
Economics

John Godden
Revenue and Operations
Research Branch
Ministry of Revenue

Julie Leggatt
Fiscal Resources Branch
Ministry of Health

Frank Longo
Industry and Technology Branch
Ministry of Industry, Trade and
Technology

Brad Rolph
Taxation Policy Branch
Ministry of Treasury and
Economics

Tom Sweeting
Taxation Policy Branch
Ministry of Treasury and
Economics

Appendix D
Tax Forces

Tax Forces were an integral part of the commission's community consultation program. Groups of volunteers in various communities formed "tax forces" to stimulate local discussion of tax issues, to identify for the commission tax issues of interest in their communities, and to prepare for the commission's public hearings. The commission assisted these volunteers in their efforts.

Aboriginal Sector

Michael Cheena
Jim Chicago
Bob Crawford
Jimmy Dick
Phil Goulais
Ralph Jewitt
Rose McInnis-Nixon

Credit Union Sector

Geoffrey Cauchi
Stella Pawlik
Joanne Regimbald
Dave Semley

Education Sector

Bill Bone
Harold Dyck
Jean Faulds
Adrian Guldemond
Linda Langdon
Msgr Dennis Murphy, SJ
Hugh Oliver
Sue Thornham
Betty Turner
Marguerite Yamaskaki

Cobourg

Anne Baayen
Allan McCracken
Rod McLean
Jacqueline Neun
Ron Neun
Deborah O'Connor
Bob Robertson
George Ryken
Johanna ter Woort
Lloyd Williams

Grey-Bruce

Bob Carson
Pat Derochie
Denise Edwards
Ken Furlong
Ann Hankinson
Wayne McCausland
Roseanne McConnell
Peter Mitchell
Byron Monk
Tim Nicholls-Harrison
Brian O'Hagan
Gordon Pratt
John Woodhouse

Hamilton

Brian Adamzack
Andrea Hovarth
Peter Hoyle
Jody Orr
Mike Pennock
Urmis Soomit
Alan Whittle

Kenora

Judy Bain
Ruth Bergman
E. Blouin
Don Cameron
Dave Canfield
Alex Clark
Bill Doerksen
Dan Dufresene
J. Duncan
Dan Favrean
Kerry French
Charles Galloway
Rita Gingras
Charlotte Holm
Bob Homstrom
George Kovall
Conrad Lalonde
G.B. Leckie
Don Lindstrom
Dave McDonald
Ingrid Parks
Chris Poate
Diane Pochailo
James Retson
David Rhind
Bill Richardson
Harry Shankowsky
Karen Tio
Penny Todd
Doreen Toth
Ted Weiss

London

Joan Ball
Gina Barber
Steve Bolton
Leo Bouillon
Steve Cordes

Sheila Davenport
Kerri Farnham
Lynda Hodgins
Marnie Kloppenburg
Marina Lundrigan
Margaret MacGee
Charles McNeil
Laila M. Norman
Norm Pizzali

Ottawa

Aline Akeson
Barbara Roadhouse Bresnahan
Dave Brown
Gordon DiGiacomo
Judith Dowler
Stephane Emard-Chabot
Ron Kellestine
Amy Kempster
Sr Helen Le Brun
Dennis Lewycky
Ellen Lougheed
Skip McCarthy
Dan McIntyre
Cindy Moriarty
Frank Peddle
Louise Tardif

Peterborough

John Boyko
Katherine Jacko
Chuck Lamers
Bill McMaster
Leslie F. Morris
Ray Peters
Neil Rogers
Eric Steinmiller

Sault Ste Marie

Jeff Arbus
Cathy Beaudette
John Bennett
Pierre Boivin
Jean Brassard
Gayle Broad
Kathleen M. Brosemer
Lorretta Chartrand
Susan Cuerrier
Frank Darou
Ray Dawson
Rev. Phyllis Dietrich
Paula Dunning
Thomas Gillespie
Sharon Graham
Trudy Higginson
Paul Mathewson
Deborah Missere
Rosemary O'Connor
Louise Primeau
Bob Richards

Sudbury

Carol Anderson
Ron Cecchetto
Barry Cotton
Jean Dennie
Colombe Hinse
John Hinse
Fred Johannes
June Laird
Yvon Leblanc
Janice Leuschen
Edna Martin
Russ Price
Vicki Smith-Danyliw

Thunder Bay

Tony Carfagnini
Glen Chochla
Linda Gambee
Brenda Huntus
Peter Lang
Greg Laws
Bill Mork
Dawn Powell
Frederic Pretulac
David Ramsay
Brenda Reimer
Don Smith
Margaret Wanlin
Susan Ward

Timmins

Paul Bagordo
Lionel Bonhomme
James Cullin
Peter Doucet
Bonnie Foster
Joe Godin
Trafford Hall
Andrew Marks
Roger Mawdsley
Jean McAllister
Christine Oerton
Brenda Savard
Judy Shanks
Joseph R. St. Jean
Bruce Strapp
Jan Vandermeer
Vivian Walsh
Trevor Yeomans

Toronto

Ann Curry
Alex Cywink
Pat Fenton
Catherine Glen
Josephine Grey
Ken Hale
Gael Hepworth
David Kidd
Samantha Lam
Janet Maher
Marion McComb
Megan McIlroy
Mary Ann O'Connor
Frank Ruffo
Brian Samuel
Deborah Wandal
Jean Woodsworth

Windsor

Matthew Diegel
Irene Friend
Carolyn Fuerth
Linda Long
Mike Longmore
Bill McIntosh
Rose Menyes
Prem Nanda
Alan Paterson
Alena E. Sleziak
Walter Willms

Appendix E
Submitters

This appendix lists the organizations and individuals who sent submissions to the commission's offices. Other submissions were presented by participants at the public hearings (see appendix F). In addition, the commission received petitions, form letters, and advocacy letters concerning: property tax and cottages, condominiums, farms, managed forests, trailer parks, and travel agencies; books and sales tax; the taxation of child support payments; market value assessment; the tire tax; the assessment of multi-unit apartments and the impact on tenants' rents; education funding (separate and private schools); land speculation tax; and wealth taxes.

Maureen Adamache
Ottawa

AG Care
Jeff Wilson
Chair
Chatham

Alliance of Canadian Travel Associations
John Kennedy
President
Marion Graber
Executive Director
Toronto

D.G. Andrews
Oakville

Charles Anthony
Toronto

APC Ltd.
Alex Perlman
President
Toronto

Arnprior Region Federation of Agriculture
Dick Staathof
Director
Toronto

Association franco-ontarienne des conseils d'écoles catholiques (AFOCEC)
Monique Landry-Sabourin
Présidente
Sudbury

Association of Canadian Distillers
K.M. Campbell
President
Ottawa

Association of Municipal Clerks and Treasurers of Ontario
Joyce Foster
President
Mississauga

Association of Municipalities of Ontario
Helen Cooper
President
Toronto

Atikokan Board of Education
Allan Korkola
Director of Education

Doug Austin
Windsor

Basshaunt Lake Homeowners' and Cottagers' Association
L. Harms
President
Georgetown

Ken Belch
Brampton

Trevor and Kathy Bertenshaw
Oshawa

Bloor Bathurst/Madison Business Association
David Vallance
Toronto

Board of Education for the City of Hamilton
Margaret Cunningham
Chairman of the Board

Board of Trade of Metropolitan Toronto
G.E. Meinzer
President
J.A. Collins
General Manager
Donald King
Past president

Borough of East York

Ila Bossons
Metropolitan Councillor for Toronto Midtown
Toronto

Michel Boulay
Oshawa

Brampton Board of Trade
Jack Coughlin
President

Paul Brickus
Toronto

Terry Brown
Peterborough

Hank Brunnader
Burlington

Donald W. Bryant
Huntsville

Canadian Appliance Manufacturers Association
Erik Lesalins
Chairman, Tax Committee
Rexdale

Canadian Bankers' Association
Barbara J. Amsden
Director, Financial Affairs
Allan R. Cooper
Vice-president, Financial Affairs, and Treasurer
Helen K. Sinclair
Past president
Toronto

Canadian Bar Association, Ontario
Linda Adlam-Manning
Executive Director
Erica L. James
President
Toronto

Canadian Chemical Producers' Association
David W. Goffin
Secretary-Treasurer and Vice-president, Business Economics
Ottawa

Canadian Co-operative Association
Judy Goldie
Manager, Ontario Region
Ottawa

Canadian Council of Retirees, CLC
George Goebel
President, Ontario Section
Don Mills

Canadian Crafts Council
Peter Weinrich
Executive Director
Ottawa

Canadian Federation of Independent Business
Linda R. Ganong
Director, Provincial Affairs, Ontario
Catherine Swift
Senior Vice-president, Provincial Affairs
Willowdale

Canadian Hearing Society
Dennis Morris
Executive Director
Toronto

Canadian Independent Record Production Association
Brian Chater
Executive Director
Toronto

Canadian Institute of Public Real Estate Companies (CIPREC)
James R. Bullock
President
L. Ross Cullingworth
Past president
Ronald A. Daniel
Executive Director
Toronto

Canadian Life and Health Insurance Association Inc.
James S. Witol
Vice-president, Taxation and Research
Toronto

Canadian Manufacturers' Association
Wayne McLeod
Chairman, CMA Ontario
Toronto

Canadian Professional Sales Association
T. J. Ruffell
President
Toronto

Canadian Property Tax Association
Alan Duncan
Chairman, Ontario Chapter
Willowdale

Canadian Recording Industry Association
Brian Robertson
President
Toronto

Canadian Tax Foundation
Douglas J. Sherbaniuk
Executive Director
Toronto

Canadian Union of Public Employees
John Calvert
Senior Research Officer
Ottawa

Carleton Board of Education
Derek Walter
Chairman
Nepean

Patricia P. Carlos
Apsley

Barb Carlstrom
Lakefield

George Carr
Toronto

Carrying Place Property Owners' Association
G. A. Henderson
President
Kettleby

Chimo Park Community Association
D.W. Ware
Director
Kanata

City of Belleville

City of Brampton
Peter Robertson
Mayor

City of Brantford

City of Burlington

City of Cambridge

City of Etobicoke

City of Hamilton
Robert M. Morrow
Mayor

City of Kingston

City of Kitchener

City of Mississauga

City of Niagara Falls

City of North York

City of Orillia

City of Oshawa

City of Ottawa
Jacquelin Holzman
Mayor

City of Peterborough
John A. Doris
Mayor

City of Scarborough

City of Stoney Creek
Frank Carrocci
Treasurer

City of Thunder Bay

City of Toronto

City of Waterloo

City of Welland

CN Real Estate
Ron Ditchburn
Manager, Property Tax
Toronto

Coalition for Lesbian and Gay Rights in Ontario
Tom Warner
Member
Toronto

R.W. Collings
Oshawa

Community Services Council
Barbara J. Moorhead
Executive Director
Newmarket

Conference Board of Canada
James R. Nininger
President and Chief Executive Officer
Ottawa

Consumers' Association of Canada (Ontario)
Joan Huzar
President
Toronto

Harry Cooke
Toronto

A.J. Cormack
Toronto

Corso Italia
Phil Capone
Co-ordinator
Toronto

Council of Ontario Construction Associations
David W. Surplis
President
Toronto

County of Kent

County of Peterborough
Doris Brick
Warden

County of Renfrew
Michael Johnson
Chief Administrative Officer and Clerk Treasurer

CP Rail System
G.R. Mackie
Executive Vice-president
Toronto

Crop Protection Institute
Paul D. Cook
Member Services Manager
Etobicoke

J. Gordon Dagg
Buckhorn

N.H. Dalziel
Barrie

Frank Darou
Sault Ste Marie

Deep Foundations Contractors Inc.
W.E. Lardner
Thornhill

T. Delaney Inc.
Tom Delaney
President
Toronto

Dennis Date Consulting
Dennis Date
Kanata

James Devitt
Ottawa

Don't Tax Reading Coalition
David Hunt
Coordinator
Toronto

Dufferin-Peel Roman Catholic Separate School Board
Arthur R. Steffler
Chairperson of the Board
Mississauga

Dufferin-Peel Secondary Unit, Ontario English Catholic Teachers' Association
Wayne Cornack
President
Mississauga

Greg J.A. Durocher
Alderman Ward 2
Cambridge

Dutton Co-operative Child Care Centre
Peter Munavish
President, Board of Directors
Iona Station

Ecolomics Inc.
Murray C. Robinson
President
Don Mills

Ecumenical Coalition for Economic Justice
David Pollock
Chairperson, Administrative Committee
Toronto

Richard Elliott
North York

Falconbridge Limited
E.A. Seth
Vice-president
Toronto

Federal Superannuates National Association
Percy Bateson
President
Eugene Wilson
Past president
Ottawa

Federation of Ontario Cottagers' Association Inc.
Barry Mitchell
President
John Carter
Vice-president, Taxation
Scarborough

Federation of Provincial Non-Profit Organizations Working with Seniors in Ontario
Robert Morton
President
Woodbridge

Betty Fevreau
Thornhill

Mary-Joe Figueira
Mississauga

First Brands Corporation
Robert Rastorp
President and Chief Executive Officer
Scarborough

500 Duplex Tenants' Association
Jean Newman
Toronto

Food Services Industry Group
Robert E. Boone
Senior Vice-president
Toronto

Forum on Responsible Education
Stan Currie
Ottawa

Frontenac Condominium Corporation #28
James Peck
President
Kingston

General Motors of Canada Limited
George A. Peapples
President
Oshawa

George Morris Centre Agri-Food Competitiveness Council
Larry Martin
Chair
Guelph

George Weston Limited
Robert H. Kidd
Senior Vice-president and Chief Executive Officer
Toronto

Robert G. Good
Puslinch

David A.I. Goring
Toronto

Grey County Board of Education
Michael J. McKenna
Director of Education
Hepworth

Grimsby District Chamber of Commerce
Paul Stringer
Vice-president

Haldimand Federation of Agriculture
Brian Reid and Frank Sommer
Canfield

Haliburton Forest and Wildlife Reserve Limited
Peter Schleifenbaum

Hamilton-Wentworth Roman Catholic Separate School Board
Jerry G. Ponikvar
Director of Education
Hamilton

Colin Hardman
Oakville

Jagdish Hattiangadi
North York

Heather's Heritage Haven Limited
M. Lindsay Lambert
Ottawa

John Helm
St Catharines

Timothy C.S. Hemming
Toronto

Marrius R. Hoefman
London

Dorothea Hoerz
Kakabeka Falls

Hermann Hoerz
Kakabeka Falls

Hope Township Ratepayers' Association
John Boughen
Chairman
Port Hope

Hotel Association of Metropolitan Toronto
David Hutchinson
Toronto

Grace Hunter
Etobicoke

IBM Canada Ltd.
J. Hutchison
Director of Taxes
Markham

Inco Limited
J.W. Ashcroft
President, Ontario Division
Copper Cliff

Institute of Chartered Accountants of Ontario
R.T. Neville
President
D.A. Wilson
Executive Director
B.G. Blay
Past president
R.G. Gage
Past president
R.T. Rutherford
Past president
Toronto

Institute of Municipal Assessors of Ontario
K.F. McGillivray
Executive Director
Don Mills

Insurance Bureau of Canada
J.L. Lyndon
President
Toronto

Island View Drive and Area Ratepayers' Association
Harold E. Fry
President
Wiarton

J.E. Agnew Food Services Ltd.
Jeff Agnew
President
Kingston

Japan Automobile Manufacturers Association of Canada
T. Kunii
Chairman
Toronto

Roy N. Jennings
Sarnia

Melvin C. Johnson
Hamilton

Tom Kaneb
Cornwall

Amy Kempster
Ottawa

Thoywell A. Kennedy
Etobicoke

Kenora Board of Education
Marion Helash
Chair

Kids First
Donna Mann
Cindy Peterson
Cambridge

Kingston Area Condominium Association
Harold Snell
George Czanecki

Kiwanis Club of Scott's Plains (Peterborough) Inc.
William Tannock
President

J.A. Knowles
Lanark

Michael Kosnaskie
Pembroke

Peter Kurita
Warkworth

Lake of the Woods District Property Owners' Association Inc.
D.H. Magnus
President
Winnipeg

Lake Rosseau North Association
Paul White
President
Rosseau

Lakehead University
Robert G. Rosehart
President
Thunder Bay

Lambton County Roman Catholic Separate School Board
John F. Ross
Director of Education and Secretary
Sarnia

Mary Lawr
Haliburton

Wayne Lealess
Windsor

London Chamber of Commerce
John Redmond

London Social Planning Council
Kathryn Munn
Chair

Lumber and Building Materials Association of Ontario
Hannah M. Hancock
Executive Vice-president
Scarborough

Lynden Park Mall Tax Committee
John Faber
Secretary, Realty Tax Committee
Brantford

Lytton Park Residents' Organization Inc.
R.B. Atkins
President
Toronto

MACATAX
Harvey L. McIntyre
Winnipeg

S. MacKenzie
Nepean

Malden Township
Daniel Reaume Laing
Councillor
Amherstburg

Manitoulin Municipal Association
Jessie M. Graham
Secretary
Kagawong

Markham Board of Trade
Vern Penner
President
Unionville

Gilles Marleau
Orleans

Robert Marquis
Richmond Hill

Allan and Noreen Marsh
Mooretown

Victoria Mason
Nepean

James W. Mauro
Thunder Bay

Rob Maxwell
City Councillor, Ward 11
Toronto

McCaskill Management Consulting Corp.
David G. McCaskill
Mississauga

Kenneth McDonald
Willowdale

R.B. McKenzie
Ottawa

K. Mesure
Orangeville

Metro Toronto and Region Public Advisory Committee
Moyra Haney
Co-chair
Toronto

Roger J. Middleton
Toronto

Mississauga Board of Trade
Wayne Gallant
Past president
Sid Valo
Past president

Jameel Mohammed
St Catharines

Sam Mohammed
Toronto

Molson Breweries
William M. Smith
Director, Corporate Taxation
Toronto

Dennis J. Monaghan
Elgin

Don L. Moore
Oakville

Moore Corporation Limited
J. McArthur
Vice-chairman and Chief Financial Officer
Toronto

A. George Moreton
Willowdale

Griffith A.V. Morgan
Guelph

Steve Morris
London

Joseph L. Moss
Embro

Motor Vehicle Manufacturers' Association
Norman A. Clark
President
Toronto

Municipality of Metropolitan Toronto
Daniel Crombie
Metropolitan Toronto Clerk
David J. Hipgrave
Director, Corporate Planning Division

Muskoka Board of Education
Marilyn Rowe
Chair
Bracebridge

Muskoka Lakes Association
Robert Hodgins
Chairman, Taxation Committee
Toronto

National Farmers Union
John Dowling
Ontario Coordinator
Westport

Jacqueline Neun
Port Hope

John Newell
Toronto

Doug Norman
Maberly

Northumberland County Tourism Advisory Committee
Gail Mann
Cobourg

A.E. Nutis
Ottawa

Ontario Association of Children's Aid Societies
Mary A. McConville
Executive Director
Toronto

Ontario Association of Non-Profit Homes and Services for Seniors
Michael Klejman
Executive Director
Woodbridge

Ontario Cable Telecommunications Association
Roy O'Brien
Executive Director
Willowdale

Ontario Cattlemen's Association
Robert Kerr
President
Guelph

Ontario Chamber of Commerce
J.G. Carnegie
Executive Director
Don N. Eastman
Vice-president, Policy
Toronto

Ontario English Catholic Teachers' Association
Greg Pollock
Executive Assistant, Government Relations
Toronto

Ontario English Catholic Teachers' Association, Brant Unit
Ted Charnish
President
Brantford

Ontario English Catholic Teachers' Association, Hamilton-Wentworth Unit
Fred Susi
President
Hamilton

Ontario Federation of Agriculture
David A. Older
Co-chair, OFA Property Tax Working Group
Toronto

Ontario Finnish Resthome Association
Lewis S. Massad
Executive Director
Don Walimaki
Chairman of the Board
Sault Ste Marie

Ontario Forest Industries Association
Ian D. Bird
President
Toronto

Ontario Home Builders' Association
Hugh Heron
Chairman
Ian Rawlings
President
North York

Ontario Institute of Agrologists Land Use Committee, Ottawa Branch
Brad Gilmour
Ottawa

Ontario Medical Association
Peter S. Fraser
Chief Executive Officer
Toronto

Ontario Mining Association
Patrick Reid
President
Peter McBride
Manager of Communications
Toronto

Ontario Motion Picture Theatre Association
Robert Stinson
President
Toronto

Ontario Motor Coach Association
Brian Crow
President
Richard Glaesser
Policy Analyst
Toronto

Ontario Natural Gas Association
Paul E. Pinnington
President
Toronto

Ontario Non-Profit Housing Association
Roger Maloney
President
Toronto

Ontario Public School Boards' Association
Ernie Checkeris
Past president
Paula Dunning
Past president
Toronto

Ontario Public School Teachers' Federation
Gene Lewis
President
Toronto

Ontario Public School Teachers' Federation, Halton District
Bill Barrett
President
Burlington

Ontario Public Supervisory Officials' Association
Rae Stoness
Executive Director
Oakville

Ontario Real Estate Association
D.J. Flood
Director of Government Relations
Don Mills

Ontario Restaurant Association
Michael Capotosto
Chairman, Government Affairs Task Force
Orville Rose
Executive Director
Toronto

Ontario Secondary School Teachers' Federation
Larry French
Legislative Researcher
Toronto

Ontario Separate School Trustees' Association
Patrick Slack
Executive Director
North York

Ontario Soil and Crop Improvement Association
Ken McCurdy
President
Elwin Vince
Past president
Guelph

Ontario Tire Dealers Association
R.B. Arthurs
Executive Director
London

Ottawa Board of Education
W.H. Bird
Superintendent of Business and Finance

Ottawa-Carleton Board of Trade
Lorraine Flaherty
President

Ottawa-Carleton Federation of Agriculture
Terry Otto
President
Metcalfe

Ottawa Roman Catholic Separate School Board
Wayne E. Bishop
Superintendent of Finance

Oxford County Roman Catholic Separate School Board
Georges Groulx
Superintendent of Business
Woodstock

Parking Authority of Toronto
Norris P. Zucchet

B.F. Parr
Etobicoke

Paudash Lake Conservation Association
Valerie Hunnius
Secretary
Toronto

Francis K. Peddle
Ottawa

Peat Marwick Stevenson & Kellogg
Donald L. King
Partner
Toronto

Peel Board of Education
William Kent
Chair
Mississauga

Peterborough County Coalition of Lake Associations
Craig Nicholson
Chairman
Toronto

Peterborough Two Tier Property Tax Committee
Malcolm G. McCarthy
Director
Eldon P. Ray
Chairman

Pharmaceutical Manufacturers Association of Canada
Judith A. Erola
President
Ottawa

K. Polack
Toronto

Port Cares Women's Committee
Barbara DeRuiter
Pam Swick Janjac
Port Colborne

Bryan Prentice
Willowdale

Price Waterhouse Chartered Accountants
Leo Ferens
Toronto

Primesite Appraisal Service
Robert L. Warwick
Wallaceburg

Project Industries
Brian Wesley
President
St Catharines

Prospectors and Developers Association of Canada
Fenton Scott
President
Toronto

Provincial Council of Women of Ontario
Margaret MacGee
President
London
Eileen Makowetsky
President
Chatham
May Nickson
V.P. Economics
Chatham

Queen's University
R.D. Fraser
Vice -principal (Resources)
Kingston

Joseph Quittner
Toronto

Rail Ways to the Future Committee
Ross Snetsinger
Toronto

Ratepayers' Association Humphrey Township
E.V. Reeser
President
Toronto

Ratepayers of Renfrew County
Laurence F. King
Eganville

Real Women
C. Gwendolyn Landolt
National Vice-president
Ottawa

Region of Waterloo Taxpayers Coalition
Grant Strome
Cambridge

Regional Appraisal Services
Bernard E. Vanden
Ottawa

Regional Chairmen of Ontario
Peter D. Pomeroy
Halton Chair
Oakville

Regional Municipality of Haldimand-Norfolk
Robert Johnstone
Treasurer and Commissioner of Finance
Keith Richardson
Regional Chairman
Townsend

Regional Municipality of Halton

Regional Municipality of Ottawa-Carleton

Regional Municipality of Waterloo

Retail Council of Canada
Alasdair McKichan
President
Toronto

Retail Task Force, c/o Hudson's Bay Company
Michael C. Ward
Director, Real Estate Assessments
Toronto

David Rodgers
Ottawa

John Rozema
Sarnia

Arvo J. Salo
Prospector
Virginiatown

Sandy Hill Community Health Centre
Birgit Neilson and J.M. Dupont
Co-chairs, Promotions Committee
Vanier

Sarnia Construction Association
Andrew J. Pilat
General Manager

Stewart W. Shackell
Nepean

Sherwood Jones & Burns Ratepayers Association
Richard Robyn
President
Barry's Bay

Dudley Smith
Thornhill

Paul A. Smith
North York

Ross G. Snetsinger
Toronto

Social Planning Council of Metropolitan Toronto
Michael Shapcott
Child Poverty Action Group

Richard Sommers
Kitchener

Joe Spano
King City

Geoffrey W. Squibb
Toronto

Stelco Inc.
R.J. Milbourne
President and CEO
Hamilton

H. Ralph Stratford
Whitby

Sudbury Board of Education
Vicki Kett
Chairperson

Sudbury English Catholic Secondary Teachers' Association
Roland Muzzatti
President

Summerhill Residents' Association
Barry de Zwaan
President
Toronto

Sun Life Assurance Company of Canada
John D. McNeil
Chairman and Chief Executive Officer
Toronto

Sudbury Business and Professional Women's Club, Current Affairs Committee
Betty Rheume
Chair
Sudbury

Lev Tarasov
Rockwood

Task Force on Food Banks
Michael Shapcott
Toronto

Tax Executives Institute, Inc.
Hugh D. Markey
President, Toronto Chapter
Vincent Alicandri
Chair, Canadian Income Tax Committee, Toronto Chapter
Toronto

Taxpayers' Coalition, Oakville
Donald Gussin
Secretary

Taxpayers' Coalition, Peel Inc.
Ken Jenner
President
Mississauga

Taxpayers' Coalition, Richmond Hill
Eric Van
Publicity Chairman

Taxpayers' Coalition, Uxbridge
Barrie Clulow
Communications Committee

Tenants' Association for 1500 Bathurst
Randall Withell
Chairman
Toronto

320 Lonsdale Road Tenants' Association
T. Andrew Stewart
President
Toronto

D. Wayne Tingle
London

Toronto Board of Education
Joan M. Green
Director of Education
Susan McNeil
Administrative Services Department
Beare Weatherup
Chair

Toronto Mayor's Committee on Aging
Lisa Castelin
Administrator

Town of Hanover
D.W. (Doug) Hancock
Mayor

Town of Harriston

Town of Markham

Town of Newcastle

Town of Niagara-on-the-Lake
Michael M. Dietsch
Lord Mayor

Town of Palmerston
A. Keith Askett
Mayor

Town of Port Elgin

Town of Richmond Hill

Town of Simcoe

Town of Whitby

Town of Whitchurch-Stouffville

Township of the Archipelago

Township of Armour

Township of Brougham
B.L. Irving
Reeve

Township of Camden

Township of Goulbourn

Township of Howard

Township of Lake of Bays

Township of Olden

Township of Raglan

Township of Sebastopol

Township of Strong

Township of Tiny
Ross Hastings
Reeve

Township of Wilmot
Lynn A. Myers
Mayor

Township of Yarmouth

Townships of Griffith and Matawatchan
Paul Doyle
Reeve

Toy-Sport Agencies Limited
J.G. Ward
Vice-president
Don Mills

Tricon Group
W.H. Hardy
President
Ottawa

Trust Companies Association of Canada
John L. Evans
President and CEO
Ottawa

Umbrella Central Day Care Services/Child Care Committee of Scarborough
Tess Ayles
Executive Director

United Chiefs and Councils of Manitoulin
Robert H. Debassige
Tribal Chairperson/Executive Director
West Bay

United Co-operatives of Ontario
R.E. Bethune
Chief Executive Officer
Mississauga

United Counties of Stormont, Dundas and Glengarry

United Townships of Head, Clara and Maria

Urban Development Institute Ontario
M. Kells
President
Don Mills

Cora Urbel
Don Mills

Blanche L. van Ginkel
Toronto

Vanier Institute of the Family
Robert Glossop
Director of Programs
Ottawa

Village of Barry's Bay
Robert J. Norlock
Clerk-Treasurer

VS Services Ltd.
James E. Graham
President and Chief Executive Officer
R.E. Boone
Senior Vice-president and Legal Secretary
Toronto

Norm Walpole
Waterford

Eric Walton
Kingston

Waterloo County Board of Education
A. Ewasko
Superintendent of Business and Treasurer
Kitchener

Beresford J. Watt
Port Hope

Weston Downs Ratepayers' Association
Nick Lavalle
President
Woodbridge

John Whalley
Professor, University of Western Ontario
London

C.R. Whitfield
Ottawa

Ian L. Whitmore
Toronto

Marjorie Wild
Toronto

William Allan House
Neil Bernard Dukas
Barriefield

Colin J. Williams
Don Mills

T. Douglas Willock
Toronto

A. Witt
Brantford

Women Teachers' Association of Ottawa
Lee Cassellman

Writers' Union of Canada
Penny Dickens
Toronto

James M. Yaraskavitch
Renfrew

York Mills Ratepayers' Association Inc.
D'Arcy Macdonald
Chairman, Taxation Committee
North York

Appendix F
Public Hearings: Participants

The commission held public hearings between 13 April and 29 June 1993. Many of those who registered and participated provided written submissions.

London, 13 April

Peg Arntfield

City of London
Sheila Davenport
Councillor

Jim Logan
Manager of Revenue and Tax Collector

John Coutanche

Susanne Dann

W.G. Davies

Fellini Koolini's Restaurant
Joe Kools Restaurant
Pamela Parker-Landsdown
President

Freedom Party of Ontario
Robert Metz
Leader

Barbara Gibson

Wayne Gibson

Geoffrey Hale

John Paul II Secondary School
Michelle Smith
Vice-president, student council

Key Property Management Corporation
Randy Ferguson

Lake Huron Preservation Association
Douglas Banks

London and Area Council of Women
Candace Brecevic
Laila M. Norman

London and Area Tenants Federation
Leo Bouillon

London Board of Education
Cheryl Miller
Chair

Daniel Skidmore
Director of Education

J.H. Morris
Superintendent of Business

London Chamber of Commerce
Bryan Allendorf
Jim Kee
Bill Salmon
Mike Walker

London and District Construction Association
Thomas E. Dool

London and District Labour Council
Gina Barber
Gil Warren

London and Middlesex County RCSS Board*
Carol Donnelly
Trustee

Paul Whitehead
Trustee

Jim Squires
President, CUPE Local 1166

London and Middlesex Roman Catholic Parent Teacher Association
John Jevnikar
President

London-Middlesex Taxpayers Coalition
T.A. Rennie

London and St Thomas Real Estate Board
Ron Paulger
Joe Pinheiro

Low Income Family Empowerment – Sole Support Parents Information Network (LIFE-SPIN)
Harmony Kubu

John MacCallum

Marg MacCallum

James MacNeill

Charles McNeil

Debra S. Normand

Notre Dame Parent Teacher Association
Mary Wilson
President

Ontario Federation of Home and School Associations
Marian Obeda
Regional President

Oxford and Middlesex County Federation of Agriculture
David A. Older

Port Stanley Terminal Rail Inc.
Roy Broadbear
President

Jeff Willsie
Vice-president

Deborah Prothero
Secretary

Rodney Two Tier Property Tax Committee
John Fisher

St Thomas More Parent Teacher Association
Jane Kubica
President

Schickedanz Brothers Ltd.
Tina Schickedanz

Sheet Metal Workers International Union
Dennis Males
Gordon Stewart
David Zavitz

Maureen Sheppard

Lindsay Sheppard

Steelway Building Systems
Glen G. White

Township of Brantford
Donald Glassford
Chief Administrative Officer

Township of Usborne
Patricia Down
Mayor

Township of Yarmouth
Marian Millman
Mayor

University of Western Ontario
Janet McClain
Political Science Department

Bernard Wiley

James Williams

Bob Wood

---

* *RCSS Board denotes Roman Catholic Separate School Board*

Cobourg, 14 April

J.S.W. Aldis

Cash Crop Farmers Association
George Ryken

Cobourg Labour Council/Company of Concerned Canadians
Linda Nicholas

Cobourg and Port Hope Chambers of Commerce Joint Government Policy Committee
Will Scoffield

Dairy Farmers Association
Paul Burnham

Bev Dahmer

Wilfred Day

Cindy Diminie

Fare Share Food Bank
Ulla Elliott

Shelly Ferguson

Jayne Fraser

Brenda Free

Hog Producers Association
Ted Van Netten

Shirley Jack

Lakeshore Estate Planning Council
Brad Curtis
Thomas Hill

Lynghorne Lynch Lillico
C.B. Lynch

Northumberland Federation of Agriculture
Fred Thomson
President

Northumberland Rural Awareness Committee
Ben Currelly

Ontario Coalition Against Poverty
Deborah J. O'Connor

Sharon Peck

Peterborough Victoria Northumberland RCSS Board
Don Folz
Ken Kary

Port Hope Chamber of Commerce
Roger Ingram
President

Donna Stockwell

Township of Cramahe/Northumberland County
Doug Galt
Township Reeve/County Warden

Peterborough, 19 April

Belmont-Methuen Conference
Leslie F. Morris

Canadian Auto Workers, Local 1987
Rob Freeman

Canadian Research Committee on Taxation
Frank Peddle
Director of Research

County Federation of Agriculture
Seldon Parker

County of Peterborough
Gary Stewart
Warden

Robert A. Donovan

Greater Peterborough Chamber of Commerce
Vince Gatt
President

Mae Smith
Vice-president

Eric Steinmiller
Treasurer

Don Frise
Jack Johnston
Jim Potts
Jim Robinson

Bill McMaster

Northern Pigeon Lake Ratepayers Association Inc.
George Jewett
Past President/Peterborough City Board of Education Trustee

Peterborough Coaliton for Social Justice
Floyd Howlett
Chair, Steering Committee

Peterborough County Soil and Crop Association
Grant Bennett
President

Peterborough Injured Workers Group
Debra Garvey

Peterborough Labour Council
Peter How

Peterborough Two Tier Property Tax Committee
Malcolm McCarthy
Director

Eldon P. Ray
Chairman

Hanno Beck

Ellen Rambukkana

C.J.S. Stuart

Township of Ennismore
Doris Brick
Reeve

Township of Harvey
John W. Millage
Clerk-Treasurer and Chief Administrative Officer

United Citizens Organization
Ray Peters
President

Victoria County Federation of Agriculture
Terry Boyce
Margaret Jones

Sault Ste Marie, 7 May

Canadian Catholics for Social Justice
Dick Brady

Central Algoma Board of Education
Allen Prodan

Clean North
Kathleen M. Brosemer

Trudy Higginson

Injured Workers Paralegal Service
Rick Smith
John Murphy

Inter-faith Social Assistance Review Coalition
Phyllis Dietrich

Michael McCrosson

Municipal Welfare Office
Ray Diotte

Ontario Public School Teachers' Federation
Steve Summers
District President

Ontario Secondary School Teachers' Federation, Sault Ste Marie Division, District 30 Algoma
Jim Agnew

Phoenix Rising Women's Centre
Bryna Coppel-Park

Louise Primeau

Sault Ste Marie Chamber of Commerce
Liisa Peer
President

Sault Ste Marie Construction Association
Richard Thomas

Sault Ste Marie and District Labour Council
Bob Richards
President

Sault Ste Marie and District RCSS Board
Regis O'Connor
Chair

Township of Hornepayne
Don Chevalier

Timmins, 12 May

Agricultural Society
Elmer Cook
Louise Dambrowitz

Dairymen's Association
Bob Barber

Falconbridge Limited
John P. Pappone
Manager, Employee Relations and Administration, Toronto

Bonnie Foster

Trafford Hall

Mabel Lucyk

Management and Economic Development Consultants
Roger Mawdsley

Mattagami Region Conservation Authority
Kees Pols
Brian Tees

Brenda Savard

Timmins Board of Education
John Huggins
Director

Bill Ferrier

Robert McArthur

Timmins District RCSS Board
Michel E.B. Serre
Director of Education

Timmins Labour Council
Jerry Loranger

Township of Black River-Matheson
Pierrette Blok, Mayor
President, Association of Mining Municipalities

Jan Vandermeer

Sudbury, 13 May

Association franco-ontarienne des conseils d'écoles catholiques (AFOCEC)
Monique Landry-Sabourin
Présidente

Coalition for Responsible Local Government
Ted Callaghan
Fred Johannes

Conseil des écoles séparés catholiques du district de Sudbury
Jacques Lachapelle
Directeur de l'éducation

Crisis Housing Liaison
Eugene Williams

East Parry Sound Board of Education
Dean Currie
Art Osburn

Falconbridge Limited
John M. Doyle
Director of Taxation, Toronto

Falconbridge Pensioners Organization Local
Robert Burrow
Director, Administrative Services

James B. Tester
Chairman

First Vice President's Task Force for Seniors' Advisory Council
Margaret Harche

INCO Limited
José A. Blanco
Vice-president Ontario Division

Jane Stapleton
Accounting/Taxation Department

Everett Kingston

Lake Penage Ratepayers Association
Martin Sutinen

Nipissing District RCSS Board
Robert Lucenti
Chair

Rhéal Perron
Président, Section de langue française

Sid Tomkins
Chair, English Language Section

North Bay and Area Centre for the Disabled
Homer LeBlond

North Bay and District Chamber of Commerce
Glen DeVuono

Persons United for Self Help
Joanne Nowther
Chair

Randy Beland
Coordinator

Pierre's Consulting
Pierre M. Laberge

John D. Rutherford

Sudbureans Organized Against Poverty
Rick Desormeaux

Sudbury Board of Education
Doreen Dewar
Chair, English Language Section

Joyce Laking
Chair, Property and Finanace Committee

Earnie Checkeris
Vice-chair

Larry FitzPatrick
Superintendent of Business Administration

Sudbury and District Chamber of Commerce
Austin Davey
Chairman, Government Relations Program

Sudbury and District Labour Council
John Filo
President

Sudbury District RCSS Board
Margaret Dowdal
Chair

Marcel Lapierre
Vice-chair

Robert Boucher
Supertindent of Business and Finance

Task Force for Seniors' Advisory Council
Chris Stewart

Township of Strong
Rodger Brimacombe

United Way, Sudbury District
Patrick Meagher
Labour Community Services

St Catharines, 17 May

AG Care (Agriculture Group Concerned About Resources and the Environment)
Mary Wiley

Rob DePetris

Lincoln County RCSS Board
Susan Venditti
Chair

Nancy Grodesky
Vice-chair

Vincent Monaghan
Director of Education

W.K. Newell

Niagara Construction Association
Werner Wiens
President

Howard Crawford

Niagara North Federation of Agriculture
Dave Wiley
President

Mary Lou Garr

Niagara North Soil and Crop Improvement Association
Ken Durham

Niagara Peninsula Fruit and Vegetable Growers' Association
John Fedorkow
President

Norfolk Federation of Agriculture
Richard Walker

North Niagara Milk Producers' Committee
Maryanne McDougall

Port Cares Women's Committee
Barbara DeReuter
Pam Swick Janjac

Ingrid Regier

Helmut Rempel

St Catharines Chamber of Commerce
Hannah Gibbons
Rick Hesp
Bill Rickers

St Catharines and Thorold Social Planning Council
Patrick Dunphy
Executive Director

Patricia Wallis

Kenora, 19 May

Stuart Almost

Association for Community Living
Jim Retson

Dryden Board of Education
John Borst
Director of Education

Nelson I. Reed
Superintendent of Business and Finance

William Dawes

Peter Elgi

Home Support for Seniors
Jane Davidson

Kenora and Area Taxpayers' Coalition
Penny Todd
Chair

Kenora Board of Education
Marion Helash
Chair

Len Hakenson
Vice-chair

Jim Lunny
Trustee

Richard W. Coburn
Director of Education

Dean Carrie
Superintendent of Business

Gordon McCuaig

Kenora District RCSS Board
Walter O'Neill
Business Administrator

Cecil Poirier
Jim Stevenson

Roy Lever

Milk Producers Association
Peter Brunner
President

Ministry of Environment and Energy
Christine Hansen

Northwestern Independent Living Services
Tamsin Collings
Executive Director

Northwestern Ontario Recycling Association
Gertie Russell

Public Advisory Committee on Landfill
Katherine Olson
Chair

Robin Hill Farm
Charlie Griffiths

Soil and Crop Association
Robert Wall

Town of Dryden
Paul S. Heayn
Treasurer

Town of Kenora
Karen Brown
Municipal Treasurer

Pat Geisel
Tax Collector

Thunder Bay, 20 May

Myrna Adams

Armando Fanti

Independent Living Centre
Susan Ward

Lake Shebandowan Campers' Association
M. Nawrocki
President

Robert Turner

Lakehead Board of Education
Lynn Peterson
Trustee

Brooks Rapley
Trustee

Eric Wilson
Manager of Finance

Lakehead District RCSS Board
Susan Soldan
Superintendent of Business

Lakehead Social Planning Council
Brenda Reimer
Executive Director, Access to Permanent Housing Committee

Lakehead University
Carol Camire
Social Work Department

April Vass
Social Work Department

Masood Investment Trust
James Mauro

Northern Women's Centre
Gwen O'Reilly
Co-ordinator

Paipoonge Ratepayers
Terry Taylor

Frederic Pretulac

Paul Pugh

P.U.S.H. Northwest
Ron Ross

David Ramsay, MP

Anne Skalesky

Social Planning Council
Liz Poulin

Thunder Bay Cattlemen's Association
Hermann Hoerz

Thunder Bay Cattlemen's Association/Potato Growers Association
Mike Halow

Thunder Bay Chamber of Commerce
Dawn Powell
Vice-president

Ernie Prokopchuk
Chair, Government Affairs Committee

Thunder Bay and District Labour Council
Glen Chochla
Peter Lang

Thunder Bay Federation of Agriculture
Don Belluz
President

Thunder Bay Injured Workers
Steve Mantis

Rita Ubriaco

Grey/Bruce, 25 May

Bruce County Board of Education
Paul Martindale
Director of Education

Ken Mann
Superintendent of Business

Allan MacKay
Don Tedford

Bruce County Federation of Agriculture
Grant Collins
Past president

C. Lynn Fielder
Byron Monk

Cindy Cartwright

County of Grey
Sam Luckhardt
Chairman, Finance Committee

Grey County Board of Education
Michael J. McKenna
Director of Education

Joyce Weber

Grey County Federation of Agriculture
George Black
Karl Braeker
Ken Furlong

Grey County Soil and Crop Improvement Association
Mac Thomson
President

Barry Tolton
Secretary

Don Dietrich

Robert Harrison

Huron County Board of Education
Paul Carroll
Superintendent of Business and Operations/Director designate

Wayne McCausland

Brenda McIntosh

Owen Sound and District Labour Council
Greg Cooper
President/Executive Council Member

David Trumble

Silent Valley Park Ltd.
Bill Jay
Murray Lembke
Wilda McCarther

Town of Palmerston
A. Keith Askett
Mayor

Town of Port Elgin
Brian Cleaver
Mayor

Dennis Haggerty
Councillor

Town of Southampton
Norm Gurr
Councillor

Township of Amabel
William Ferris
Reeve

Patrick J. Stock
Treasurer

Bill Wallace

Wellington Federation of Agriculture
George Strachan

Ottawa, 1, 2 June

Action Centre for Social Justice
Aline Akeson

Action Logement
Ethel Côté
Animatrice

Action Sandy Hill
Robert Edmonds

Alta Vista Community Association
Gordon Law

Amberwood Village/Condominium Presidents' Council
Norman Long
Chair

William Carr

L'Association de parents, élèves et professeurs de l'école secondaire de la Salle d'Ottawa
J. Andre Quesnel

Association of Non-Profit Homes and Services for Seniors
Susan LeConte
Doug McKeen

Bayview Lodge Inc.
Neal Dick

Mitchell Beer

Elizabeth Beilby

Better Beginnings, Better Futures
Robert Davidson
Betty Holly
Dorthy Piernick

Big Rideau Lake Association
Stephen Sebastyan

Barbara Roadhouse Bresnahan

Canadian Chemical Producers' Association
David W. Goffin
Secretary-Treasurer and Vice-president, Business Economics

Canadian Crafts Council
Peter Weinrich
Executive Director

Canandian Federation of University Women
Claire Heggtveit

Carleton Board of Education
Carol Parker
Chair

Michael E. Clarke
Manager, Finance and Administration

Janice E. Sargent
Strategic Planning Associate, Research and Planning

Carleton RCSS Board
Anne Stankovic
Chair

Cedardale Riverfront Properties Association
Steve Jeffery

Chimo Park Community Association
W.C. Vant-Haaff

Citizens for Fair Taxes
Shibly Abela
Keith Dowd
Frank Spink
Ivan Wood

City of Ottawa
Jacquelin Holzman
Mayor

Jim Watson
Councillor

Coalition for Fair Municipal Taxes
Gerry LePage

Conseil scolaire de langue française d'Ottawa-Carleton
Carole Dupuis
Association de parents de la section catholique (PSC)

Cornwall Warehousing Ltd.
Denis Lemieux

Council on Aging of Ottawa-Carleton
Peter Cornell
Chair, Economics Committee

Ann Davis

Dundas County Federation of Agriculture
Gordon Garlough

Tim Dunston

Eastern Ontario Landlords Organization
Luigi Caparelli
President

Economic Realities Workshop
Janet Parry

Federal Superannuates National Association
Edmond Blais
Ottawa Branch

Fédération des caisses populaires de l'Ontario Inc.
Pierre Lacasse

Federation of Citizens Associations of Ottawa-Carleton Inc.
Amy Kempster

Federation of Ottawa-Carleton Tenants' Associations
Dan McIntyre

Charles Ficner

Glengarry County Federation of Agriculture
Richard Lapointe

James Harris

Inter-Agences et Entraide Budgétaire
Suzy Haché
Richard Monette

International Association of Machinists and Aerospace Workers
Louis Erlichman
Canadian Research Director

Jackson Brown Associates Inc.
Joanne Jackson

Jack Korwin

Long Island Waterfront Group
Stuart Rogers

Victoria Mason

Robert McLarty

Mothers Are Women
Evelyn Drescher
Maureen Langsford

National Union of Public and General Employees
Bob Dale

Ontario Advisory Council on the Status of Women
Jacqueline Pelletier

Ottawa Board of Education
Marian Lothian
Chair

Stan Currie
Joint Council, Elementary and Secondary School Advisory Committees

P.A. Hill
Special Education Advisory Committee

Ottawa-Carleton Board of Trade
Aimée Britten
Past chair, Municipal Affairs Committee

Charles Murphy
Finance and Taxation Committee

Ottawa-Carleton French Language School Board, Catholic Sector
Robert Poirier
Interim Director

Ottawa RCSS Board
Betty-Ann Kealey

Holly Paterson

Prescott County Federation of Agriculture
Murray Allen
Director

Germain Malette
Director

Prescott-Russell County Board of Education
James Rahn
Director of Education

Regional Municipality of Ottawa-Carleton
Alex Cullen
Councillor and Chair, Ottawa-Carleton Fair Tax Working Group

Renfrew County Federation of Agriculture
Brian Hamilton
Dave Campbell

Russell County Federation of Agriculture
Rejean Pommainville
Director

Susan Skinner

Stormont County Federation of Agriculture
Bud Atkins

Support and Custody Orders for Priority Enforcement (SCOPE)
Judy Poulin

University of Ottawa
Ronald G. Bodkin
Department of Economics

White Lake Property Owners Association
John L. Fachnie
Chairman

C.R. Whitfield

Working Group for Sustainable Communities
David Sherwood
Chair

Hamilton, 3 June

African Lion Safari
Don Dailley
President and General Manager

Assumption College
Sandra Marchesano
Laurie Valent

Brant County RCSS Board
Carol Cigagna
Director of Education

Florence Homeniuk

Canadian Oncology Society
Michael Goodyear

Michael Charles

Rowena Charles

Jennifer Charnish

City of Burlington
Walter Mulkewich
Mayor

R.J. Rooks
Executive Co-ordinator, Corporate Projects

K.A. Commodore

Pauline Davis

Dofasco Inc.
Jim Stirling
Manager, Public Relations
John Allinote

Dundurn Community Legal Services
Randy Schroeder
Staff Lawyer

Hamilton and District Chamber of Commerce
Lee Kirkby
Executive Director
Kathy Drewitt

Hamilton-Wentworth Federation of Agriculture
Larry Freeman
Henry Swierenga
Fritz Trauttmansdorff

Hamilton-Wentworth RCSS Board
Patrick J. Daly
Chair
Jerry Ponikvar
Director of Education
Tony Davidson
P. Ann Hogan
Peter Leigh-Bell
Patricia McKeown
Eileen O'Neill

Ontario Forestry Association
Ron Huntington

Parent-Teacher Association, Resurrection School
James Letwin

John Rudy

Rasma Saulitis

Social Planning and Research Council
Mike Pennock
Executive Director

Social Planning Council Downtown Hamilton Business Improvement Association
Marvin Caplan
President

St John's College Student Council
Stephanie Hospodar

Stelco Hilton Works
Glenn Bond
Accounting Manager

Stelco Inc.
Gary Seichter
Manager, Financial Planning

Wentworth County Board of Education
Allan Greenleaf
Director of Education
Jack Duncan

Timothy Wright

Windsor, 8 June

Le conseil des écoles séparées catholiques de Windsor
Denis Levert
Surintendant des écoles de langue française

County of Kent
Bob Foulds
Administrator-Clerk and Deputy Treasurer
Laverne Kelly

Essex County Federation of Agriculture
Dan Diemer
President
Lorraine Olson
Richard Trimble

Essex County RCSS Board
Don Petrozzi
Chair
Cynthia Armstrong
Kay Dame
Gerry Pouget
Robert Prince

Essex County Soil and Crop Improvement Association (ECSCIA)
Bill Mailloux
President

Federation of Catholic Parent-Teacher Associations of Ontario
Mary Ann Cuderman
Treasurer
Paul Bezaire

FESFO (Student Francophone Organization for Ontario)
Annie Bordeleau
President

Kent County Board of Education
John Anderson
Bob Asselin
Dorothy Fisher
Elmer Jackson

Kent Federation of Agriculture
Larry Dunlop
Alex Miller
Phil Shaw
Ron Van Damme

Lambton Federation of Agriculture
Joyce Anderson
Darrell Randell

Legal Assistance of Windsor
Marian Overholt

Mario G. Lorenzon

Meda Limited
Richard Rosenthal
Executive Vice-president

Ontario Secondary School Teachers' Federation
Leisha Nazarewich

Ontario Separate School Trustees' Association
Mary Hendricks
President

Patrick Slack
Executive Director

Earle McCabe
Deputy Executive Director

Paul Whitehead
Trustee, London and Middlesex County RCSS Board

Ontario Soil and Crop Improvement Association
Tim Williams

St Thomas of Villanova Parent Advisory Committee
M.J. Meloche
A. Moscatello
K. Mulvey

Peter Sonnenfeld

Ken Ternoey

La section de langue française du Conseil des écoles séparées catholiques du comté d'Essex
Jacques Kenny
Président

Donna Bastien
P. Chauvin
M.J. Stewart

Township of Howard
J.A. Campbell
Clerk-Treasurer

David Langstaff
Reeve

Susan Weldon

Wilson, Walker, Hochberg, Slopeu
Gerard Charette

Windsor and Area Coalition for Social Justice
Bill Capitano
Rick Coronado

Windsor Bicycling Committee
Mark Buckner
Chair

Windsor Child Support Taxation Lobby
Karen Rockwell-Georgiou
Chair

Windsor Coalition Against Poverty
Pat Taman

Windsor and District Labour Council
Mike Longmore

Windsor and District Chamber of Commerce
Fred Quenneville
President and General Manager

Michael Charette
Tim Fuerth
James Macri

Toronto, 10, 11, 28, 29 June

Neil Aberle

A.J. Diamond, Donald Schmitt and Company
A.J. Diamond

Advocacy Resource Centre for the Handicapped (ARCH)
David Baker
Executive Director

AG Care (Agricultural Group Concerned About Resources and the Environment)
Jeff Wilson
Chair

Alliance of Canadian Travel Associations Ontario
Marion Graber
Executive Director

Gerald Heifetz

John Andrachuk

Association canadienne-française de l'Ontario
Jean Tanguay
President

Association of Municipalities of Ontario
Elizabeth Behrens
Regional Councillor, Town of Oakville

Doris Brick
Reeve, Township of Ennismore

Ron Chittick
Director of Finance and Administration, City of Peterborough

Grant Hopcroft
Controller, City of London

Bill Logan
Councillor, Region of Halton

Jack McLachlan
Clerk-Treasurer, Township of Tuckersmith

David Smith
Waste Management Engineer, City of St Catharines

Association of Ontario Health Centres
David Allester
Vice-president

Bernard Betel Centre for Creative Living
Harold Segal
Chair, Social Action Committee

Birge 20 , Victoria University
Ted Reeve
Program Officer for Economic Justice

Murry Blankstein

Bloor Bathurst/Madison Business Association
David Vallance

Board of Trade of Metropolitan Toronto
Don McIver
Maralynne Monteith

Borough of East York
Michael Prue
Mayor

Eric Nichols
Treasurer

Ray White

British Car Council
Tom Hyland

Donald W. Bryant

Business Survivors Association of Toronto
Laurence Cazaly

Canadian Association for Community Living
Diane Richler
Executive Vice-president

Canadian Bankers Association
Judy Bussey

Canadian Booksellers Association
Stephen Payne
External Affairs Coordinator

Edward Borins

Catherine Keathie
Canadian Magazine Publishing Association

Canadian Federation of Independent Business
Catherine Swift
Senior Vice-president

Judith Andrew
Director, Provincial Policy

Canadian Federation of University Women: North Toronto Group, Politics and Law Group
Helen Banks
Donalda McLean

Canadian Institute for Environmental Law and Policy
Jack Gibbons

Canadian Institute of Public Real Estate Companies (CIPREC)
Ronald Daniel
Executive Director

Siim Vanaselja

Canadian Life and Health Insurance Association
James S. Witol
Vice-president, Taxation and Research

Gordon H. Graham

Canadian Pensioners Concerned, Ontario Division
Bruce Mutch
Rae MacLeod
Jean Woodsworth

Canadian Property Tax Association Inc. (CPTA)
Barry Remington

Canadian Taxpayers Federation
Paul Pagnuelo

George Carr

Chambre économique d'Ontario
Don Lassaline

Child Poverty Action Group
Colin Hughes

Citizens for Property Tax Reform
Midge Day
Storm MacGregor

City of Scarborough
Frank Faubert
Councillor, Ward 8

E. Alan Graf
Budget Officer, Finance and Management Services

Brenda Librecz
Director, Business Development

City of Toronto
Peter Tomlinson
Director, Economic Development

City of Toronto – Department of Public Health, Health Promotion and Advocacy Section
Maria Herrera
Maria Lee

City of Toronto Finance Department
John Woods
Deputy City Treasurer

Coalition for Social Assistance Reform
Randy Ellsworth
Isabel Mahoney
Melodie Mayson

Madeline Cole

Communist Party of Canada (Ontario)
Darrell Rankin
Ontario Executive Committee

Confederation of Resident and Ratepayer Associations
Howard Joy
Chair

Consumers' Association of Canada (Ontario)
Audrey Verge
Chair, Economics Committee

Council of Ontario Construction Associations
Frank Bisson
Bill Empey
David A. Frame

CP Rail
Ronald G. Mason
Senior Manager, Property Tax, Ontario

John Taylor

Heather DeVeber

Deep Foundations Contractors Inc.
William E. Lardner
Richard Yasny

Deer Park Ratepayers Group Inc.
Katherine Packer

Durham Board of Education
Wayne Wilson
Trustee

East York Board of Education
Eric Lewis
Director of Education

Nora Gray
Superintendent of Financial Services and Plant

Education Advisory Council
Michael Wytiahlowsky

Etobicoke Federation of Residents' and Ratepayers' Associations
Terry Mudry

Family Service Association
Rosemarie Popham
Director, Social Action Committee

John Tinher
Director

Federation of Metro Tenants' Associations
Ken Hale
Deborah Wandal

Federation of Ontario Cottagers' Associations Inc.
John C. Carter
Vice-president (Taxation)

David A. I. Goring

Ted Gwartney

Halton Region Conservation Authority
Murray Stephen

Martin Hofman

Chester Hunter

Insurance Bureau of Canada
Stan Griffin
President

Paul Morin

Johnston & Daniel Limited Realtor
J.R. Gairdner
President and Chief Executive Officer

John Kent

The Kingsway People
Harold Bradshaw
Eric Jones

Arnold Klement

Labour Council of Metropolitan Toronto and York Region
Bill Howes

Lake of Bays Association
John Kenny

B. Bill Lew

Susan Lieberman

Life Underwriters Association of Canada
Edward W. Polci
Chairman and Chief Executive Officer

W.T. Babcock
Vice-president, Public Affairs

John Bowden
Member, Board of Directors

Karl Keilhack
Vice-president, Taxation

Robert MacLean

Brian F. McConville

J.A. (Jack) McNulty

Metropolitan Separate School Board
Elvira DeMonte
Chair

Dawn Drayton
Trustee

John Jasenec
Deputy Director and Treasurer

Gordon MacLean
Senior Co-ordinator

Metropolitan Toronto Presidents' Negotiations Council (elementary)
Dwight Chalmers

Metropolitan Toronto School Board
Anne Vanstone
Chair

K.N. McKeown
Director of Education

Motor Vehicle Manufacturers' Association
Norman A. Clark
President

David C. Adams
Manager, Committees

Aldo Dibiase
Chrysler Canada Ltd.

Bob Hassard
Maureen Kempston-Darkes
Neil MacDonald
Bryan Swift
Mike Walker

Multiple Dwelling Standards Association
Ib Amonsen

Municipality of Metropolitan Toronto
Ila Bossons
Councillor

Scott Cavalier
Task Force on the Reform of Municipal Financing

Ed Zamparo
Task Force on the Reform of Municipal Financing

Muskoka Lakes Association
Robert Hodgins
Chair, Taxation Committee

North Hill District Home Owners' Association
Tim Kennish
President

North York Board of Education
Elsa Chandler
Bart Hildebrand

North York Harvest Food Bank
Mary Lucas

Older Women's Network
Helen Lowenberger
Metro Toronto and Area Council

Ontario Association of Cemeteries
Douglas Reid
Robert Sumsion

Ontario Association of Non-profit Homes and Services for Seniors
Michael Klejman
Executive Director

Ontario Association of School Business Officials
Richard J. McIntosh
Executive Officer

Ontario Automobile Dealer Association
Bill Davis
Director, Government Relations Committee

Dave Lalonde
Shelley Schleuter

Ontario Chamber of Commerce
Joe Couto
Co-ordinator, Economic Policy

Don Eastman
Vice-president, Policy

Ontario English Catholic Teachers Association
Terry Mangan
Deputy General Secretary

Greg Pollock
Executive Assistant, Government Relations

Claire Ross
Government Relations

Ontario Federation of Agriculture
Roger George
President

Ed Ketchabaw
Dave Older
Ed Segsworth
Carl Sulliman

Ontario Federation of Home and School Associations
Bette Turner
First Vice-president

Ontario Federation of Labour
Gordon Wilson
President

Chris Schenck
Research Director

Ontario Forest Industries Association
R. Marie Rauter
President

Martin Kaiser

Ontario Forestry Association
James Coates

Ontario Hydro
Sam Roberts
Corporate Real Estate Division

Ontario Jewish Association for Equity in Education – FFREE Families for Religious Equality in Education
Shalom Schachter

Ontario Mining Association
Patrick Reid
President

Ontario Natural Gas Association
Paul E. Pinnington
President

Bernie Jones
Larry Youell

Ontario Public Health Association
Brian Hyndman
Chair, OPHA Working Group on Social and Economic Justice

Ontario Public School Boards' Association
Joe Gunn
President

Mike Benson
Executive Director

Lionel Feldman
President, Lionel Feldman Consulting

Ontario Public Service Employees Union
Diane Bull

Ontario Restaurant Association
Paul Oliver
President

Ontario Secondary School Teachers' Federation
Larry French
Jim McQueen

Ontario Social Development Council
Malcolm Schookner
Executive Director

Parkdale Tenants' Association
Bart Poesiat
Parkdale Community Legal Services

Parking Authority of Toronto
Norris P. Zucchet

Kenneth Polack

Public Service Alliance of Canada
Stephen Jelly
Executive Assistant to Management Committee

Retail Task Force
Harold Chmara
Director, Planning and Tax, Hudson's Bay Company

Leonard Eisen

Retail Council of Canada
Peter Woolford
Vice-president

Richmond Hill Chamber of Commerce
Jim Chwartacky

Robinwood Management Corporation Limited
Robert Herman
President

Rupert Community Residential Services of Toronto Inc.
Michael Shapcott

A.G. Scott

David Schenck

St Gregory Separate School CPTA
Eileen Rice

Sherwood Park Residents' Association
Phil Aber
Director

Jean Smith

Social Planning Council of Metropolitan Toronto
Andrew Mitchell
Program Director

Gerard Kennedy
Director, Daily Bread Food Bank

Stewart Associates
T. Andrew Associates

Summerhill Residents' Association
Barry de Zwaan
President

Taxpayers Coalition of Durham Region
Barry Clulow
Al Ingham

Ronald Taylor

Tenant Landlord Coalition for Equal Taxation
Tina Schickedanz

Tenants' Condo Co-op Development
Thed Evdoxiadis

Toronto Arts Council
Anne Bermonte
Associate Director

Toronto Assocation of Neighbourhood Services
Chilsa Neves

Toronto Board of Education
David Moll
Chair

Irene Atkinson
Chair, Education Finance Committee

Toronto Board of Jewish Education
Irwin E. Witty
Executive Director

Toronto Food Policy Council
Sean Cosgrove

Toronto Mayor's Committee on Aging
Margaret Bryce
Planning and Development Department

Town of Uxbridge
Susan Para
Regional Councillor

United Church
Susan Eagle

United Steelworkers of America
Harry Hynd
Director, District 6

Ken Delaney

United Way of Greater Toronto
Liz Mulholland

Urban Development Institute Ontario
Neil McFadgen
Chair, UDI Tax Committee

Valhalla Inns
Peter Peachey
President

Waterloo Lutheran Seminary
David Pfrimmer

Alan H. Wood

York Mills Ratepayers Association
John Clinkard
President

Yarmila Filey

York Region RCSS Board
Terrance G. Ryan
Chair

John A. Sabo
Superintendent of Business and Finance

Kingston, 15 June

Brew-on-Premises Association of Ontario
David Campbell
Janice McIlroy

Camp Brylene
Jack and Louise Wight

City of Kingston
Helen Cooper
Mayor

Rick Fiebig
City Treasurer

Coalition for Fair Municipal Taxation-Kingston
Lily Inglis

Durham Board of Education
Ruth Lafarga
Past chair

Frontenac County Board of Education
John H. Bates
Director of Education and Secretary

Frontenac-Lennox and Addington County RCSS Board
Tom Foley

Ronald Greenwood

Hastings County Board of Education
Ron Denyes
Director of Education

Ernie Parsons
Vice-chair

Hastings-Prince Edward Catholic Teachers Association
Don Reidel
Unit President

Kingston Area Condominium Association
George Czarnecki
Harold Snell

Kingston Coalition for Social Justice
Keith Anderson

Kingston and District Association of Parents with Physically Handicapped Children
Leslie Bellemare
Darrell Sabean

Kingston District Chamber of Commerce
Doug Treleaven

Kingston and District Labour Council
Jack Cooper
Vince Maloney

Kingston Environmental Action Project
Kurt Halliday
Eric Walton

Kingston Township Industrial Landowners Association
Peter Allerston

Leeds Federation of Agriculture
Earl McFadden

H. Morris Love

Low Income Needs Co-operative
Cate Stoker

Irene Mooney

National Farmers' Union of Ontario (Region 3)
Peter Dowling
Rick Munroe

Ontario Federation of Agriculture, Lennox and Addington County
Earl Smith

Ontario Forestry Association
Arthur Mathewson
Co-chair

Ontario Private Campground Association/Eastern Ontario Travel Association
Neal J. Dick

Jeanine Proulx

Vicki Schmolka

Sharbot Lake Property Owners Association
Fred Johnson
Alex MacLeod

Stop Look and Listen
Marc Raymond

Stormont Dundas and Glengarry County RCSS Board
Peter Van Moorsel

Stormont Dundas and Glengarry Public School Board
Joe Gunn
Trustee

James W. Dilamarter
Director of Education

Sydenham Ward Tenants' and Ratepayers' Association
Helen Finley

Peter Vasko

Village of Bath
Bruce Talbot
Reeve

Cynthia Flavell
Councillor

Village of Tweed
H. Allan Leal
Mayor

Kitchener, 17 June

Association of Professional Student Services Personnel
Ted Gaudun
Waterloo Catholic Board Chapter

Leonard Modderman
Waterloo Catholic Board Chapter

Susan Barabas

Blessed Sacrament Catholic School, Home and School Association
Wayne Morriss
President

Brantford Regional Chamber of Commerce
Wayne Bilyk

Cambridge Chamber of Commerce
Marilyn Wilkinson

Catholic Rural Life Conference
Bill Capitano
Chairman and Chaplain

Palmira (Micky) Murphy
Past chair and Co-ordinator

Tony Beerink

Chamber of Commerce
Jeff Jutzi
Vice-chair, Federal/Provincial Affairs Committee

Christ the King Community Association
Doran Hart

City of Cambridge
John McIntyre
Treasurer

Economical Mutual Insurance
Graham Cudlipp
Vice-president, Finances

Rose Blasman Ellis

Philip Fernandez

Arthur Gibbons

Guelph Chamber of Commerce
John Bowey

Dan Hallman

Holy Rosary School Community Association
Bernie Marshall

Kids First Parent Association
Deani VanPelt
Chapter Coordinator

Donna Mann

Judy Nairn

Norfolk Federation of Agriculture
Rudy Stickl

Norfolk Fruit Growers Association
Thomas Haskett
President

Murray Porteous

Ontario Forestry Association
Gaspar Horvath

Ontario Fruit and Vegetable Growers' Association
Michael Mazur
Executive Secretary

Ontario Private Campground Association
Peter Bingeman
2nd Vice-president

William Jay
Past president

Rick McArthur

Our Lady of Grace Catholic Parent/Teacher Associaion
Ildi Kloiber
Judi Moore
Nancy Emond
Gary Kilpatrick

Parent Group of St Anne School
Lloyd Henry
Ronnie Lowrey

Regional Municipality of Waterloo
K. Seiling
Mayor

St Ambrose School Community Association
Mary Margaret Laing
Doreen Strybosch

St Boniface School
Donni Rasmussen
K. Spitzig

St David Catholic Secondary School
Shawna Cruz
President

Jeremy Steffler

St Joseph School Community Association
Angela Yates-Shields

St Peter Catholic School Community Parent Association
Toni Armas
Kathy Micallef

St Teresa Parent Teacher Association
Carolyn Hartlen
Mary Alice Zister

St Thomas School Community Association
Les Sulpher
Sharon Sulpher

Fred P. Schneider

Sir Edgar Bauer Catholic School
Marilena Burek

Lev Tarasov

Town of Simcoe
James D. Earl
Mayor

Peter Black

University of Guelph
Alex Michalos
Department of Philosphy

Waterloo County Board of Education
Walter Gowing
Trustee

A. Ewasko
Superintendent of Business and Treasurer

Waterloo Federation of Agriculture
Larry Erb
Richard Good
Mary O'Connor

Waterloo RCSS Board
Colleen Elsaesser

Waterloo Region Catholic Secondary Adminstrators' Association
Tom Forestell
Michael Schmitt

Waterloo Region RCSS Board
Steve Haller
Chair

Bill Brown

Wellington County Board of Education
Donald N. Ross
Assistant Superintendent of Finance

Albert H. Willis

Wood Drive Cottagers Association
Ralph Olsen
John Vail
Marian Vail

Irene A. Zalagenas

Mississauga, 21 June

Douglas Andrews

I.J. Band

Cardinal Slipyj Parent Teacher Association
Larry A. Faseruk
Director

Christ the King School, Parent-Teachers Association
Ron Cooper

City of Mississauga
Hazel McCallion
Mayor

Mona Monkman
Acting Director, Financial Management

Clear Lake Property Owners, Environment North
Roy A. Lindsay
Vice-president

Marian Lindsay

Dufferin Federation of Agriculture
Harold Davidson
Bruce Horsley
Bruce Hunking

Dufferin-Peel RCSS Board
Arthur R. Steffler
Chair

Pat Mason
Chair-Special Services Association

Tom Riley
Director

Tanya Palmer
President, Ontario English Catholic Teachers Association

Espanola Board of Education
John McMillan
Business Administrator

Etobicoke Board of Educaation
Lorraine Nowina
Chair

Sam MacKinlay
Superintendent of Business

Fair Share for Peel Task Force
John Huether

Fertilizer Institute of Ontario
Tom Sawyer
Executive Vice-president

Eyvind Fogh

Green Point Cottage Owners Association of Lake of Bays
Ian Dance
President

John Kenny

Lake of Bays Association
Douglas Lawson
Vice-president

Limitless Learning
Richard Dominico
Principal

Little Lake Joseph Association
Kenneth Langmuir

Mississauga Board of Trade
Fraser Gall
Chair, Taxation Committee

Pat Fitzgerald
Wendy Templeton

Mississauga Italian Canadian Senior and Handicapped Club
Guiseppe Sciortino

Muskoka Board of Education
Marilyn Rowe
Chair

Ed Hodgins
Superintendent of Business Affairs and Treasurer

Ontario Corn Producers' Association
Terry Daynard
Executive Vice-president

Bill Wagter

Ontario Private Campground Association
Frances Craig

Ontario Trucking Association
David H. Bradley
President

Park Royal Community
Brian Couche

Robert Parsons

Peel Federation of Agriculture
Philip Armstrong
Provincial Director

Frances E. Johnston
President

Norah Perkes

Regional Municipality of Peel
Emil Kolb
Regional Chairman

Louise Eason
Treasurer

Sherkston Resorts Inc.
Ian Wilbraham

Simcoe Condo Corporation #161
Carl McDaid
President

Simcoe County Board of Education
Gail O'Brien

Simcoe County Federation of Agriculture
Ed Pridham
Vice-president

Robert F. Walker
Paul Wardlaw

Simcoe County RCSS Board
Mearl Obee
Director of Education

Peter Durochie
Lynn Gariepy
Francis Smith

J. Gordon Taylor

Julius Toth

York Region RCSS Board
Luigi Tucci
Trustee, Vaughan, Area 2

Appendix G
Fair Tax Commission Publications

Educational Material

Tax Primer: Searching for Fairness, February 1992
Discussion Paper: Searching for Fairness, March 1993

Newsletters

Tax Talk
1 (1), December 1991; 2 (1), February 1992; 2 (2), March/April 1992;
2 (3), summer 1992; 2 (4), fall 1992; 3 (1), winter 1993; 3 (2), fall 1993
Property Tax Newsletter, March 1992 and June 1992

Working Group Reports

Environment and Taxation – First Report, March 1992
Corporate Minimum Tax, March 1992
Tax Treatment of Real Estate Gains, March 1992
Retail Sales Tax/Goods and Services Tax, April 1992
Women and Taxation, November 1992
Environment and Taxation – Final Report, December 1992
Low Income Tax Relief, December 1992
Property Tax, December 1992
Wealth Tax, March 1993

Advisory Group Report

Advisory Group on Taxation of Cooperatives, February 1993

Position Papers

Position on the Ontario Investment and Worker Ownership Program, November 1991

Position on the Federal Discussion Paper on Personal Income Tax Co-ordination, December 1991

Research Program

The research program of the Fair Tax Commission included studies by outside consultants as well as by staff of the commission. Listed below are studies being published for the commission by the University of Toronto Press in 1993 and 1994. Studies available in mimeographed form through the Ontario Ministry of Finance Library are found after the published series.

Fair Tax Commission, Research Studies
Edited by Allan M. Maslove
University of Toronto Press

The Economic and Social Environment for Tax Reform

Bruce Campbell (Canadian Centre for Policy Alternatives). "Changes in the World Economy and Fiscal Implications for Canada and Ontario"

David Conklin and John Whalley. "The Ontario Tax System in the Global Economy of the 1990s"

Peter Dungan. "The Economic Environment for Tax Reform in Ontario"

Brian B. Murphy and Michael C. Wolfson (Statistics Canada, Analytical Studies Branch). "Pensions, Deficits, and Ageing: Impacts for Ontario's Residents"

Fairness in Taxation: Exploring the Principles. 1993

John G. Head. "Tax-Fairness Principles: A Conceptual, Historical, and Practical Review"
Lars Osberg. "What's Fair? The Problem of Equity in Taxation"
Leslie Green. "Concepts of Equity in Taxation"
A. Marguerite Cassin. "Equitable and Fair: Widening the Circle"
Leo Panitch. "Beyond the Crisis of the Tax State? From Fair Taxation to Structural Reform"

Financing Local Government

John Bossons, Harry Kitchen, and Enid Slack. "Local Government Finance: Principles and Issues"
John Bossons. "Residential Property Tax Incidence "
Harry Kitchen and Enid Slack. "The Taxation of Non-Residential Property"

Issues in the Taxation of Individuals

James B. Davies. "Equity and Tax Mix: Theoretical Perspectives"
James B. Davies and David Duff. "Wealth Tax Proposals: Distributional Impact and Revenue Potential"
Kathleen M. Day and Stanley L. Winer. "Internal Migration and Public Policy: An Introduction to the Issues and a Review of Empirical Research on Canada"
Peter Dungan. "The Macroeconomic Impacts of Harmonizing the Ontario Retail Sales Tax with the Federal GST: Simulations with the FOCUS-ONTARIO Model"
Jonathan R. Kesselman. "Compliance, Enforcement, and Administrative Factors in Improving Tax Fairness"
Maureen A. Maloney. "What is the Appropriate Tax Unit for the 1990s and Beyond?"

Taxation and the Distribution of Income

Ken Battle and Sherri Torjman (Caledon Institute of Social Policy). "The Interaction of the Welfare and Tax Systems in Ontario"
Sheila Block and Richard Shillington. "Incidence of Taxes in Ontario in 1991"
Brian Murphy, Michael C. Wolfson, and Ross Finnie (Statistics Canada, Analytical Studies Branch). "A Profile of High-Income Ontarians"

Business Taxation in Ontario. 1993

Duanjie Chen and Jack Mintz. "Taxation of Capital in Ontario and Canada: An Interindustry and Interprovincial Comparison"
Bev Dahlby. "Payroll Taxes"
David Sabourin, Stephen Gribble, and Michael Wolfson (Statistics Canada, Analytical Studies Branch). "Ontario's Corporate Income Tax: An Analysis of Effective Tax Rates"
Ernst & Young. "The Impact of Taxes on Business Locations"

Taxation in a Sub-National Jurisdiction. 1993

Richard A. Musgrave and Peggy B. Musgrave. "Tax Equity with Multiple Jurisdictions"
Albert Breton. "Fiscal Federalism in a Competitive Public-Sector Setting"
Douglas G. Hartle. "The Federal-Provincial Tax Collection Agreements: Personal Income Tax Coordination, A Background Report"
Brian Erard and François Vaillancourt. "The Compliance Costs of a Separate Personal Income Tax System for Ontario: Simulations for 1991"
D.A.L. Auld. "Evaluating the Options for Fiscal Stabilization Policy at the Provincial Level"

Taxes as Instruments of Public Policy

Sheila Block and Allan M. Maslove. "Ontario Tax Expenditures"
Arthur Donner and Fred Lazar. "The Economic Effects of an Environment Tax"
Morley Gunderson and Wayne R. Thirsk. "Tax Treatment of Human Capital"
Mark Sproule-Jones. "User Fees"

Taxing and Spending: Issues of Process

G. Bruce Doern. "Fairness, Budget Secrecy, and Pre-budget Consultation in Ontario, 1985–1992"
Evert A. Lindquist. "Improving the Scrutiny of Tax Expenditures in Ontario: Comparative Perspectives and Recommendations"
Wayne Thirsk and Richard Bird. "Earmarked Taxes in Ontario: Solution or Problem?"

Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America
Lorraine Eden (monograph)

The Work of the Fair Tax Commission
Hugh Mackenzie. "The Commission Process"
Barbara Ostroff. "Public Consultation"
Allan M. Maslove. "The Research Program"

Research studies available in mimeographed form

Harold Chorney. 1992. "Tax Stabilization Policy in Ontario"
Deloitte & Touche. 1991. "Corporate Taxation." Jointly funded by the Ontario Ministry of Treasury and Economics, Taxation Policy Branch
Ernst & Young. 1993. "Corporate and Personal Tax Comparisons"
Lionel D. Feldman. 1992. "The National Non-Domestic Rate in Britain: Any Lessons for Ontario?" Jointly funded by the Public School Boards of Metropolitan Toronto
Lionel D. Feldman. 1993. "Education Finance and Governance in France and Italy: an Overview." Jointly funded by the Public School Boards of Metropolitan Toronto
Douglas A. Holland. 1992. "Issues Paper on Not-For-Profit Co-operatives." Jointly funded by the Cooperative Housing Association of Ontario
KPMG Peat Marwick Thorne. 1992. "Wealth Transfer Taxation: Planning and Avoidance Techniques"
Kathleen A. Lahey. 1992. "The 'Tax Unit' Debate: Basic Structural Choices"
Kenneth J. McKenzie. 1991. "The Taxation of Nonrenewable Resources: An Overview of the Literature"
Alex Michalos. 1992. "Taxation, Fiscal Policy, Migration and the Quality of Life"
Schlesinger & Associates. 1992. "Property Taxes in Massachusetts: State and Local Responses to Tax Revolt and Recession"
Schlesinger & Associates. 1992. "Property Taxes, Personal Income and School Funding in Connecticut"
Almos Tassonyi. 1993. "The Benefits Rationale and the Services Provided by Local Government"
Frances R. Woolley. 1991. "Women and Taxation: A Survey"

Commissioners' Personal Comments

Jayne Berman

DISABILITY AND TAXES: TOWARDS GREATER EQUITY

TAXATION AND ECONOMIC INCENTIVE

Disability and Taxes: Towards Greater Equity

The complex and crucial issues surrounding society's responsibilities to the disabled are, in large part, beyond the scope of the Fair Tax Commission's mandate. The commission, in executing this mandate to enhance the fairness of the collection of taxes in Ontario, has elected to examine and make recommendations on four specific tax supports to the disabled which presently exist:

1) the disability tax credit
2) the credit for disability-related expenses
3) the deduction for attendant care, and
4) the exemption from assessment for modifications to property for the accommodation of disabled residents

The recommendations read as follows:

22 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the disability tax credit and replace it with a flat rate, taxable benefit payable to all persons with disabilities.

23 If Ontario gains more control over its personal income tax system through amendments to the federal-provincial Tax Collection Agreements, Ontario should eliminate the credit for disability-related medical expenses and the deduction for attendant care. In their place, Ontario should establish a program outside the tax system to subsidize the cost of attendant care or medical expenses for persons with a disability.

110 Provided a unit value residential assessment system is adopted, in which assessments of individual properties of the same type and in the same geographic area vary only with differences in physical dimensions, exemption from local property taxation for modifications to property for the accommodation of elderly or disabled residents should be eliminated; any appropriate assistance should be provided through direct spending programs.

The commission has chosen to recommend the removal of the disability tax credit for two particular reasons. The first lies in the relative benefit of this credit to the higher- versus lower-income disabled. The credit is only useful where tax is owed against which it may be applied or where the individual is able to transfer the credit to family members involved in giving care or support. A flat rate taxable benefit would accrue to *all* disabled individuals, regardless of income or tax status.

The goal of enhancing equity between disabled and non-disabled members of society and between lower- and higher-income disabled is one which I heartily applaud; however, I disagree with the route chosen by the commission towards this enhancement.

The problem can be better addressed through the conversion of the present tax credit into a refundable tax credit. Thus, individuals who qualify but who may have no tax liability will also benefit from the measure. The positive features of retaining a tax credit for the disabled are many, but chief among them is the fundamental recognition of differing economic means. Taxing fairly requires that we recognize differing economic burdens in the assessment of tax. The origin of the tax credit lies in the recognition that persons with disabilities had expenses necessary to the fundamental acts of daily living which lowered their real economic power and thus their ability to pay tax. The removal of this recognition and the suggestion that yet another subsidy program will be created to repay or subsidize this group violates the basic concept of fairness in taxation.

There are, of course, complex issues involved in the creation of a refundable tax credit. Social assistance entitlements must not be lowered by the credit amount, or we have simply shifted the dollars from one program to another. Similarly, an agreement would need to be reached with the federal government regarding the potential increase in federal taxes due to the existence of such a credit.

There are other benefits to retaining and improving the existing disability tax credit, of which one is the minimization of the burden of paperwork for the disabled. Tax forms must already be completed, while an additional benefit program would require application by the individual and administration to deliver it. The disabled community already exhibits a poor take-up rate of programs directed towards it. The Report of the Parliamentary Standing Committee on Human Rights and the Status of Disabled Persons tabled in March 1993 cites a 10 per cent take-up rate for the disability tax credit in 1991 and a 1 per cent take-up rate for the medical expense tax credit. These poor take-up rates point to fundamental flaws in the education of the disabled community in their use. Continued maintenance of these credits must be accompanied by an education campaign and by support services to insure that those who qualify do indeed benefit from the programs.

A final justification for the retention of the disability tax credit lies not so much in principles of tax equity as in a pragmatic recognition of the extreme pressures being brought to bear on government spending in this era of deficit financing. A shift of the emphasis from reductions in tax liability to enhancements of government subsidies for the disabled may be unrealistic in the present climate. I do not feel we further the lofty ideal of "tax fairness" by increasing tax burdens on the disabled community and hoping that we can redress relative economic burdens entirely through subsidy programs.

The commission's recommendations to eliminate the credit for disability-related expenses and the deduction for attendant care are, I feel, similarly flawed. The commission based its recommendations on certain problems inherent in the design of the credit and deduction. They are as follows:

a) The credit for medical expenses provides far greater support to disabled individuals who experience high one-time expenses than to individuals who suffer from on-going medical costs. This situation has developed owing to the existence of a threshold for claims.
b) There exists an inequity between those disabled who are self-employed and those who are not, due to the fact that the self-employed can often legitimately deduct the same medical expenses under the business expense deduction, which has no threshold, while those who utilize the medical expense tax credit to deduct these same expenses will be limited by the threshold.
c) The list of goods and services which are claimable under the medical expense credit is frequently out of date and does not adequately reflect the total basket of support services utilized and required by the disabled community.
d) Attendant care deductions are more valuable to those who have higher incomes. The benefit is correspondingly lower for lower-income individuals.
e) Low-income individuals without a tax liability cannot avail themselves of the medical expense tax credit unless they are in a position to transfer it to a supporting relative.
f) While all medical costs incurred in receiving care in an institution are deductible, there is a $5000 limit imposed on such costs for an individual being cared for in his or her own community. This creates an unfortunate bias towards institutional living and an inequity for individuals attempting to maintain a productive life in the community.

Most of the problems I have outlined can very adequately be addressed through simple changes to the existing medical expenses tax credit and attendant care deduction. These changes would include:

a) the removal or reduction of thresholds for claims;
b) improved communication between the Tax Administration Office and the representatives of the disabled community in arriving at current and comprehensive lists of appropriately covered items;
c) conversion of the attendant care deduction to a credit; and
d) fuller credit for attendant care services provided within the community.

The final issue, that of the lack of benefit of the tax credit for low-income individuals, is more problematic. Conversion of the medical expense tax credit to a refundable credit poses many significant challenges.

1 The dollar volume of support through the program may increase exponentially without significant government control on expenditures.

2 Commitment to audit will have to be increased to ensure that requests for credits reflect approved goods and services.

3 Cash flow considerations will continue to be problematic for the disabled, who will receive recompense for the purchase of goods and services only once a year rather than at the time of need.

I believe that while significant community support for goods and services to the disabled is desirable, the tax system may not be the most appropriate method of delivery for such a comprehensive support program. In the interim, I would favour the retention of the medical expense tax credit, the conversion of the attendant care deduction to a credit, and the institution of the improvements described earlier, until such time as a fuller, more comprehensive subsidy or public insurance program evolves to fully compensate the disabled for costs incurred in performing the routine tasks of daily living and employment.

The final recommendation of the commission in this area – that exemptions of modifications to property for the accommodation of disabled residents should be eliminated – is a highly problematic one. Again, the commission, in the pursuit of simplicity and fairness, has suggested that this particular burden can best be alleviated by a direct spending program. The principle underlying this – that the equal assessment of all property despite its use is appropriate and that the disabled must somehow be compensated afterwards – is flawed. Assessment attempts to arrive at some form of measurement of value or equivalency in order to tax people for their consumption of community services. Taxing a disabled individual's residence at a higher level owing to the existence of ramps or wider passages does not improve tax equity or reflect that individual's responsibility or ability to pay for community services. No choice has been made to purchase a property of larger proportion for personal pleasure. The extra room provided for successful manoeuvring has not enhanced the home's intrinsic value. A subsidy program is a poor substitute for getting the taxable amount correct in the first instance.

To conclude, this commissioner feels that the fair treatment of those in our community with disabilities must include the recognition in our tax system of their additional expense burdens and must tax fairly the real economic power of these individuals after they have invested in the supports necessary to afford them access to the basic daily rights of life.

Taxation and Economic Incentive

The following is a response to a group of recommendations which in various ways run counter to the commission's avowed objectives of maintaining competitiveness and economic efficiency. The particular recommendations with which I experience the greatest difficulty are the following:

29 Ontario should seek the agreement of the federal government to end the exclusion of 25 per cent of capital gains from taxable income. Similarly, all capital gains should be included in corporate income for corporate income tax purposes.

30 Ontario should seek the agreement of the federal government to abolish both the $100,000 general lifetime exemption for capital gains and the special $500,000 lifetime exemptions for farming and small business assets. If the federal government does not agree to make the changes at the federal level, Ontario should make the changes in the Ontario income tax.

34 Ontario should maintain effective rates of tax on business at approximately their current levels relative to other jurisdictions, given the evidence with respect to:

- effective tax rates in competing jurisdictions,
- the impact of effective tax rates on business location decisions, and
- the shifting of corporate taxes to employees, consumers, and investors.

38 Ontario should not attempt to use its corporate tax system as a mechanism for delivering incentives that are more generous than those offered in the federal system. Corporate tax deductions in Ontario which are either in addition to federal deductions or accelerated compared with federal deductions should be eliminated.

40 Ontario should eliminate the bias in the corporate income tax against income generated in service industries by removing the preferential rate for profits from manufacturing and processing.

46 Ontario should eliminate the graduated rate structure for its existing payroll tax and replace it with a uniform rate of tax based on all remuneration.

Tax Competitiveness

Recommendation 34

Recommendation 34 appears to suggest that it is a necessity for Ontario to maintain tax rates at a competitive level. However, in two fundamental respects it falls short of recognizing and reaffirming the vital link between tax policy and economic performance. It assumes that in fact tax rates at their current levels relative to other jurisdictions are presently competitive and it suggests that the current relationship between Ontario taxes and those of its chief trading partners and chief competitors is satisfactory. In his 1993 paper "Canada–US Tax Competitiveness in Manufacturing Industries" for the Conference Board of Canada, Mahmood Iqbal concluded that Canada's tax system is relatively less competitive than that in the United States; however, this difference is marginal. Ernst & Young concluded in their study, "The Impact of Taxes on Business Locations," that Ontario and Canadian taxes on corporation investment are somewhat higher than those of US jurisdictions.

Although these references are used in justification for the commission's recommendations to retain the status quo, I feel they make a stronger case for the necessity to re-evaluate. The Conference Board report succinctly summarizes the sensitive links between taxation and economic activity.

> The competitive advantage of a country depends on a host of economic and non-economic factors. Skilled human resources, investment capital and the level of research and development are the key economic factors determining the prosperity of a country. These factors, directly or indirectly, are affected by the taxation structure of the home and competing countries ... Taxation policy influences the economic environment which in turn affects the competitive position of the country in the global market. Capital, and to some extent skilled labour, are highly mobile ... If the gap persists between the Canadian and US systems, more investment capital will leave, hampering the country's economic growth. (Iqbal 1993, 1, 12)

I feel the commission's recommendation should have been restated to support increasing tax competitiveness rather than maintenance of current levels. A fair tax system is one which permits healthy economic activity to take place and thus fosters economic prosperity for all its citizens.

Recommendation 38

Recommendation 38 suggests that Ontario should not utilize its tax system as an economic lever but should tie it to levels set by the federal government. The rationale for this recommendation lies in a desire for simplicity, a disbelief in the influence tax incentives bring to bear on business or investment decisions, and a fear that interprovincial tax competition will result in an erosion of tax revenue. Simplicity, while certainly a desirable feature of a tax system from an administrative and compliance perspective, is certainly not a feature which should supplant economic competitiveness in importance. The existence of a separate provincial corporate tax system springs from a belief that provinces require the tools to support and encourage economic activity. Suggesting we limit this flexibility in the emerging global economy would be a backward step. Conklin and Whalley's research paper for the commission ("The Ontario Tax System in the Global Economy of the 1990s") does not support this scepticism about the role of tax incentives. They say:

> Ontario's tax system will play a significant role in future business location decisions. Capital has become increasingly mobile in recent

> years, particularly in the manufacturing sector. Businesses are more willing to change the location of their activities in response to their assessment of economic realities – Ontario is now involved in a new permanent competition with other jurisdictions to attract investment, and the jobs and local purchases that come with that investment. The tax structure is an important weapon in this competition. (Conklin and Whalley n.d., 43, 46)

Recommendation 40

Recommendation 40 suggests a removal of the current preferential rate for manufacturing and processing profits in the corporate tax system. While the commission deliberated on this issue, I believe that we all shared a concern about the presence of bias against the service sector. It seemed appropriate for the commission to consider ways in which the bias might be eliminated. Certainly the growing importance of this sector and the blurring of the lines between services and manufacturing must be recognized and addressed in the tax system. In the final instance, the commission elected not to chart a course in this particular arena. It left open the important question whether symmetry between the corporate tax rates in both sectors is to be achieved at the higher or the lower level. In choosing to remove the preferential rate from manufacturing it has left open the possibility of increasing this sector's tax burden. In keeping with recommendation 34 (tax competitiveness), it would have been preferable to have been more specific and to have concluded our commentary with a proposal to lower service sector rates or to moderate between the two, thus removing the bias between these two sectors of the economy.

Recommendation 46

With this recommendation the commission has chosen to suggest the establishment of a uniform rate of tax for the Employer Health Tax, removing the present preferential rates for smaller payrolls. The foundation for this recommendation lies in the commission's acceptance of the assumption that increases in payroll tax burdens will be absorbed by labour, rather than capital. Bev Dahlby, in his 1993 paper "Payroll Tax," explored this theoretical framework in some depth. He concludes, when applying the basic supply and demand model, that labour would bear around 90 per cent of the burden of the Employer Health Tax, given current knowledge levels about the elasticity of demand and supply of labour in Western economies. However, he acknowledges several crucial limitations or caveats to these results. Three of these are as follows:

1) The model assumes a competitive labour market. He acknowledges that in reality, owing to the existence of unions, we have a significant departure from the competitive model.

2) The model assumes that real wages are completely flexible and adjust in response to the introduction of a payroll tax, to equate the demand and supply of labour. In fact he cites a study by Hamermesh (1980) to refute this perfect responsiveness.

3) The adjustment in wage rates plays a role in equating the demand and supply of labour. He acknowledges that firms may not reduce their real wage rate in the face of an excess supply of labour because the resulting decline of labour productivity would increase their marginal cost of production.

The conclusions of the study are severely weakened by these assumptions made about the responses of labour and capital and by the lack of ability to model other economic variables. According to Dahlby himself, no study has developed models that incorporate the markets both for labour and for capital. The models used assume such rigidity of factors and fail to take into account such key economic variables as to severely call into question the conclusion that payroll taxes are borne by labour.

The other rationale the commission has cited for its choice to rely more heavily on payroll taxation lies in the relative level of payroll taxes vis-à-vis other jurisdictions. The report cites Cleroux's findings wherein the tax burden of Ontario was compared with that of the five US states which absorb 70 per cent of Ontario's exports. He found that while the total tax burden was highest in Ontario, the payroll tax burden was higher in those five states. This was seen to be an opportunity to increase tax revenue without adversely affecting competitiveness. The assumption underlying this recommendation is that firms are unconcerned about the total tax burden and will willingly absorb additional taxes of one type or another if they are, in fact, level or less than in other jurisdictions. I submit that firms will assess the *total* burden of taxation in a particular locale when evaluating their cost structure and making investment decisions.

While the logical underpinning of this recommendation is weak, there are many compelling reasons for my rejection of this proposal.

1) Employment growth in recent years has been concentrated in the small business sector. From 1979 to 1989, 70 per cent of the increase in employment occurred in firms with fewer than 50 employees (Dahlby 1993). A tax which endangers the vitality of this sector has potentially disastrous economic consequences for the province. Over 84 per cent of employers in Ontario have payrolls of $200,000 and less and would be adversely affected by this measure (Dahlby 1993).

2) Payroll taxes, along with property taxes, are the most important tax paid by smaller firms. Payroll taxes are higher as a percentage of revenue and as a percentage of taxable income for small firms than for large firms. These taxes represent 37 per cent of the tax burden on a firm with less than $1 million in assets and 28 per cent of the burden for firms with over $10 million in assets (Dahlby 1993).

3) Small firms are more labour intensive than large firms and less able to substitute capital for labour. Payroll taxes, if increased, will further jeopardize the growth and development of employment in this sector owing to their heavy reliance on labour as a factor of production.

4) Smaller firms exhibit lower wage rates and thus will have even fewer opportunities to pass on higher payroll taxes to labour than larger firms. This sector is already at a competitive disadvantage in attracting and retaining skilled staff.

5) Higher rates of personal income taxes and payroll taxes may cause some individuals to work in the underground economy. This would merely exacerbate a compliance problem which has

already grown in response to the increased taxes and economic hardship of recent years.

6) The relatively small revenue potential of this measure, combined with the fact that small firms would see their liability double, renders this proposal unwise from an economic and tax fairness perspective. It would serve us poorly to risk the health of an economic sector which is characterized by high failure rates, lower margins, higher tax burdens, less mobility, and significant job creation.

7) This recommendation repudiates Recommendation 34, which states: "Ontario should maintain effective rates of tax on business at approximately their current levels relative to other jurisdictions," and would have a harmful impact on the competitiveness of this vital sector of our economy.

Recommendations 29 and 30

These recommendations seek the abolition of the exclusion of 25 per cent of capital gains from taxable income and the abolition of both the $100,000 general lifetime exemption for capital gains and the special $500,000 lifetime exemptions for farms and small business assets. The commission has based these recommendations on the following:

1) a fear that effective rates of tax on income earned from employment will exceed rates of tax on income from capital, thereby compromising fairness;

2) an unwillingness to accept the tax implications of capital mobility;

3) a concern over the amount of tax revenue forgone by these measures; and

4) a preference for more closely targeted incentives and ones which are delivered at the time of the investment, regardless of the future success or failure of the venture.

I strongly disagree with these recommendations, which I feel disregard the vital links between capital accumulation and economic well-being. In "The Taxation of Savings and Investment," a research report prepared for the Economic Council of Canada (1987b), this link is aptly described.

> The taxation of savings and investment plays a key role in the determination of present and future output and living standards. Savings accumulated out of current income (together with foreign investment) finance capital formation, which in turn raises future output by increasing the physical capacity with which other factors of production have to work. The resulting factor productivity in turn determines wage levels, the return to capital and living standards in general. Thus by encouraging or discouraging saving taxation of capital income can play a major role in determining economic well-being. (page 1)

Fundamental changes in the taxation of capital gains such as those proposed would have tremendous and negative impacts on capital formation and therefore the economic health of the province. Michael Boskin and William Gale, in their 1987 paper entitled "Tax Policy and Economic Growth: Lessons from the 1980s," found that capital formation was quantitatively a quite important determinant of postwar US growth. The rate of domestic investment was ultimately constrained by the supply of national saving. Thus, taxation and deficit policies which affect investment by altering savings affect the growth rate over protracted periods. My dissonance with these two fundamental recommendations is based on the following:

1) They have the potential to impact severely on the province's growth and economic prosperity, owing to the inevitable flight of both domestic and foreign investment.

2) It is inappropriate and quite inequitable to fully tax capital gains when at least part of the gain can be accounted for by inflation.

3) Recommendation 30 has the potential to discourage participants in the agricultural industry from further investment. Both from the standpoint of economics and social welfare it is not in our

interest to depress this vital sector of our economy. Although the measure theoretically impacts the taxpayer only upon sale or disposition of the farm, I believe it forms part of his/her calculation of lifetime gains and decisions regarding farm expansion or contraction. Furthermore, the commission failed to reach consensus regarding specific measures for retirement relief which might have offset this punitive recommendation.

4) Similarly, I have very grave concerns regarding the elimination of the $500,000 capital gains exemption for small business. For the reasons outlined in the payroll tax section, it would be imprudent to impose such a harsh tax consequence on this vital economic sector. The capital gains relief for small business acts as a leveller over the business owner's lifetime. The combined package of lower margins, high failure rates, poor access to capital, lower mobility, and lower wages is partially offset by progressive measures such as the small business tax rate and the capital gains exemption. It is incorrect to suppose that investment and growth in this sector would be unaffected by such a change.

This commissioner would have been more satisfied with the output of the commission's deliberations had they taken a braver approach with respect to the encouragement of economic activity through increased tax incentives and more competitive tax rates.

There exist in the commission's report additional recommendations which run counter to this objective and with which this commissioner, therefore, has considerable difficulty. They include:

1) Recommendation 26 (reduction of the maximum retirement benefit eligible for tax assistance through contributions to pension plans and RRSPs);

2) Recommendation 123 (increasing the number of personal income tax brackets and raising the top marginal rates to 28 per cent provincially);

3) Recommendation 32 (seeking the establishment of a national wealth transfer tax); and

4) Recommendation 60 (extension of the retail sales tax to financial services).

These recommendations jointly have the potential to reduce savings and investment, to induce mobility of capital and labour, and to further depress the Ontario economy. A fair tax system is not achieved through measures which induce capital flight and reduce economic vitality, thereby placing the burden of financing government services on an ever dwindling economic base.

W.R.C. Blundell

During the deliberations of the commission there were a number of instances where I found myself in opposition to the consensus position of our group. Some of the more important of these, where I thought that the issues were important enough to register a contrary view, are:

1 education funding (chapter 28)

2 certain elements related to the taxation of individuals (chapters 16 through 19)

3 certain elements related to the taxation of corporations (various chapters), and the

4 tax mix.

Education Funding

I am not persuaded that the proposal to shift the funding of education from the residential property tax base to the provincial personal income tax base is a prudent one, for the following reasons.

1 During the commission's public consultations, most school boards expressed concern that centralization of funding (and hence control) at the provincial level would significantly constrain their

ability to serve the specific educational needs of their individual communities, and would work against raising the overall quality of teaching within the province.

2 Further, since municipal governments do not have the authority to borrow funds, local ratepayers would be denied the right to make decisions on education because all funding would come from a central source.

3 In my view, the proposal to shift the funding of education from the residential property tax base onto personal income taxes imposes a burden on the latter tax base that it cannot reasonably carry.

4 There is a valid concern that lowering residential property taxes will not lower the cost of housing, because such tax reductions will tend to get capitalized into the price of houses. Consequently, the chief beneficiaries will not be householders, but rather people who own stocks of houses.

5 The residential property tax has served, and can continue to serve, as a reliable tax base, relatively insensitive to economic cycles and virtually immobile in an increasingly global world.

With respect to commercial and industrial property tax, the proposal to replace the local tax with a property tax operated at the provincial level will greatly reduce local autonomy and flexibility. In my view, the authority of each municipality to set its own commercial and industrial property tax rates gives each community greater ability to influence local economic development, and accordingly, the quality of life for all its citizens.

There is a need, however, to move aggressively ahead with the reform of municipal government financing. The commission's report recommends that funding for general welfare assistance and provincially mandated services to children be raised from the municipal to the provincial level. This could be an important condition in getting on with the disentanglement of provincial and municipal responsibilities which, in large measure, are stalled. In my view, sorting out the responsibilities and funding bases between the provincial and the municipal governments is the first priority.

Finally, a number of school boards identified the potential for significant cost savings by rationalizing the boards within a jurisdiction and/or integrating their non-academic activities. These initiatives should be pursued.

Taxation of Individuals

Ontario's urgent priority from now through until the end of this decade is the creation of new, high-value–added jobs. The Ontario economy is in transition from one dominated by branch plants and resource-based industries to one which, it is hoped, will have a greatly expanded base of businesses in the knowledge industries of the future, as set out in the documentation of Ontario's industrial strategy. During this critical period of Ontario's economic development, there is an urgent need to promote capital formation, particularly in the hands of individuals and small-to-medium–sized corporations, and to provide incentives for risk taking and entrepreneurial activity. In this context, the following commission recommendations are particularly counterproductive.

1 The proposed tax treatment for contributions to registered pension plans and RRSPs will be a disincentive to saving. During the public consultations, individuals repeatedly expressed their desire to be self-sufficient, particularly in retirement, and not a burden on society. In addition, Ontario's (and Canada's) increasing levels of foreign borrowing to finance government deficits make domestic savings an escalating priority.

2 The proposals to restructure or possibly eliminate the dividend tax credit (subject to appropriate measures regarding the integration of small business income) and to abolish capital gains exemptions will be a significant deterrent to needed increases in risk taking and capital formation, both of which are essential for job creation. In particular, the partial exclusion of capital gains is intended to recognize both the impact of inflation and the fact that many gains are realized on share prices that have been increased through the retention of earnings of the corporation, which themselves have already borne tax. Further, any reductions of dividend tax credits will also, obviously, lead to double taxation.

3 The proposed personal income tax rates are excessive at the top end (i.e., a combined federal/provincial rate of 60 per cent). The result will be to drive away mobile professionals, and to discourage highly qualified individuals from locating in Ontario.

In my view, combined personal income tax rates modestly in excess of 50 per cent (e.g., 52–54 per cent) can only be sustained for limited periods of extreme fiscal pressure through the application of temporary surtaxes. A more progressive scale, as is proposed, may contain elements of greater fairness, but high fiscal demands have forced governments to flatten the curve by raising the rates for middle-income earners, where the major base of revenue exists.

4 The proposal to encourage the federal government to introduce a national wealth transfer tax, in my view, is untimely. It has very modest potential for increasing government revenues, and would strongly work against capital formation and incentives for entrepreneurs. Further, a significant portion of personal wealth exists with a very limited number of families whose wealth is extremely mobile.

In summary, the proposals contained in the report for broadening the personal income tax base (including converting tax deductions to tax credits), plus the proposed rate changes, will lead to an inordinately heavy tax burden on middle- and upper-income taxpayers, well beyond the perception given by looking at the proposed rates alone.

Tax Treatment of Corporations

I am generally in agreement with most of the commission's recommendations with respect to the tax treatment of corporations; however, I would like to register the following views.

1 With respect to the proposal on tax expenditures to shift from treating these as tax deductions to tax credits, I am not in support of making these refundable for businesses (or for that matter for individuals) under any circumstance. Tax expenditures by their very nature tend to be open-ended, and experience shows that taxpayers are quick to take advantage of government refunds. Tax

expenditure programs should not be designed to reward or protect losers.

2 On payroll taxes, the proposal to eliminate the graduated rate structure will place a heavy additional burden on small business, and it will have a negative impact on employment and the creation of new jobs. Many representations at the commission hearings were against payroll taxes. There is a strong perception that the burden of payroll taxes falls almost completely on the shoulders of the employee, and that it is very much anti-job creation.

3 With respect to the bias in corporate income tax rates between manufacturing/processing and services industries, in my view there is a case for maintaining a bias towards traded goods and services that bring important value to the Ontario economy. The current distinctions are probably inappropriate. However, I would support new definitions that provide special, modest tax incentives to high–value-added traded goods and services industries, which are the most exposed part of the economy to foreign competition.

4 The proposal with respect to business entertainment expenses has the potential to be unreasonably harsh. Business meals and entertainment are a necessary business expense. To the extent that businesses and individuals abuse the legitimate intent here, I would support their disallowance.

5 The proposals on environmental taxes would, in my view, benefit from a thorough review of the science underlying the identified concerns before they are finalized.

Tax Mix

Tax mix is at the heart of any debate on tax fairness. In summary, relative to the commission's recommendations, I would favour shifting any future additional tax burden, if needed, to the consumption tax base. In my view, all the other important provincial tax bases are loaded to, or even beyond, sustainable levels.

In very general terms:

1 Consumption taxes are the most visible to all citizens and therefore provide the highest level of discipline on public spending;

2 have the greatest potential to raise significant amounts of revenue;

3 promote necessary saving over consumption; and

4 provide the taxpayer with some dimension of control: by varying consumption one can vary taxes paid.

Finally, in my view, it would be desirable, and fair, to shift some of the heavy personal income tax burden on middle-income earners onto the consumption tax base.

Neil Brooks

Missed Opportunities

The thrust of the commission's report is that the tax system is in need of reform. Most significantly, the commission argues that the tax system should be more progressive. High-income individuals should pay a larger share of their income in taxes than they now do, and middle- and low-income individuals should pay less.

The commission also argues that many subsidies now delivered to people in the form of tax deductions or credits should be repealed or converted to direct subsidy programs. It urges that provisions in the tax system that provide relief to low-income taxpayers should be more closely integrated with the provisions of the direct cash transfer system. It makes the case for levying environmental taxes to ensure that those who consume goods and services that impose costs on the rest of society bear the full cost of their activities. And it reminds us that in determining whether or not the tax system is equitable in the sense of treating similarly circumstanced taxpayers in the same way, account should be taken of taxpayers' social realities.

I thoroughly agree with this thrust. However, regrettably, I find myself unable to agree with many of the commission's specific recommendations, and I also disagree with a good deal of the analysis in the report. Following these preliminary comments, my dissent and personal comments on the report are divided into three parts.

First, I discuss the content of the report itself and the process followed by the commission in discharging its mandate. My point of departure is that the analysis in the report is often shallow. Even regarding the issue most central to the report, increased progressivity, the case supporting it consists, in the main, of bold assertions and rhetoric. The report also fails to deal seriously with the arguments and empirical evidence that those opposed to progressivity have mustered against it in recent years. I believe that these serious deficiencies in the form and content of the report arose from the process the commission adopted in pursuing its work. At the outset, the commission debated at some length on what process it should follow in discharging its mandate. I objected at the time to the process that was established and remain convinced that it was the wrong choice.

At one level, the question of how the commission should have proceeded with its work likely reflects a difference of opinion over the primary role of the commission. Some commissioners appeared to view the commission's role as primarily one of attempting to strike a tax bargain between people representing different interests, to build a consensus around particular solutions, to educate the public about the tax system and its perceived inequities, and to search for politically acceptable tax reforms.

I took a different view. The primary role of commissions like the Fair Tax Commission should not be simply to discover what people or interest group leaders want for themselves or their constituents, and then attempt to determine the best means of implementing or compromising those wants. Instead, it should be to deepen our understanding of the issues it addresses, thereby creating an opportunity for more thoughtful public discussion, which, in turn, will enrich not only society's understanding of itself, and its needs and values, but also the choices it confronts.

Public inquiries will only achieve their democratic potential if they provide the public with alternative visions. Thus, the most important part of a commission's task should be to reconceptualize issues in ways that promote clarity of thought; to reveal the theoretical presuppositions that underlie all policy analysis; to examine the logic of policy arguments; to gather and assess the validity and reliability of the evidence relating to the empirical questions that underlie policy choices; to point to novel ways to overcome what previously has been regarded as intractable policy dilemmas; and to provide the public with alternative visions of what is possible. These tasks demand a sophisticated analysis of public policy issues.

Obviously, to achieve these purposes, commission reports have to be written in a style that is clear, vivid, and free from the jargon of accountants, lawyers, economists, and other experts. However, that does not mean that such reports should be simplistic or only deal with simple ideas. Quite the contrary. The greatest challenge of public inquiries is to make sophisticated insights and complex findings accessible to the public. If public inquiries do not perform this function, the prevailing ideology of the economically powerful, whatever its basis, will remain an unchallenged part of the national common sense and unchallengeable by people and groups without their vast resources.

The second part of my dissent briefly reviews some of the substantive recommendations of the report with which I disagree. The commission's central recommendation relating to increasing the progressivity of the tax system involves shifting billions of dollars of tax revenues from the residential property tax to the income tax. This recommendation is undoubtedly well intentioned but seriously misguided. Not only will it at most only modestly increase the progressivity of the tax system, but more seriously it will give rise to large and unpredictable windfall gains and losses, it will increase the inefficiency with which resources are allocated in the economy, and it will impair the revenue-raising capacity of the province. I also state my strong disagreement with the commission's related recommendations on education financing and on changing the method of assessing residential property from market value to unit assessment. With respect to education financing, I criticize the commission for failing to follow its argument for provincial funding to its logical conclusion. I find the commission's case for unit assessment, at worst, incoherent and, at best, a retrograde step.

I also criticize the recommendations relating to the wealth tax, resource taxes, and the corporate tax for not going far enough. There are clearly limits on a provincial government's ability to use the tax system as an effective instrument for achieving social equality; however, in these and other areas the commission's analysis and recommendations concede too much to the power of owners of capital and multinationals.

In the final part of my dissent, I muse about the possibility that the commission was likely given a hopeless task, since the tax system now plays so many different roles in the social and economic life of modern welfare states. I conclude by reiterating the important role I think the commission should have played in democratizing the tax reform process.

The Commission's Work

Content of the Report

My major concern with the report, as a document to be acted upon by the government in forming its tax policy, is that it fails to take adequate account of the cumulative knowledge and the relevant theories, concepts, findings, and tools of analysis of economics and other social sciences. Although social science methods and knowledge have well-known limits, and a good deal of public finance research is of questionable value to practical reform exercises, research over the past two decades has increased the opportunities available for a detailed understanding of the consequences of taxation. Yet, because of the process the commission adopted for proceeding with its work, and eventually preparing its report, almost none of this research informs the recommendations.

The lack of in-depth and sophisticated analysis in the report could be illustrated by reference to almost any chapter. In order to highlight the lost opportunities, I will mention two examples. It is now widely recognized that tax evasion is a pervasive phenomenon in Ontario. Moreover, it is difficult to imagine a greater tax unfairness than tolerating a system in which taxes are shifted from dishonest to honest taxpayers. Over the past decade, a burgeoning literature, both theoretical and empirical, by accountants, economists, psychologists, and sociologists, as well as scholars from other disciplines, has attempted to come to grips with the important question of who evades taxes, and the factors that distinguish tax evaders from people who comply. This literature is rich with insight. The commission could have performed an invaluable service in this area by developing a comprehensive, detailed, and practical strategy for increasing compliance with the law based upon this research. Instead, the chapter on compliance simply concludes with a few general and unhelpful suggestions. Furthermore, the analysis appears to rest on the premise that taxpayers engage in a strict cost-benefit calculus when deciding whether or not to evade taxes. When applied to most taxpayers, this is a widely discredited theory of compliant behaviour.

The chapter purporting to show the percentage of their income families in various income classes pay in taxes, which one might have assumed would be the heart of the report, professes to show that the present Ontario tax system is roughly proportional in its distribution. However, none of the many general problems with these types of qualitative incidence studies are alluded to by the commission. Yet these problems are so severe that many commentators believe that the only value of these studies as a tool for determining the distribution of the *existing* tax system is to amuse, despite their value in predicting the short-run incidence of changes in the tax system. Furthermore, to the extent that one takes these studies seriously, the analysis presented in the chapter is based upon only the most straightforward type of incidence study. Unlike many recent incidence studies, it makes no attempt to measure the distribution of the tax system based upon a taxpayer's lifetime income, or at least some longer-term measurement of income than one year. It does not even appear to account for, or deal with, the standard objections to studies based on annual income; for example, that at the low-income end of the scale, the apparent high tax burden is almost meaningless since this category contains a mixed bag of people who have almost nothing in common. It includes professionals just starting out in their careers, wealthy retirees, those with volatile income who have just suffered a bad year, and the perennially poor. Further, at the low-income level, it is senseless to look at the tax burden paid without acknowledging that, in part, the size of this burden is simply a function of whether transfers take the form of tax credits or cash grants.

Although the chapter acknowledges that what comes out of tax incidence studies is solely determined by what goes into them – namely, the assumptions about who ultimately pays the individual taxes – it does not justify the assumptions it uses, nor does it fully acknowledge the importance of these assumptions. Different assumptions about the incidence of particular taxes can turn the results on their head. In fact, a number of recent studies in Canada have purported to show that the distribution of the tax burden is sharply progressive. The chapter does not confront or explain these findings. Although I was never given a copy of the background paper on which this chapter is based (and perhaps all this is explained there), I do recall that some of the assumptions I was told were being made, such as the one regarding the shifting of the corporate tax, were both novel and without foundation. Finally, I might note that recent studies on tax incidence have used general equilibrium models to quantify the effect of taxes on wage rates, interest rates, and the prices of goods purchased by consumers. Such models have been used to calculate both the distributional and efficiency effects of taxes. Such information would appear to be highly relevant to policy makers who must choose among alternative tax rules. The chapter pays no attention to this kind of useful modelling.

Other economic concepts that are now the stock-in-trade of tax policy analysts, such as "excess burden," "cost of capital," and "marginal effective tax rates," are barely alluded to in the report. Even with respect to the most central conclusion of the report – that the tax system should be made more progressive – no attempt is made to evaluate the effect this might have on work effort, personal savings rates, tax evasion and avoidance, or migration. Even the purely technical tax problems created by such things as the effect of inflation on tax bracket creep, and the effect of increasing personal tax rates to an even higher level than the prevailing corporate tax rates, are not addressed. Personally, I am in favour of higher marginal tax rates, even higher than those the commission recommends, but I am troubled by the fact that the commission did not take seriously, consider, or deal openly and objectively with the arguments made by those who oppose increased progressivity.

Few economists or social scientists with specialized and in-depth knowledge of tax issues were involved in the commission's work. Although numerous research studies were commissioned, the analyses and results of most of these studies were never integrated into the commission's work. Only a few of these studies were presented to the commission, let alone debated or questioned. Most of the recommendations made by the commission were resolved at brainstorming sessions during the summer of 1993. In resolving these issues, commissioners were left to draw largely upon their own knowledge and experience and what they had learned from the working group reports and at the public hearings. Near the end of the summer, since time was running out, commissioners were simply invited to respond to questionnaires in order to resolve some issues.

Finally, and unfortunately, the study does not look at the Ontario tax system comprehensively. Many contentious taxes are not analysed at all, such as the corporate capital tax and the land transfer tax. No opinion is even offered on the most regressive tax in the Ontario tax system, the approximately 40 per cent tax on lottery tickets. And no attempt is made to analyse the shortcomings of the most important tax – the income tax. One might read the report and conclude that, except for the need to convert a few social policy tax expenditures into direct subsidies and to increase the progressivity of the marginal tax rates, the income tax is fair. Nothing could be further from the truth. The income tax is a mess. It is riddled with inconsistencies and, for lack of a better word, technical loopholes. These measures are invariably not only unfair, but also seriously distort the efficiency with which resources are allocated in the Canadian economy. Billions could be raised by reforming the income tax base. None of this is clear from the report. Indeed, in spite of the inveighing against tax expenditures, few corporate tax expenditures are analysed in detail and their repeal recommended in the report.

Process

Like most commissions, the Fair Tax Commission was appointed to serve many functions: as a vehicle for analysing policy, for identifying a consensus about policy, and for building support for new policy directions. The treasurer elaborated on these functions in the background documents he had prepared for the Standing Committee of the Legislature on Government Agencies at the time of the commission's appointment:

> The primary objective of the Fair Tax Commission is to assist the Treasurer in designing and implementing a tax system that is more equitable. Its work will deal with both general and specific tax issues.
>
> Other objectives are to engage a broad cross-section of people in the inquiry; build a consensus around workable solutions; and enhance the public's understanding of the tax system and thereby increase the system's sense of legitimacy. To this end, the Fair Tax Commission will work with a wide variety of constituent groups in all phases of its inquiry. The commission will need to not only hear Ontario's many and

diverse voices, but invite them to participate in the process – to be involved in both the consultative and analytical parts of tax policy development.

As outlined in the second chapter of the report, in pursuing these functions the commission established (at the request of the treasurer) eight working groups, involving more than 200 participants, to deal with specific tax issues; organized an elaborate community consultation program; undertook an ambitious set of public hearings; and prepared and distributed various pamphlets, booklets, and newsletters. At every level, the commission's work in preparing these programs swamped its work of independently analysing tax policy issues and hampered the commission in its attempts to develop a strategy for comprehensively reviewing the tax system.

Almost a year and a half of the commission's own time was taken up discussing, administering, and assisting the various working groups and community "tax forces." Most of the commission staff was involved full-time in activities relating to these programs. Consequently, little time was spent by the commission or its staff analysing tax policy issues from policy perspectives informed by economics and other social sciences.

Not only did the process not provide for the integration of expert knowledge into the work of the commission, but it also frustrated the search for creative and comprehensive solutions to problems. The working groups, for example, were asked to look at specific topics that often cut across policy areas. As an illustration, one working group was asked to examine the question of whether Ontario should enact a land speculation tax. People who had an interest in, or knowledge about, the real estate market were asked to participate. Although a land speculation tax is an appropriate area of study in some contexts, it seems odd that it would be carved out of what was meant to be a larger look at tax fairness issues. A land speculation tax might be justified on grounds of tax equity (by taxing away undeserved gains), housing policy (by reducing house price inflation), or economic efficiency (by raising revenues by taxing economic rents). A working group composed only of people interested in the real estate market, and asked to look only at a land speculation tax, is unlikely to be responsive to the policy issues presented by any of these more general justifications.

Public consultation has a role to play in public inquiries, but a more modest role than that envisioned by the commission. The views of a wide spectrum of the public are necessary to assist in identifying and clarifying issues, in providing context for problems, in helping to set objectives and priorities, and in testing the feasibility of potential policy choices.

However, particularly in areas such as tax policy, in which all citizens have an equal interest, any form of interest group negotiation at the public inquiry stage would appear to defeat the very purpose of establishing a commission. Furthermore, it should be the role of the government, not the role of a commission appointed to render independent advice, to seek to achieve social consensus in light of the values and interests that government was elected to further.

It is a serious mistake to attempt to conflate all aspects of the public policy process into the role of a single commission. Important aspects of the process are likely to be short-circuited. I leave it to others to decide whether the commission was successful in engaging a broad cross-section of people in its inquiry, in building a consensus around workable solutions, and in enhancing the public's understanding of the tax system. However, my concern is that to the extent these tasks were achieved, they were achieved at the expense of generating new ideas and visions and at the cost of not subjecting new and old ideas to rigorous public policy analysis.

Economists working in the tax area, like all experts, frequently overestimate their intellectual accomplishments and, like everyone, are subject to be blown by the winds of political power and prevailing ideologies. I have spent much of my academic career constantly reminding economists of that. Nevertheless, in tax policy analysis, as in most areas of public policy, they have an important contribution to make. The role of the public inquiry is to ensure that the generally powerful concepts, sophisticated analysis, and findings of these experts inform the public debate. The government's job is then to ensure that this is the beginning, not the end, of the public policy process, and that, at the end of the day, the legislation introduced reflects the preferences of all Ontarians, not simply those of a small group of experts or policy advisers.

The Commission's Recommendations

Education Financing

At present, over 50 per cent of the cost of education in Ontario is funded by a local property tax levied by school boards. The commission recommends that most education costs be funded by the province out of general revenues. School boards would retain the right to raise an amount equal to no more than 10 per cent of their provincial funding from the local residential property tax base.

I am in favour of full provincial funding for education. The commission's suggestion of "nearly" full provincial funding detracts from the entire concept.

The case for full provincial funding bears repeating, as much as to reiterate the importance of the commission's main recommendation as to call into question the qualification attached to it. The present Ontario system of school finance is inequitable, irrational, a blatant denial of equal educational opportunity, and an egregious anomaly in a province committed to liberal ideals. Students living in the wealthiest and most advantaged communities have much greater educational resources than students living in the poorest communities. In an economy that is indisputably provincial in character, we continue to treat educational funding as a predominantly local function. In a culture in which we devote more money to schooling than almost any other government function, hardly anyone outside a small band of initiates understands how schools are financed.

The only equity principle that should underlie school financing is obvious, straightforward, and compelling – there should be equal finance expenditures for equally situated students.

The most frequently advanced arguments against full provincial funding are, first, that local taxpayers should be free to choose how much they spend on educational services and, second, that some local control over school funding is necessary to retain local control over school policy. The first argument is a hoax; the second is illogical. Owing to financial constraints, there is no meaningful choice for many parent-taxpayers regarding how much money should be spent on educating their children. Furthermore, why should the preferences of the majority of voters in a local school board district be able to determine what level of educational services should be received by students in the community, when they alone are unlikely to bear the costs or reap the benefits if such spending is lower or higher than that provided by other school boards? If wealthy families wish to spend more on their children's education, they should be free to do so, but they should not have access to the state's taxing power in order to accomplish this.

As a matter of logic, the amount of provincial control over local schools is not determined by the amount of provincial support given, but by the procedures and policies followed by the province in providing the support. That is to say, lack of control over educational funds is not incompatible with local autonomy with respect to matters such as curriculum, school operation, and staffing decisions. The experience of jurisdictions where there is full funding confirms that daily school operations are not any more bureaucratized or insensitive to community needs than those in jurisdictions that rely upon local funding.

If the overriding objective of school funding is to help ensure equity of educational opportunity throughout the province, the finance system has to recognize the variety of local conditions that affect each school board's ability to deliver a common standard of service. Also, under this method of educational financing, the social goals to be achieved through the educational system should be openly debated in devising the formulas for distributing funds. Since one of the major purposes of education in a democratic society should be to serve as a vehicle for social mobility, the formula established should ensure that greater educational resources are focused on students who have greater educational needs. Foremost among such students are those who perform significantly below grade level, or those who begin their schooling with substantial economic and social disadvantages.

Depending upon the formula adopted for allocating finances to schools, and how well those factors have been implicitly taken into account in the present system, there could be serious transitional problems in moving to a system of full provincial funding. Reallocating currently available provincial revenue would result in the downward levelling of many boards, a politically unpopular strategy. The transition could perhaps only be realistically undertaken if new moneys were allocated to education. This point becomes significant in thinking about whether the property tax should be reduced if the province takes over full school financing, which is discussed below.

School finance policy embraces a whole series of issues intimately related to educational reform, including the relationship between school finance systems and student performance goals, teacher compensation, site-based management and budgeting, accountability systems, school choice, and the integration of non-educational children's services into the education system. Full provincial funding does not foreclose or dictate any particular resolution of these issues.

In short, there is no case for allowing educational funding to vary at all between schools based upon the capacity or effort of local taxpayers.

The Residential Property Tax

The commission recommends that the educational residential property tax be repealed and that the approximately $4.6 billion of lost revenue be made up from miscellaneous sources, but, most importantly, from increasing the income tax rates. The commission notes that this would increase the progressivity of the tax system. Along with a few other minor changes it would increase the tax paid by families with incomes over $50,000 and reduce the tax paid by those with incomes less than this. I disagree with this recommendation. If the province is to fund education fully, it ought simply to take over that portion of the property tax now dedicated to school boards and equalize the rate across the province over time. That is to say, in terms of designing a fair tax system in Ontario, there is little to be gained by substantially reducing the property tax. Instead, the transition to the new system would result in substantial unfairness and economic dislocation. Moreover, such a move would impair the province's ability to raise additional revenue.

In justifying this substantial reduction in the property tax, the commission notes that the tax is regressive and generally unsatisfactory. The property tax is not nearly as bad as the commission contends and has an important role to play in the Ontario tax system. There is no evidence that it is overly burdensome at its existing level when compared with other jurisdictions and with what it has been historically, or by referring to taxpayers' attitudes and behaviours towards it.

The property tax cannot be justified by reference to a single compelling rationale. It performs a number of functions in the tax system. Although it does not perform each function perfectly, taken together the justifications for it are convincing. It provides a stable source of revenue. It is highly visible. It is hard to evade and avoid. It is the only tax in the system that is levied on an aspect of personal wealth. Although not closely related to ability to pay, it is likely not as regressive as the commission contends. Furthermore, in terms of fairness, it is the kind of tax that, once introduced and once markets have adjusted to it, creates more inequities when repealed than when left in place. The tax also improves the allocation of resources by acting as a corrective to the loopholes in the income tax in relation to personal residences.

If the province were to take over the educational component of the property tax, it should not dedicate the revenue to education. Education should be funded out of general revenues. The province might wish to reduce the reliance on the property tax over time by not increasing property tax rates. However, it would be a serious economic and political error to reduce the property tax.

The commission concludes that the property tax is highly regressive. It relies upon its incidence study in reaching this conclusion. However, in addition to the general reasons for being sceptical of the results of these kinds of incidence studies, this study's analysis likely overstates the regressivity of the tax for two reasons. First, it assumes that the entire tax is paid by tenants and other consumers of household services. The conclusion that the property tax is regressive follows because the poor generally spend a greater portion of their income on rent capital than the rich. In economic literature, this assumption about the incidence of the property tax is referred to as the "traditional view." However, what is referred to as the "new view" assumes that not all the tax is shifted to consumers of household services, but instead that the owners of all property bear some burden of the tax. Under the new view, property taxes are progressive since the rich obtain a greater portion of their income from capital ownership than the poor. Another even more recent view is that property taxes are a form of efficient user charge for local public services. Under this premise, the question of incidence is of much less concern. Although the evidence regarding the incidence of the property tax is inconclusive, recent studies provide more support for the new view than the traditional one.

Second, the commission calculates the share of income each family pays in property tax based upon its members' annual income. Given the long-term nature of housing consumption, it seems quite inappropriate to judge its incidence on a one-year basis. No matter what the incidence assumption, the property tax is less regressive in a lifetime sense than an annual one. Also, it appears that transitory influences on measured income may be more important than life-cycle issues in causing annual and lifetime tax incidence profiles to differ.

Another fairness issue arises when a property tax that is already in place is reduced. People who study local public finance have long recognized that property taxes may be reflected in house values. This phenomenon is known as property tax capitalization. It arises because people who buy a house knowing the property tax will take it into account when determining what price they are willing to pay. The higher the property taxes, the less they are likely to be willing to pay. Arguably, the purchaser of a house who is aware of the amount of property tax levied is on no stronger ground in later claiming it is unfair than the purchaser of a house who knows it has a drainage problem. The known future property tax liability, and the known defective drainage system, were presumably discounted in the price the buyer paid for the house. Although the amount of the property tax that has been capitalized in the price of homes is not known for certain, simply taking the median result of the empirical studies that have been undertaken to answer this question would suggest that a substantial portion is likely to be capitalized.

The phenomenon known as tax capitalization implies that many inequities in the property tax cannot be reversed by changes in the tax. Because the effect of the tax is built into the market values of property, most of the tax burden has been absorbed by people who no longer own the taxed properties. The proposal to remove the education component of the property tax would bring about large and varied changes in the taxes associated with home ownership in Ontario. Although not an intended result, significant one-time gains and losses to owners of property are the predictable consequence of implementing the recommendation.

In arguing for a reduction in the property tax, the commission does not take into account the effect the tax has on the efficiency with which resources are allocated in the economy. Housing stock and services in Canada are vastly undertaxed under existing income, corporate, and consumption taxes. The imputed rental value of homes is not taxed under the personal income tax, and capital gains realized on the sale of principal residences are exempt from taxation.

The corporate tax does not fall on this form of income from capital. Consumption taxes in Canada invariably exempt most housing services. This extremely favourable treatment of the return from investment in housing undoubtedly provides a powerful incentive for people to invest in homes instead of other capital assets. This is bad tax policy because it distorts the allocation of resources and reduces the efficiency of the economy. It is also bad housing policy because these implicit subsidies for home ownership become larger the bigger the house and the higher the income of the taxpayer.

Although a property tax in excess of that needed to pay for local services is far from being a perfect tax on the return from investment in housing, it is certainly better than no such tax at all. It enhances economic efficiency by equalizing the tax burden on different types of capital incomes. At the very least, this issue should be thoroughly explored before the government reduces reliance on the property tax and runs the risk of seriously increasing the misallocation of resources in the provincial economy.

Finally – and this is an argument about the political economy of reducing the property tax, not necessarily about the fairness of doing so – the government is going to need all the revenues it can collect over the next decade. Not only will it not be able to reduce the tax burden in Ontario, it might have to increase it to further reduce the deficit or to finance the rising demands for, say, more and better educational services. Moving $3.5 billion of tax revenues from the property tax to the income tax will substantially impair the government's ability to raise additional taxes. The property tax, whatever its faults, is hard to avoid, difficult to evade, has few effects on taxpayers' work or savings behaviour, and, at least in the present political climate and at its present levels, appears to be politically acceptable. Increasing the income tax rates to the levels suggested by the commission would likely politically foreclose the possibility of raising additional revenue from this source. Moreover, if the experience of the past few years is any indication, increases in the personal income tax might prove to be a most unstable source of revenue. Certainly one could predict substantial revenue leakage in moving from the property tax to the income tax.

If the government wishes to increase the progressivity of the tax system to the degree suggested by the commission, the more sensible way to do so would be simply to make relatively modest adjustments in the income tax rate structure and look for ways of making the property tax itself less regressive. The proposal to reduce the property tax substantially and to raise the lost revenue by increasing the income tax makes no sense to me.

Market Value vs Unit Assessment

The commission recommends that the method of assessing residential property for tax purposes should be changed from fair market value to unit assessment. Unit assessment would be based upon a home's rental value, instead of its fair market value, but would be determined, not by a case-by-case estimate of rental value, but by the weighted application of four factors: size of the building, dimensions of the lot, type of building, and location. It is difficult to know how this scheme would work since the details are not worked out in the report and I do not know of any jurisdiction where it has been used. However, it appears to have almost no advantages over fair market assessment and has a considerable number of disadvantages.

One of the principal reasons the commission gives for shifting from fair market value to unit assessment is that unit assessment more reasonably reflects the cost of services provided to residential property than its market value, and, hence, it is fairer. I have two difficulties with this argument. First, it is a mistake to try to link the property tax too closely to any one rationale. As noted above, the property tax serves a number of purposes in the overall tax system. Moreover, attempting to link any method of assessing property too closely to the cost of local services is ultimately pure fiction and bad politics. It is pure fiction because it ignores the public good features of many local goods and services. What does it mean to say that the benefit one receives from police and fire protection, or the services of local libraries, parks, and other government amenities, is somehow related to the rental value of one's home? As an empirical judgment about the value particular people attach to these services, this is surely nonsense. As a matter of politics, it ignores the fact that not only do we all benefit personally from these public services, but, also, we all benefit because others benefit. Indeed, the logical conclusion of the commission's justification for unit assessment would be the adoption of Margaret Thatcher's ill-fated poll tax.

Second, even if one thought that the property tax should be tied closely to local benefits, no evidence supporting the view that unit assessment is a closer proxy for the benefits of such services than fair market value is supplied in the report. Indeed, fair market value might have the advantage of capturing the amenities of the neighbourhood that are often created by local government policy.

The other major alleged advantage of unit assessment is that it would be simpler and easier to administer than fair market value assessment. It does appear that measuring the size of a house and a lot, and perhaps classifying a building and its location, sounds a lot easier than determining its fair market value. However, what complicates the proposed unit assessment enormously, if not irreparably, is deciding how these four factors should be weighed. The report suggests that it would be done by reference to the rental value of the house. But determining the rental value of residential homes is surely more difficult than determining their fair market value. Many types of houses are never rented, and obtaining information about those that are would be an almost impossible task. By contrast, the true sale price of every house is recorded and easily accessible. The difficulty of getting information on rentals is illustrated by the fact that the most significant feature of annual rental value systems that are used in some jurisdictions in the world is that they resort to some use of capital value assessment because of the difficulties of determining annual rental values. In those countries, the annual rental value is assumed to be equivalent to a fixed proportion of estimated capital value. For this reason, a clear trend in property tax assessment around the world is a move from the old annual rental value method of assessment to fair market value. It is almost certain that unit assessment, as proposed in the report, would be more complicated to administer than fair market value assessment.

Unit assessment could be simplified by basing the assessment on a smaller number of measurements, but the cruder the method becomes as a predictor of rental value, the more divorced it becomes from any kind of reality. Also, people generally have an intuition about the concept of fair market value, but it is doubtful anyone would understand the sense of determining their tax liability by measuring the size of their house and lot, classifying their home, and then applying a formula depending upon where they live. Moreover, how would the large tax differences between people who live across the street from one another, but in differently designated locations, be explained? Unless location was not taken seriously, the system would appear to create inexplicable disparities in assessment.

Fair market value is also criticized as a method of assessment because it has adverse planning implications. It is alleged to promote less intensive use of land and buildings. However, surely any attempt to use the tax system as it applies to residential buildings to achieve land use planning objectives is bound to fail. It is much more sensible to use zoning laws and other policy instruments that precisely target planning objectives. Also, if people living intensively should pay less tax to promote land use planning objectives, then the simple answer is to levy a lower rate of tax on them, not to attempt to design a system of assessment that would apply throughout the province to achieve this end.

Fair market value assessment is sometimes criticized because it deters owners from improving their property. The evidence for this is weak since, invariably, the additional property tax that would have to be paid as a result of improvements will only be a small percentage of the overall cost of the improvements. In any event, in theory, unit assessment would appear to give rise to even more perverse incentives. Under unit assessment, so long as improvements in a house did not result in additional square footage, or in the house being reclassified, there would be no additional tax liability. Thus, there would be an incentive to improve houses in ways that did not affect these features of the house. This is reminiscent of the incentive effects of the old English tax on the number of windows in a house. The tax simply caused homeowners to build windowless houses.

As a corrective tax, to reduce the misallocation of resources produced by the exemption of homes from both the personal and the corporate tax, the property tax should be levied on the fair market value of homes. As a complementary and corrective tax, the logical definition of the property tax should include the full income undertaxed by the predominant components of the income tax. This income would include the imputed rental income of property in its present use, plus any additional element of non-monetary income evidenced by the opportunity costs of foregoing development to a higher use. The fair market value of the property is most likely to be the best proxy for this amount.

The commission's recommendation to move to unit assessment appears to be decidedly out of step with the general trend of tax reform. Every report on tax reform I am aware of, including four reports published in Ontario over the last couple of decades, has concluded that market value assessment is the best available alternative for achieving a uniform and equitable property tax assessment base. Most jurisdictions in the world that tax residential property values, including numerous developing countries and all other provinces in Canada and states in the United States, use some form of fair market value assessment. So far as I can tell there is no pressure in those jurisdictions to move to some other method of assessment. The judgment is made and confirmed by experience that market value assessment is the most equitable, efficient, and simple method of levying a tax on property. Ontario, and in particular the six municipalities within Metropolitan Toronto, appear to be the only jurisdictions out of step.

There is little doubt that the integrity of the real property tax largely depends upon maintaining up-to-date and accurate assessments of market value. Failure to do this can ultimately lead to the breakdown of the property tax when the revision of assessments would lead to politically unacceptable shifts in the tax burden. Some parts of Ontario, particularly Metropolitan Toronto, appear at present to be in this position. This situation calls for the phasing-in of fair market value assessment to ease the problems posed by the transition, and the complete separation of the assessment of residential homes from that of commercial and industrial buildings. However, unit assessment would create as many, if not more, transition problems, particularly in the rest of Ontario.

Fair market value assessment, when properly implemented, is relatively easy to administer and to understand, neutral, and as fair as any alternative. Except in the City of Toronto, at the public hearings of the commission I attended, I do not recall anyone suggesting the province should change the method of real property assessment. Naturally, there were complaints about the way the tax was administered, but the commission did not investigate the validity of any of these complaints. Officials from the Finance Department undertook the task of looking into them.

To substitute unit assessment for fair market value would be a retrograde and irresponsible step. Undoubtedly improvements can be made in the assessment practices relating to fair market value, but this is not an argument that the concept is wrong in principle. The government should give the Finance Department the resources and ability to get on with the job.

Wealth Tax

A further reason why I feel that fair market value assessment should be retained as the method of assessing residential property is that I strongly support an annual net wealth tax. If residential houses are not valued at their fair market value, the move to an annual net wealth tax would be effectively foreclosed.

A tax on wealth is an essential component of a fair tax system. A wealth tax should be viewed simply as an integral aspect of the system by which resources are distributed in a market economy. There is no ethical principle that would justify the enormous wealth holdings of a small number of Canadians. Pronounced economic inequalities threaten social and political freedoms. Extremes in wealth also allow the very wealthy to disengage themselves from the concerns that other members in our society confront on a daily basis, and to effectively secede from the community.

The commission recommends that Ontario attempt to reach agreement with the federal government and other provinces to establish a national wealth transfer tax; I would go further. Canada should have both a wealth transfer tax and a net annual wealth tax. If the federal government refuses to enact a wealth tax, Ontario should consider enacting a provincial wealth tax. A wealth tax that is imposed every year on the value of a taxpayer's net wealth has many advantages over a wealth tax that is imposed only when wealth is transferred. It is a more direct expression of the need to redress the most egregious inequalities generated by the market economy. The importance of the symbolism of a new wealth tax should be not discounted. Affirmations that equality of opportunity and social equality are legitimate and important social aspirations of Canadians have been lacking in Canadian politics in recent years. An annual net wealth tax is also a more effective instrument for distribution than a wealth transfer tax. It is also fairer since it is levied every year and not on the essentially random occasion of a taxpayer's death. It would also provide an instrument for collecting data on the distribution of wealth and its changing composition. These data are essential in a democratic market economy if citizens are to be able to gauge the full effect of the rules they put in place to govern the economy. An annual wealth tax can be used more effectively in controlling and monitoring the enforcement of the income tax. It provides a greater incentive for people to disperse their holdings during their lifetime. Finally, there are fewer transitional and intertemporal inequities in enacting a net wealth tax than in enacting a wealth transfer tax.

Some argue that a net annual wealth tax would be hard to administer because it would require taxpayers to value their wealth and may even require them to sell some of their wealth in order to pay the tax. These arguments are unpersuasive. This is not the place to deal with them in detail, except to point out how little concern is paid to these problems when it is the assets of the economically weak that are being considered. When workers lose their jobs and have exhausted their unemployment insurance benefits, before they can qualify for social assistance they must value all their assets (except their homes) and systematically liquidate them until they only have assets valued at less than one month's entitlement to general welfare assistance.

Wealth is a wonderful thing – for those who have it. It provides security, freedom, and power. Canada and Ontario have a number of asset-based welfare policies for the rich, such as tax-deferred retirement funds. It would be sensible welfare policy if an asset-based welfare policy were designed for the less fortunate. For low-income families, assets would psychologically connect them with a viable and hopeful future, promote the development of human capital, provide a foundation for risk-taking, increase personal efficacy and political participation, and improve household stability.

To develop a political constituency for wealth taxes, perhaps, the proceeds of the tax should be used for some type of asset-based welfare program. Although several types of asset-based welfare policies have been proposed, one proposed by Robert Haveman, an American economist, involves giving a universal grant of, say, $20,000 to all persons at the age of 18. These assets would be placed in a government account and could be used by people over their lifetime to invest in recognized services for their education, training, or human development. This would allow all individuals to gain some measure of freedom over the planning of their own lives while reducing, in some measure, the enormous disparities that now exist in the opportunities facing children from rich families and those of poor families. Thus, the wealth tax could be seen as a way to doubly increase equality of opportunity.

Resource Taxation

The commission recommends that the Ontario Mining Tax be changed from a tax on profits to a tax on the economic rents earned by mining companies – that is, their profits earned above a normal rate of return. It suggests that to achieve this objective this tax should take the form of a tax on mining companies' cash flow.

I do not dissent from this recommendation; however, in addition to a cash flow tax, the government should levy a royalty on mining production. A cash flow tax can be set to compensate the government for the depletion of irreplaceable natural resources; however, special taxes on mining companies should be able to serve as policy instruments in achieving at least three other governmental objectives.

First, these taxes should have the ability to be used to compensate for the social costs of mining. Mining, by its nature, results in substantial environmental impacts and necessitates public expenditures in order to protect and reclaim the physical environment. In addition, government efforts are often needed to sustain communities after mineral resources have been exhausted. At a time when we are attempting to encourage recycling, at the very least we ought to ensure that mining companies bear the full cost of exploiting virgin material. The studies that find a cash flow mining tax to be the most efficient tax in the mining industry assume that mining imposes no external costs on the environment. Second, the government should be able to use mining taxes to ensure that mining companies are using whatever market power they have to set high prices for Canadian resources in world markets. Third, mining taxes should be able to ensure the government a stable source of revenue from the mining industry.

For reasons such as these, most mining jurisdictions around the world levy some form of royalty on the amount or value of the product of mining companies. To minimize the distorting effect of royalties on production, the royalty might take the form of a sliding net royalty based upon the value of sales and levied at the "pit's mouth."

Corporate Taxes

The commission recommends that Ontario maintain effective tax rates on business at approximately their current levels relative to other jurisdictions. The primary reason for being concerned about the competitiveness of Ontario's effective corporate tax rate appears to be the possible effect of increasing the rate on business investment location decisions.

My view would be that there is more room for increasing the effective rates of corporate tax, particularly by removing corporate tax expenditures, than the report implies. Although the results of the empirical studies on the determinants of business investment location decisions admittedly vary, my reading of the empirical evidence points to the finding that effective tax rates have little effect on business locations. Tax analysts have traditionally attributed the absence of a detected tax effect primarily to two factors. First, provincial taxes invariably account for a very small fraction of the cost of doing business. Consequently their impact is swamped by other factors that exert a greater impact on a firm's bottom line, such a labour costs, proximity to markets, and energy costs. Second, high taxes tend also to provide public services of a high quality that businesses value, such as public education, police and fire protection, and the construction and maintenance of public infrastructure. More recently, studies have pointed to the importance of a skilled and adaptable work force, the accessibility of technology, the presence of businesses undertaking related activities, the accessibility of capital, and the quality of life as being crucial in determining where business will locate.

Also, it is worth noting that when one looks around the world at effective corporate tax rates, one finds almost no correlation between the effective tax rate imposed on corporations, no matter how it is measured, and any other indicator of economic activity.

A danger with conceding that effective corporate tax rates should be harmonized with other jurisdictions is that there is nothing, of course, unique about taxes as a cost of doing business. The same logic would suggest that a jurisdiction should attempt to harmonize, for example, the costs it imposes on business as a result of environmental or health and safety regulation. Should we really be prepared to accede that much state autonomy to the multinationals without strong and convincing evidence of the detrimental economic effects?

The commission also expresses concern about the ability of multinationals to shift their profits out of Canada by manipulating the prices that related corporations charge each other for the transfer of goods and services among themselves. The commission therefore recommends that the Ontario government should consider this factor when setting corporate tax rates; seek agreement with other provinces to require corporations to file consolidated returns and establish minimum corporate tax rates; and urge the federal government to play an active role in international forums in attempting to ensure that multinational corporations are taxed fairly.

What should be done in this area is clear. At present, the amount of profits a multinational is assumed to earn in Canada is determined by requiring the value of goods and services transferred between related corporations to be determined on the assumption that the corporations were dealing with one another at arm's length. Multinationals should be required to allocate their profits among countries on the basis of a formula approach similar to that used by Canadian provinces. That is to say, they should be required to report the worldwide profits of each separate and unitary business they carry on and then allocate a portion of their profits to Ontario on the basis of a formula, such as the percentage of their worldwide sales and payroll in Ontario. The complex and unworkable "arm's-length" method of allocating profits among countries has cost the federal and provincial governments hundreds of millions of dollars in unjustified and unnecessary revenue loses; has diverted scarce resources – in tax planning, complex accounting, and audit practices – in attempting to set and to regulate the price of every category of product, services, or intangible asset exchanged between related corporations; has created inequities by placing small- and medium-sized wholly Canadian businesses at a competitive disadvantage with multinational corporations that are able to play transfer pricing games; and has failed to guarantee any substantial degree of international uniformity in the division of income for tax purposes

Furthermore, the theory underlying the arm's-length method, that a fair market value can be assigned to transfers between related corporations, is incoherent. For most transactions between related corporations there are no comparable free market transactions. As one commentator has noted, attempting to enforce rules under these circumstances is like organizing an Easter hunt without first hiding any eggs. More fundamentally, the theory ignores the reality of multinational corporations. For many of their worldwide activities they operate as one firm. Formula apportionment is the only method of tax accounting that fits the economic reality of world trade conducted within global enterprises.

The present negotiations over a North American free trade zone provide the Canadian government with an unparalleled opportunity to initiate an important step towards worldwide adoption of formulary apportionment. The Canadian government should work with the governments in the United States and Mexico to establish a formulary apportionment system in North America. Multinationals operating within NAFTA countries would be required to file consolidated returns showing their total profits within these three countries. A formula could then be used to allocate their profits among the member states.

While seeking agreement is fine, Ontario should also consider the possibility of adopting its own form of formulary apportionment. A number of states in the United States, with much less at stake, adopted a form of formulary apportionment and applied it to multinational corporations. As Canada's largest province, and the province with the most at stake, Ontario should lead the way in developing and refining solutions to this problem. The present arm's-length method of allocating the profits of multinationals has undoubtedly led the Ontario tax system to subsidize, in effect, foreign operations of multinational firms operating here at the expense of Ontario jobs. Further, a formulary apportionment regime would eliminate most of the difficult deferral, tax haven, and source rule problems that now plague the Canadian international tax system.

The commission also recommends that Ontario should not attempt to use its corporate tax system as a mechanism for delivering incentives more generous than those offered in the federal system. I do not understand the reasoning behind this recommendation, but rather suspect it reflects a confusion about the nature of tax expenditures that is revealed in a number of places throughout the report. Tax expenditures are analogous to direct expenditures. Unless there is some reason to suppose that Ontario should harmonize its direct spending programs with the federal government, there would appear to be no obvious reason why it should harmonize its tax expenditures.

Over the past decade or so the provinces have assumed a new economic role largely because of a transformation in technology and economic factors that affected all regions in Canada, the increasing vulnerability of the Canadian economy to foreign competition, and a major change in the relative responsibilities within the Canadian federal system of government. Some provinces have now developed comprehensive plans to establish provincially based foundations critical to the process of economic development. In developing these plans, there is no reason why provinces should be constrained in providing subsidies through the tax system in relation to those provided by the federal government. There might be administrative and other reasons why a province might want to harmonize its technical corporate income tax system with that of the federal system, but there is no obvious reason why it should harmonize its tax expenditure measures. Indeed, this recommendation seems somewhat inconsistent with the recommendations relating to the personal income tax. There the commission recommended, in effect, that Ontario should harmonize its technical personal income tax system with the federal system, but be free to design its own tax expenditure programs. In principle, the same should be true for the corporate income tax.

Finally, the commission recommends that corporations be required to disclose the amount of the tax expenditures they have benefited from. I would go further. I do not see any reason why large corporations should not have to make public a good deal of the information on their tax returns, including, for example, their profits earned in Ontario and their taxes paid here.

The Future of Tax Commissions

As a personal comment, based on my experience with the Fair Tax Commission, it occurs to me that perhaps governments ask too much of tax commissions. The tax system can be divided into at least five distinct components: the technical tax system, whose purpose is to raise revenue equitably, neutrally, and simply; the tax expenditure system, whose purpose is to subsidize goods and services the consumption of which the government wishes to encourage; the tax/transfer system, of which the tax part's purpose is to complement the social assistance system; the tax regulatory system, whose purpose is to increase the price of goods and services that impose social costs; and what might be described as the tax distribution system, whose purpose is to assist in achieving the appropriate distribution of economic resources in a market economy. In terms of public policy analysis, these components have almost nothing in common, and, within some components, such as the tax expenditure system, the policy issues range across the complete spectrum of public sector activities. It is somewhat odd that a single commission would be asked to pass its judgment on all the issues embraced within these five components of the tax system.

The Fair Tax Commission had only a few things to say about what might be described as the technical tax system. Some recommendations relating to resource taxation, payroll tax, the retail sales tax, corporate tax, and aspects of the property tax would probably fall into this category. But, generally, the countless issues relating to the fair design and administration of the technical tax system were left untouched by the commission.

The commission had more to say about the tax expenditure system. Its basic recommendation that the tax expenditure system should be identified and properly accounted for in the public policy process is an important one. It also recommended that various social policy tax expenditures be converted into a direct subsidy program. I agreed with most of these recommendations because the tax expenditures seemed like such bad policy instruments to achieve almost any purpose. However, it does seem somewhat presumptuous for one commission to be pronouncing on social policy issues as diverse as pensions, child care, disabilities, and families. The implied premise of the commission's recommendations relating to tax expenditures is that these provisions should be examined alongside other government policy instruments dealing with each of these specific issues. Presumably, no one would suggest, for example, that a commission be established on subsidies, without regard to their subject matter.

The commission made a number of recommendations relating to the use of the tax system to deliver low-income relief. However, even here far-reaching proposals were not possible because of the close integration of the tax and transfer systems. It makes no sense to study one in isolation from the other.

The commission also made a number of recommendations relating to the regulatory use of the tax system, particularly in the area of the environment. Controlling activities that impose environmental costs involves selecting the most appropriate policy instrument for getting the job done. Again, it seems somewhat odd that the same group of people was being asked to make judgments about, essentially, the best way to reduce carbon emissions, over-packaging, traffic congestion, and so on. Presumably, in each of these areas the sensible way to formulate policy is to undertake a comprehensive study of all the potential policy instruments. For instance, recommendations relating to the regulation of traffic congestion should be the result of a coordinated area transportation plan. This might involve publicizing and subsidizing public transit options, implementing high occupancy vehicle and bicycle lanes, pricing downtown parking at cost, taxing all employer-provided subsidized parking, encouraging or mandating adoption of flexitime work schedules, eliminating highway bottlenecks, encouraging telecommunicating, enabling and encouraging employees to live closer to their jobs, using electronic sensors to allow closer vehicle spacing, prohibiting vehicle travel in certain downtown areas, and so on. In addition to, or in place of these, economists have long advocated marginal cost pricing to allocate scarce highway capacity. But it would seem to be unwise to examine only the use of the tax instrument in isolation from these other policy instruments.

To be sure, using taxes to get the price right on as many public goods as possible will lead to greater efficiency in the distribution of resources. But the ultimate issue involved in thinking about the public sector is what kind of society we wish to live in. Thus, the danger in looking only at tax instruments when examining these questions is that whether economic incentives should be used to change behaviour is not simply a technical matter; it is also an ideological and philosophical question. For example, the use of economic incentives might imply that we are indifferent about the motives of polluters, that we do not wish to make an approbatory statement about polluting behaviour, and that almost all that we value has a price. Moreover, prices in any context produce a situation where wealthier people can choose to pay the charge and continue behaving as before, while poorer people, to avoid the charge, are the ones who are likely forced to change their behaviour. Sometimes, in order to signal and achieve the kind of things that we as a society value, we should just prohibit things, such as automobiles in some downtown areas. Also, even where prices or taxes must be used, they should in many cases be regarded as a second-best approach in order to build a consensus or get something done. The moral risk is, of course, that this second-best approach will become enshrined as the pervading norm. The point is that it does not seem to be entirely sensible to examine only tax policy instruments in isolation from other instruments when attempting to achieve environmental objectives.

Finally, the commission was being asked to make a judgment about the effectiveness of the tax system in achieving a greater degree of social equality in Ontario. Here all the problems of making judgments about the other components are compounded. While all issues contain political elements, this one is shot through with politics. One of the greatest challenges over the next century will be to ensure that all Canadians receive a reasonable share of the resources we all collectively produce, but no more than a reasonable share. But, presumably, no one is under the illusion that the tax system itself, no matter how designed, is up to the task. Such an inquiry calls for an analysis of the distributional consequences of the full range of government policy instruments, including the rules governing property rights and private contracts.

People and Taxes

The regrettable thing about the Fair Tax Commission is not so much the specific shortcomings of the report, but rather the opportunity that has been lost. While provincial and federal governments have set up many commissions over the years to investigate aspects of the economy and social welfare systems, never before has there been a commission specifically set up to investigate the issue of fairness and equity in something as broad and important as the tax system.

The issue of tax fairness can be interpreted narrowly, to mean the equal tax treatment of equals, or it can be interpreted more broadly, to mean the extent to which the tax system should be used to distribute income and wealth. Given the terms of reference, and the political context surrounding the appointment of the commission, I assumed that the latter interpretation fell squarely within the commission's mandate.

The importance of appointing an independent commission to examine this issue, at this time, arose from the fact that tax progressivity has largely fallen out of favour in recent years among tax specialists, economists, business leaders, and public policy makers. Indeed, a vast literature has grown up that bolsters arguments opposed to progressivity. So to challenge this new orthodoxy in the tax field would be no small task. It was therefore essential that, if the commission was to be at all effective in discharging this aspect of its mandate, it would have to have a superb grasp of the technical points and arguments in the existing debate, in order to assess their validity.

Sadly, this was not the case. Because of the manner in which the commission proceeded with its work, little critical attention was paid to the vast technical literature that exists. While many of the key arguments that have formed the basis of the assault on progressivity are highly suspect and vulnerable to critique, no serious investigation of these arguments was ever launched by the commission. The case for progressivity is simply asserted in the report with little evidence to back it up. Key arguments on the other side are not even addressed. As a result, the anti-progressivity ideology that has dominated the tax world in recent years has gone effectively unchallenged.

Ironically, the commission could have taken inspiration from the Carter Royal Commission on Taxation, appointed by a federal Conservative government in 1962. The Carter Commission, although made up of fairly conservative-minded commissioners, conducted an exhaustive research program that involved a thorough examination of the principles and technicalities of the tax system. After years of careful analysis, the commissioners ended up proposing radical and far-reaching changes that would have made the tax system significantly more progressive. Their work sparked five years of public debate. Only some of the commission's recommendations were enacted, and often only in a watered-down version. Some observers take this as an indication that the Carter Commission failed. But if there was a failure in the democratic process in that exercise, it occurred in spite of the report. Indeed, arguably, by providing a vision of a fair tax system, and sound and thoroughly documented arguments and evidence to support it, the Carter report democratized the tax reform process in a way not seen since. It provided ordinary citizens with a vision of a more equitable tax system and the knowledge they needed to withstand the well-organized campaign by business interests against the report's recommendations.

From the outset, one of the goals of the government in setting up the commission was to involve a much broader cross-section of the public than the usual set of experts and business people that generally dominate this sort of inquiry. But, while this was a laudable goal, unfortunately the commission was structured in such a way that these people were unable to have any meaningful input. Without a strong base of technical knowledge and information to inform their deliberations, they were effectively blindsided.

Indeed, in some ways, the commission performed a disservice to some of the well-meaning individuals who took part in its processes. They were consulted in a way that almost guaranteed that their contribution would be of limited value to the broad debate in the tax policy field. This was highlighted by the revealing comments of three individuals who had been appointed to sit on a working group studying real estate taxation. These activists, who had an interest in affordable housing, were angered by the process. Eventually they quit, complaining that their experience on the working group left them feeling more disempowered than ever. Although their concerns go deeper than this, one of their frustrations was their inability to get information, arguments, and alternative ideas to counter the assertions of the economists and tax lawyers at working group meetings.

In a society in which the economically powerful wield enormous influence, a fair tax system cannot be negotiated or achieved by social consensus. The case for fair taxation must rest upon a vision of the kind of society in which we would like to live and which, in turn, is premised on value and empirical judgments that can withstand the strongest scrutiny. Unfortunately, although making a number of worthwhile recommendations, the commission missed a badly needed opportunity to challenge, and reveal the weakness in, the dominant tax policy orthodoxy, and to present a coherent and comprehensive alternative.

Robert Couzin

I am in personal agreement with most of the commission's recommendations. However, I do have some reservations regarding particular proposals and, more generally, the process followed by the commission.

The Process

The mandate of the Fair Tax Commission was extremely broad and complex. In these circumstances, process becomes important. I feel that the report suffers from problems with the process.

First, the government required that a number of isolated tax policy questions be examined by autonomous "working groups." I expressed concern from the outset that the tax system could not be properly examined in this piecemeal fashion. With deference to the skill and hard work of the working group members, I believe my misgivings were largely borne out. Moreover, the working group process effectively shortened the life of the commission and gobbled up its human and financial resources. For at least the first year of our mandate, little was accomplished beyond managing the working groups. Similarly, while I have sympathy with the goals of the consultation process, I do not believe that the commission received sufficient valuable input from its consultations with the public to warrant the time and expense. Nor did such consultation serve, as I had hoped it might, as a forum for public education in tax matters.

A second, more serious problem relates to the human resources of the commission. Given the scope and complexity of the task, we needed ready and continuous access to the best and most experienced experts. Owing to financial constraints, and to a different vision of the commission's work on the part of those who made the key decisions in this regard, I do not believe we had the kind of support we needed, at least to create the report I would have wished. This is not a criticism of the staff members, who were generally able, hard-working, and highly motivated. But their aggregate person-years of experience and their collective specialized skills were not, in my opinion, commensurate with what was demanded of them.

Finally, the decision-making process itself was, in my view, inappropriate to the subject matter. Recognizing the inherent uncertainty of the economic and technical analyses, and accepting the many imbedded political or philosophical judgments, I nonetheless believe that the commission should have been searching for the right answer, rather than a compromise among commissioners. In many cases, I believe commissioners (including me) did reach conclusions which may be anathema to their "constituents" or contrary to their own preconceptions. However, too many recommendations merely reflect the personal or political views of a majority of commissioners.

The Product

The report is not supposed to be an academic treatise. However, the style of the document does not justify gaps in the underlying research and analysis. Unfortunately, I feel that there are such gaps.

It is my impression that significant pre-existing research and analysis has not been properly integrated into either the report or the recommendations. Even our own research studies have not always been put to the best use. As I have already observed, I think the project was simply too large for the resources available. In a few instances, I feel that prejudgment of the conclusion militated against a thorough analysis of the issue. There was also, it seems to me, a certain undercurrent of distrust for "experts" and their work. Undoubtedly, one must be wary of pseudo-scientific, jargon-ridden theory. However, we ignore the accumulated wisdom of those who have thought deeply about tax policy at our peril.

Many recommendations are based on quantitative analyses. I am not a statistician, and am constrained to accept our empirical evidence. But, having regard to discussions of these data at meetings, I cannot say I am completely comfortable with all the conclusions which rely upon these analyses.

Dissents and Qualifications

With that preamble, I turn to certain areas of disagreement with the report. First, I will deal with three general themes (fairness, progressivity, and harmonization), and then proceed to comment upon some specific recommendations.

Fairness

I am troubled by a repeated refrain in the report that the tax system is unfair and needs fixing. I believe that this is a largely rhetorical (or political) device. In fact, the actual recommendations made by the commission belie that claim. The proposals are not all that far reaching. Some readers may regard this as a reflection of external, and unfortunate, constraints. In my view, the reason is rather that the tax system is, as tax systems go, not all that bad.

Progressivity

The report justifies certain key recommendations (the personal income tax rate schedule and the tax mix in particular) by equating fairness and progressivity. I disagree that tax fairness is necessarily enhanced by incremental progressivity. Indeed, I find the proposition meaningless. No matter how progressive the system is, would greater progressivity make it fairer? There is a serious intellectual and practical issue as to the meaning and measurement of progressivity. It is not properly considered in the report. Nor does the report fairly analyse the scholarly and powerful arguments against progressivity, or even refer to the important academic works which express that position. The commission claims to opt for progressivity on two grounds: equal sacrifice theory and redistribution.

Equal sacrifice theory reflects a supposed scientific or empirical determination. Is it true that there is a function describing the declining utility of money? If so, how might that function translate into a rate schedule? Redistribution is a pure political judgment: How much wealth or income should be redistributed from some citizens to others? A further, mechanical question is: How much of such redistribution should be effected through progressive taxes, taking into account other redistributive mechanisms – in particular, spending programs?

Contrary to the report, I do not believe that these two lines of analysis yield the same prescription for progressivity. The progressive rate structure would be different if one or both of these justifications were adopted. Both the degree and the shape of progressivity are critically linked to the reason for its adoption. For example, I have greater sympathy with sharp progressivity at the lower range of wealth or income, and less with progressivity in the higher reaches. This reflects my own bias in favour of redistribution to the poorest members of society, and a view that it is not the job of government to readjust the effects of markets among those who are better off. This is merely a personal view, but it illustrates what I find missing in the report: an analysis of the nature and measure of progressivity, and a serious understanding of its justifications and defects. The rate schedule is, ultimately, a political judgment, to be made by government. Our job should have been to inform that judgment with a careful and thoughtful explanation of its possible bases and effects.

Harmonization

I believe that distinctive provincial tax policies should be justified on the basis of different circumstances within the jurisdiction, rather than a different political persuasion or philosophical perspective of the two levels of government. The commission has certainly taken into account the benefits of uniformity in framing a number of recommendations. I think we could have gone farther.

Happily, the commission has not proposed a completely separate Ontario personal income tax system. But it has opted for a "tax on taxable income" (recommendation 11). I am not convinced. The report we commissioned did not favour the tax on taxable income position.

The purpose of such a system would be to permit Ontario more flexibility in setting the personal rate schedule and credits.[1] However, none of these commission proposals arise from differences between the demography or economic reality of this province and others. All are policy prescriptions which would apply in the same manner to the federal government. The power afforded provincial governments to depart from national policies regarding rates and credits is a mixed blessing. It is a mistake to be influenced by the politics of the moment. Those who would afford the province additional power presumably believe that it would establish a "fairer" rate and credit system. But additional provincial flexibility leads, over time, to unpredictable results. For example, the existing limited flexibility under the Tax Collection Agreements has led to both increased progressivity (provincial high-income surtax) and the reverse (provincial flat tax). In the long run, I prefer to rely on the collective judgment of one level of government, rather than two.

In the case of corporate income tax, I believe there is a serious case to be made for complete harmonization. The Ontario Corporations Tax Act contains few deviations from the federal Income Tax Act, and the commission has not proposed many more. The commission properly rejected calls for a minimum corporate income tax. I believe Ontario should consider levying corporate tax as a percentage of the federal base.

The commission proposes that, subject to a few caveats, retail sales tax be harmonized with the GST. I agree.

Personal Income Tax

There are several recommendations in this area which require comment.

---

[1] In particular, the report suggests the new-found power of the province should be used to eliminate (i) the marital and equivalent-to-married credit (recommendations 15, 19); (ii) the child care expense (recommendation 21); (iii) the disability credit and expense deductions (recommendations 22, 23); and (iv) the age and pension credits (recommendations 24, 25). It should also, the commission suggests, revise the rate structure (recommendation 31).

Alimony and Maintenance

I agree in principle with recommendation 16. However, the report does not deal with some difficult transition issues, as well as the problematic international element (former spouses residing in the United States and Canada would be double taxed or would obtain double benefits). I am particularly concerned about the impact of the change on court awards. In that regard, I was never convinced in our discussions that anyone really knew the extent to which courts currently take taxation into account.

Retirement Savings

I disagree with recommendations 26 and 27. Sweeping reforms are being suggested without any serious understanding of the potential impact on savings behaviour. Nor is the fairness case made out.

I find the related discussion in the chapter quite unsatisfactory. The proposal to phase down RPP and RRSP contribution limits is justified by the alleged gap between government assistance through the tax system to these plans and direct government assistance through public pensions. There seems to be no attempt to compare the cost of forgone taxes on deductions with the dollar for dollar cost of providing direct payments. The more serious issue, which affects both recommendations, is the extent to which RPP and RRSP contributions represent a partial transformation of the income tax to an expenditure tax. The report recognizes that such an analysis exists (finding no more recent or comprehensive discussion than the Carter Commission), but gives it short shrift in a single paragraph. The chapter concludes that "tax assistance for retirement savings" must be assessed as a matter of retirement policy. This reflects a misunderstanding of the issue. If one accepts the expenditure tax argument, there is no "tax assistance."

Income from Capital

I sympathize with the emotion behind recommendation 28, but the suggestion to eliminate the dividend tax credit, with only small business integration mentioned as a caveat, is naive and unacceptable. Other corporate income would be double taxed, adopting the so-called classical system used in the United States but in few other

OECD countries. The report does not examine the massive recent US study of possible integration systems, nor reflect any understanding of the various measures adopted by our trading partners. I agree that the current workings of our dividend tax credit are not satisfactory. But this suggested solution is, to my mind, ostrich-like.

I agree with the full taxation of capital gains contained in recommendation 29, but must qualify that agreement. First, no account is taken of the effect of full taxation of gains on the sale of corporate shares. I believe there should be recognition provided for the corporate level tax. Second, full taxation of gains must be viewed in the context of the personal rate schedule. Third, there is no consideration in the report of the special treatment afforded capital gains in virtually all other jurisdictions, or the rationale for such special treatment, a gap which troubles me in my general support for full inclusion.

Rate Structure

Having regard to my views expressed above, it is hardly surprising that I dissent from recommendation 31.

The proposal would increase the number of tax brackets. The impact depends upon how the brackets are established (from time to time). In any event, I do not agree that there is likely to be real gain from more brackets. And there are significant disadvantages – in particular, the problem of "bracket creep" from inflationary increases in income. The report should have grappled with such issues.

The report also implies that a top rate in the range of 60 per cent would be acceptable. I agree that there is no sacred rate. Rates have been higher, and they have been lower. However, in my view the 60 per cent figure has been floated without due regard for the report's other suggestions, in particular the base broadening, and with insufficient sensitivity to the psychological and economic effects of the comparison to rates elsewhere. I consider the full taxation of capital gains a fairer way of capturing the income of the most fortunate because it promotes horizontal equity. A 60 per cent rate would be far out of line with other provinces and with the United States, especially when one considers that it would apply to capital gains. It would also create system difficulties, being so different from the corporate rate (an issue canvassed in chapter 20, but ignored in the recommendation).

Wealth Tax

I am not unalterably opposed to taxing wealth, particularly on intergenerational transfers. Wealth, like income or consumption, is a legitimate and useful base to which taxation may be applied. In the current setting, there are certain advantages to a wealth tax in the form of succession duties. In particular, since other OECD countries impose such a tax, its acceptability may be higher.

At the same time, wealth taxes present certain problems. First, it would be a mistake to think that the tax will capture the wealth of the super-rich. That has not been the experience of most jurisdictions. The burden would fall largely on the moderately well-to-do. That is not a reason to eschew succession duties, but it is a note of caution to their proponents. Second, death duties are notoriously easy to avoid, particularly in a federal state. I certainly agree with the view that an Ontario-only tax is not feasible.

I might have been convinced to favour succession duty (as a national tax) if it had been proposed as part of a tax reform which favoured entrepreneurship and saving. Some like to refer to the US estate tax, ignoring lower US income tax rates. When combined with a proposal for base broadening affecting capital income, and top personal rates up to 60 per cent, wealth tax takes on a different tone. In that context, and in the current economic climate, I am unable to support the proposal.

Property Taxation, Education, and Local Government

I am uneasy about the implications of the commission's recommendations, and concerned that my participation in the consensus may be based upon misunderstanding, misinformation, or misestimation of the consequences. The prime examples are these:

1 Conceptually, I agree that basic education should be funded at the provincial rather than the local level. However, the real question is: What produces the best education? The response to that question depends upon politics and pedagogy, rather than public finance theory. I am not satisfied we have the information available to make this recommendation.

2 I also agree that some version of unit assessment is simpler and more sensible than the various attempts at market value. I must rely upon staff research for the conclusion that the version proposed is workable.

3 I accept and support the logic of the proposed limitations on provincial grants and subsidies to municipal governments (recommendation 111). I have seen and considered quantitative analyses of the effects of these measures on local government. I must rely on those analyses of the impact of the commission proposal.

I do not agree with recommendation 77. The report would limit the ability of communities to increase local education funding by additional levies. The report seeks to minimize "revenue-driven inequities." That is, richer individuals or communities should not get better education. I disagree. I would prefer to treat the provincial contribution as a base to which the community (or the parents) can add whatever they choose. It does not seem fair to me that some schools are funded, while other are not. More generally, I accept that richer people are better fed and sheltered, and are likely to procure better health care and education. I do not find this offensive. Nor is it a result which, in my personal view of society, should be countered by government policy. The social policy issue, to me, is not rigid equality but, rather, the base level service. I believe that the system which provides the best education is preferable. The social and economic benefit to all citizens of a better educated population is too important to be sacrificed on the altar of what I see as misplaced egalitarianism. For that reason, I would not limit the ability of parents or communities to improve the quality of education by adding personal resources to provincial base funding.

Energy Taxes

I am not convinced that the commission has obtained sufficient evidence, or performed adequate analysis of the international literature and experience, to suggest a carbon tax. I sympathize not only with the environmental goals of such a tax but also with the economic reasoning which lies behind it. However, I am unsure of the commercial consequences, and the effectiveness.

With respect to a broader energy tax, I am more negative. I have not been convinced that it is logical to tax the use of energy, since this approach does not recognize the efficiency of its production, and could actually represent a disincentive to increasing efficiency.

Concurrence

I have had the opportunity to read the personal statements of my fellow commissioners. I find a number of common elements. I would in particular register my agreement with the comments of Satya Poddar, and with Neil Brooks's remarks under the headings "Content of the Report" and "Process," with one exception. Professor Brooks concludes, "The income tax is a mess." I am at the opposite pole. It is unfortunate that the commission's process never led to a debate and resolution of such a basic question.

Susan Giampietri

Introduction

When Ontario treasurer Floyd Laughren announced the establishment of the Fair Tax Commission in March 1991, I joined a great many Ontarians in welcoming the initiative.

At that time, as most people will recall, phase two of the federal tax reform exercise had just ended with what was one of the most heated debates in Canadian parliamentary history. In the more than two-and-a-half years since the introduction of the Goods and Services Tax, it remains an issue that is, for many people, visceral. Rather than dull the hostility, time has only hardened positions. A great many people believe that the GST has had, and continues to have, a truly devastating effect on the Canadian economy.

Our commission was to be different. In contrast to the closed, elitist federal tax reform process of the mid 1980s, the Ontario government chose an inclusive approach. The commission, consciously independent from government, was established to invite public input into the tax process and involve those in society who have traditionally been excluded from the policy formation process. On the basis of this public input, coupled with research and expert advise, we were to recommend changes to the tax system that would enhance tax fairness.

In many respects, this was a daunting task. When it comes to taxes and tax reform, few people believe that the taxes they pay are fair in either absolute or relative terms.

We all have our own life experiences and constituencies that influence, to a certain degree, how we view the tax system and some of its specific provisions. In my own case, my views on the tax system have been shaped by three different aspects of my life. As a woman, I am painfully aware of the discrimination against women that exists in society. Hence, it is not particularly surprising that discrimination exists in the tax system. As a worker, and an active member of a union, I have always believed that the tax burden is unfairly shared by workers. And, as a public sector worker, I have been acutely aware of the need for taxation.

The principles underlying my views have not changed in the two-and-a-half years since my appointment to the Fair Tax Commission. In fact, the wealth of information developed by and for the commission substantiates, in many ways, the perceptions that I originally brought to the process. However, my position on a number of specific tax measures has moderated and in some cases actually changed.

When I started this process, my opposition to both general sales tax–type consumption taxes and user fees was deeply rooted. I now accept the fact that while they are clearly regressive, there is a place for a sales tax–type consumption tax in the tax mix. As well, and under certain circumstances, I believe that user fees can be acceptable if they are necessary to promote a specific activity that is socially desirable. However, I have some serious reservations with the treatment of both of these issues in the commission's commentary and recommendations.

Before addressing these and other issues where I depart from the commission's report, I should make it clear that, in many important respects, the final report of the commission reflects views that I am entirely comfortable with. The report's treatment of equality between men and women (chapter 14) reaffirms the equality inherent in the individual as the tax unit and recommends a number of specific tax changes that will, when implemented, serve to make the personal side of the tax system fairer. It is likely that implementation of these recommendations will, as well, serve to reduce discrimination in society as a whole. Similarly, our treatment of wealth taxation (chapter 19) is a solid step in the right direction that will, if implemented, ensure greater equity. In this regard, I share the sentiment expressed in the report that a tax system that ignores wealth can never be truly progressive.

In other areas, the commission proposes recommendations that challenge the regressive tax reform implemented by the federal government in the mid to late 1980s. In this regard, I am particularly supportive of the commission's decision to propose a personal income tax system based on ten brackets and marginal rates as opposed to the three that were implemented as part of the federal tax reform exercise. I also believe that the commission's conclusion that marginal rates can be higher at higher income levels than is currently the case is sound. For me, these are critical issues. I simply could not accept a personal income tax system where progressivity ended at an income threshold of about $62,866.

I also support without reservation some of the fundamental changes to the personal income tax base that we propose. In this regard, I would draw attention to the taxation of capital income (capital gains, dividends) in the personal income tax and other base-broadening initiatives.

Without question, the most important aspect of the commission's work is the proposed reform of the property tax base. The main recommendation in this regard – namely, the removal of education funding from the residential property tax – is entirely supportable on the basis of any one of the major arguments outlined so persuasively in the report.

While I support the property tax initiatives regardless of whether other recommendations are implemented, I would point out that this is one of a number of tax areas addressed by the commission that are interrelated. The property tax has, in my view, a place in a tax system that consciously does not tax wealth in any other way. It needs to be understood that no matter how flawed and imprecise the current property tax is, it still taxes people to a degree on the wealth they own.

A similar situation exists for me in the commission's treatment of luxury taxes. I came to the commission with a view that a luxury tax would enhance the progressivity of the tax system. I am persuaded, however, that there are significant problems inherent in the imposition of such a tax that render it a second-best alternative. Hence, in the event that the commission's recommendation for a wealth tax is not implemented, I believe that serious consideration should be given to the imposition of a luxury tax in Ontario. On the basis of ability to pay alone, it is in my judgment impossible to justify taxing an automobile that costs $30,000–$100,000 or more at the same retail sales tax rate as is applied to more modest vehicles.

Finally, I am in fundamental disagreement with the majority of commissioners in one area. I refer to the myriad recommendations with regard to the corporate tax system, and particularly the majority decision to argue against an increase in the corporate share of taxation and not to impose a corporate minimum tax.

To be clear, I cannot support a tax reform exercise that does nothing to reverse the tide that has seen corporate tax revenue decline as a percentage of provincial revenue from just over 19 per cent in 1961–62 to just under 8 per cent in 1991–92. Similarly, I suspect that a great many Ontarians will find it difficult to accept a report from a fair tax commission that fails to recommend a minimum corporate tax, not as a punitive measure, but as a way of ending the current practice whereby many profitable corporations pay little or no income tax and ensuring that all profitable companies pay some amount for public services.

If, as proposed in our report, the corporate revenue share is to remain at its current level or decline, then other taxes will be required to make up the difference. The two tax bases that have increased over the period during which corporate taxes declined are the personal income tax and the retail sales tax. For comparative purposes, a $1 billion increase in corporate income tax revenue applied to either the personal income tax or the retail sales tax would reduce them by 6.5 per cent and 14 per cent, respectively.

The fact that the commission has taken steps to ensure that implementation of its recommendations will make the individual side of the tax system fair is not enough. Unless and until the other side of the taxation coin is reformed and made visibly fair, the refrain that the system is unfair will remain. I doubt that workers will ever accept, as legitimate, the fact that a corporation pays no income tax, while an employee of the same corporation pays 20 per cent, 30 per cent, or even more of his or her income in income tax.

This will remain true, regardless of the arguments used to justify the continuation of a system that allows many profitable corporations to pay little or no income tax, or the eloquence with which they are presented.

Retail Sales Tax

Perhaps the most difficult issue for me throughout the commission process was reconciling the positions I had long held vis-à-vis sales taxes with the reality that there is a legitimate place in the tax system for consumption-based taxation. Sales taxes are, for example, one of the only ways to capture a contribution for infrastructure funding from people who live out of province and work or own recreational property here. Similarly, people who are able to avoid tax on income either legitimately or illegitimately have some of their income captured under the RST. Other situations that justify the imposition of a retail sales tax abound.

Over the many years of my active involvement in political debate, I have seldom seen the level of acrimony and anxiety that accompanied the introduction and passage of the federal Goods and Services Tax.

The same anger was not present with regard to the RST during either our public hearings, or in the many discussions I have had, as a commissioner, with Ontarians on tax policy issues. There are, I believe, many reasons for this.

First, sales taxation has historically been viewed as a legitimate area of provincial involvement.

Second, the Goods and Services Tax was introduced at a high rate immediately following the first phase of federal tax reform that had effectively reduced the income tax rates for high-income earners. As a result, there was a perception that the federal government was introducing a demonstrably regressive tax (the GST) to make up the revenue shortfall that would result from the reduction in the number of tax brackets and marginal rates. Despite assurances from the federal government that the GST would be revenue neutral, raising the same amount as the manufacturers sales tax that it was designed to replace, the perception of an unwarranted regressive tax grab remained.

Moreover, since the RST provides the Ontario government with a considerable amount of its total revenue, elimination of the sales tax would be exceedingly difficult, if not impossible. For example, if the Ontario government was to generate the same amount of revenue that currently comes from the RST through an increase in the PIT, it would require a 50 per cent increase in the amount of provincial income tax paid. This is obviously an untenable position.

Notwithstanding the practical obstacles to the elimination of sales tax–type consumption taxes, the fact remains that the RST is a regressive tax. As our report states, "because Ontario cannot give up this regressive tax, it is important to try to make it fairer." Our report offers a number of options in this regard. While I can support the specific initiatives proposed, I believe that the easiest way to achieve the fairness goal is through a reduction in the RST rate.

Our chapter on the retail sales tax proposes broadening the base, moving to a multi-stage tax, and generating a harmonized federal-provincial sales tax regime. I fully support the broadening of the base, and am persuaded of the utility of moving to a multi-stage tax. Having said that, I have some difficulty with our commentary and recommendation on harmonization with the GST.

Notwithstanding my opposition to the GST, I would be prepared to support a recommendation that the various provincial sales tax regimes be harmonized with the GST under certain circumstances. First, it is imperative that the resulting sales tax regime be less regressive than the current tax. And, second, part of the benefit that flows to the business community from the integration of the two sales tax regimes should be taxed back either directly, or as a part of a general tax structure that increases the corporate share of the tax and revenue pie.

In the light of a number of commission recommendations, I believe that the sales tax rate (RST+GST) could be reduced significantly. The commission recommendation to broaden the base of the RST by the inclusion of financial services will generate fully $715 million. In my opinion, this money should be used to reduce the RST rate. I find the commission's failure to make this recommendation more than a little perplexing. Unless this new-found $715 million is used to reduce the RST rate, it will result in an increase of RST revenue of nearly 10 per cent. I find such an increase in a regressive tax to be unacceptable. In a similar vein, I would have gone further and strongly recommended that some of the revenue that will accrue to the federal government from the implementation of a national wealth tax and improvement in the PIT should be used specifically to reduce the GST.

It is not outside the realm of possibilities that a combined RST-GST could be applied at a rate of 2 per cent or more below the current rate. Without question, this would reduce opposition to harmonization.

One final point needs to be made with regard to the RST and consumption taxes in general. In our chapter on the tax mix, we state that "there is room to increase the retail sales tax rate. The current rate in Ontario is below that of several other provinces and, with implementation of the reforms we recommended in chapter 24, the retail sales tax would be able to generate significantly more in revenue than it currently does."

I strongly disagree. From a fair tax perspective, the recognition should be that the RST is regressive. As such, the rate should come down, if not immediately, at least over time. This is particularly the case since the combined RST-GST consumption tax is high, notwithstanding the sales tax levels in other provinces. The recent federal election provides the grounds for some optimism that the reliance on consumption taxes will be reduced. During the election campaign, the Liberal party promised to replace the GST. While it is as yet unclear what, if any, action the new federal government will take to fulfil this election promise, a window of opportunity exists to replace the GST or, failing that, to make it less regressive.

User Fees

As I indicated in the introduction to this commentary, notwithstanding a strong predisposition against user fees, I am prepared to accept that they can play a role in promoting activity that is socially desirable. However, I disagree with the tenor of some of the specific recommendations and commentary advanced in our final report.

First, I disagree with one of the two principal arguments articulated in our report as a justification for user fees. While I am prepared to accept user fees when a clear and unambiguous case can be made for them on social and environmental grounds, I object to their implementation on the grounds of tax fairness. For me, user fees, whether justifiable or not, are always regressive. As a result, while they can be used to modify behaviour, this should not be considered as a way of raising revenue. In my opinion, they should be structured in an attempt to modify behaviour to such an extent that the revenue dries up. To be clear, this would apply to environmental user fees and excise taxes on tobacco and the like.

In addition to moderating behaviour, support for an expansion of user fees outlined in various places in our report is based, in part, on a perception that, in some areas, the public sector is providing goods that are essentially of a private nature. As a result, it is argued that the recipients of the specific benefit should be required to pay the market price or some fraction thereof. Although there are exceptions, I remain unconvinced with the utility of this approach. As a general rule, the exceptions would include such transportation and communications systems as VIA Rail and Canada Post.

However, despite the apparent fairness of charging people for the services they individually consume, the fact remains that in every instance, without exception, user fees restrict access to services that have a public component. The people who are denied access have paid their share for the capital and/or operating costs of the public good or service, not to mention numerous intangible costs. Hence, they should have a right to use the public good or service.

Let me illustrate this by way of example. In our report, we state that "society has decided that some public services should be provided to individuals as a matter or right and that no direct fees or benefit taxes should be related to them for that reason. Such taxes would inhibit access to these services and would dilute the universal right to their consumption, especially for lower-income individuals and families. It would be inappropriate to finance essential services in this way, even if it were technically possible to assign benefits and benefits taxes. The most important examples of the application of this principle in Canada are the universal health care system and universal public elementary and secondary education."

If a government was to apply a user fee to medical services, as is being contemplated by some political parties in Ottawa and by governments in some provincial capitals, the fee would not be designed for full cost recovery. As a result, people who were restricted from using the medical facilities because of cost, no matter how marginal, would still pay for some not inconsiderable amount of the cost of running the health care system through their general income tax, sales tax, and Employer Health Tax.

In addition, these same taxpayers who would have their access to health care restricted would have paid for a number of intangible costs such as the education of the medical profession. I would submit that this type of situation should not be allowed to exist for any public service unless a clear social benefit (beyond expenditure restraint) outweighs the cost, in terms of restricted access.

In addition to my concern with the philosophical justification for user fees as outlined in our report, I am uncomfortable with the impact of some of our specific recommendations. Principal among these is a substantial concern that attempts to avoid some environmental user fees will result in environmental degradation though dumping, health and safety risks for workers involved in the disposal of solid waste, and increased taxes for lower-income households.

In this regard, I am particularly concerned with the guidelines outlined in recommendation 71. In the absence of an ability to measure weight effectively, some people will overfill refuse containers in an attempt to avoid additional fees. Such an outcome not only frustrates the goal of waste reduction but places the disposal worker at great risk of personal injury. In addition to the personal pain and suffering that will result from the implementation of a solid waste user fee without proper waste measurement apparatus, there is a considerable social cost associated with medical care and lost production.

Added to the genuine health and safety concern is a fear that the imposition of solid waste user fees will result in garbage dumping. Such an outcome would be counterproductive and socially wasteful.

Finally, I believe recommendation 71 to be internally contradictory. One guideline argues that solid waste user fees should "reflect all costs associated with the collection and disposal of solid waste," while another guideline suggests that "user fee structures should provide for reduced rates for base service." This points out another problem with user fee–type taxation. That is, households are being taxed rather than the individual. As a result, a relatively large family will be taxed more heavily than a relatively small family, regardless of which family is the most conscientious with regard to waste reduction.

This is not a point that should be taken lightly. A user fee garbage collection system being developed in the City of Kanata will result in a considerable change in the amounts that some residents pay for garbage collection. Under the old property tax system, households paid between $45 and $140, with the amount clearly marked on property tax bills. Under the proposed user pay system, the average will increase to some $120 per year.

Under the proposed system, the owners of homes valued at $78,000 will see their fee for garbage collection increase from $43 to $124 a year. By contrast, the rate will decrease slightly for the owners of a home valued at $248,000.

Corporate Income Tax

I cannot accept our recommendation to continue the status quo on corporate taxation, whereby many profitable corporations can pay little or no income tax. Similarly, I find our conclusion that the Ontario government should not try to increase the corporate share of the tax pie to be problematical.

Having rejected a corporate minimum tax and an increased share of tax revenue from corporate taxation, we are left with a corporate income tax chapter that basically supports the existing corporate tax system. At the same time, we propose harmonization of rates between manufacturing and other sectors that will, in all probability, result in a corporate tax cut.

Finally, by way of introduction to my comments on the corporate tax section of our report, I have concerns with the way we address the international competitiveness issue and the recommendation for a "neutral" corporate tax system. These issues will be addressed in turn.

Corporate Minimum Tax

According to data presented in the report of the Corporate Minimum Tax Working Group, some 23,000 corporations out of 116,000 corporations surveyed in 1989 that reported book profits paid no Ontario income tax. An additional 6000 paid Ontario tax at an average rate of less than 5 per cent of Ontario book profits. Fully $18.5 billion of the $53 billion earned by these profitable corporations escaped tax entirely, while $5 billion was taxed at an average rate of less than 5 per cent. A minimum corporate tax set at a modest rate of 10 per cent would, using the 1989 base figures, have generated fully $2 billion in additional revenue.

In our report we state that "there are two potential responses to this situation. One is to focus on the outcome of the tax and tax expenditure process and consider the application of a special tax that would be imposed on profitable corporations that have been able to use subsidies delivered through the tax system to reduce their tax liability to zero ... The other is to direct our attention to the underlying reasons for the phenomenon – the fact that subsidies to corporations are delivered through the tax system – and consider whether or not those subsidies are justifiable from a public policy perspective." The majority of commissioners reject the first option, because they believe that explicit recognition and a vigorous assessment of tax expenditures will deal better with this unfairness in the tax system. I am not persuaded by this argument.

There are many legitimate reasons why profitable companies often do not pay tax. However, profitable companies should not be able to combine otherwise legitimate tax "incentives" to reduce their total tax liability to zero. A measure to accomplish this would also be symbolically important since it would send out a clear message that all must pay their share of the total tax burden. Symbols are important, and their importance should not be lost. They often act as a catalyst for public opinion. This is particularly true in the current period when working people are indeed experiencing a heavier and heavier tax burden, while the tax burden on corporations has been declining. Anyone who doubts the importance of symbolism in the context of public finance and taxation would do well to remember the angry debate that greeted the Senate's 1993 decision to provide senators with a housing allowance.

Our report provides a good explanation why taxing corporations should be part of a progressive tax system, given that non-taxation would allow income from corporate assets – and thus from the assets of wealthy shareholders – to be sheltered from tax within the corporation for long periods of time. In my opinion, this commentary leads to a conclusion in favour of a corporate minimum tax. From my perspective, it is the principle of a corporate minimum tax that is important. The actual design of the tax is secondary. In this regard, the approach adopted by the treasurer – a tax on an adjusted "book profit" base – strikes me as relatively simple and no worse than other alternatives.

International Competitiveness

In chapter 7 of our report we state: "Competitive pressures ... undermine the ability of any single jurisdiction to increase the revenue it derives from income from capital. This is particularly true for ... Ontario and Canada."

This is a key issue, and much of the discussion on it is sensible and to the point. There are real constraints on how heavily one can tax capital when capital is as mobile as it currently is. Even in this context, however, it could and should be underlined that these constraints did not fall from the sky, but are the result of deliberate policy decisions such as the Canada–United States Free Trade Agreement and the pending North American Free Trade Agreement. The kind of economic integration brought about by these agreements (which "liberalize" investments as well as trade) makes it much more difficult to tax capital – which faces few limits on its ability to shift production, investment, and jobs between countries – and this results in a shift of the tax burden from capital to individual taxpayers.

The impact that the Free Tax Agreement is having on the progressiveness of the tax system should not be overlooked. Moreover, as a society, we should not take the negative consequences of the integration as a given, and proceed simply to change the tax system to conform to new constraints.

As things currently stand, the Canadian taxpayer is subsidizing corporate relocations off shore by, for example, making money borrowed in this country to finance expansion into the United States or Mexico deductible from Canadian income.

Declining Corporate Tax Share

As I outlined elsewhere in this commentary, the corporate income tax share of total Ontario revenues has declined from some 19 per cent in 1961 to under 8 per cent today. Our report initiates an extensive discussion on the reasons why the corporate share of the total tax burden has fallen. The fall in the profit share of national income is one factor, as noted. But the downward harmonization of corporate tax revenues brought about by free market economic integration is also an important factor.

The report makes a distinction between the effect of corporate tax systems on investment and production decisions, as opposed to the decision of a corporation on where to report its profits for tax purposes.

With regard to production and investment, it is not clear that differences in the "cost of capital" have a decisive impact upon corporate investment decisions. Certainly the level of corporate tax is only one factor even in the cost of capital. Although this is noted in our report, the point seemed to be put aside when our recommendations were formulated.

With regard to where corporate profits are reported, it is noted that transfer pricing and other techniques can be used to shift profits artificially to a low-tax jurisdiction, when a company is operating in more than one jurisdiction. Analysis and recommendations aimed at limiting tax avoidance should be emphasized. In my opinion, there is a role for greater control of corporate tax evasion, both through legislation and through tighter auditing. Corporations use a range of artificial techniques to avoid tax which should be paid. I think that something can and should be done about it.

Taxation of Manufacturing and Services

Another related set of comments bears upon the issue of the "neutrality" of the corporate tax system.

The final substantive issue addressed in the corporate taxation chapter relates to equalizing the tax rate between manufacturing and processing income and income earned in the service sector. The commentary does make some valid points with regard to the difficulty of defining "processing," the fact that services are increasingly exposed to international competition, and the fact that goods and services activities are increasingly tightly integrated. Nonetheless, I do not believe the equalization of rates is either necessary or desirable. Rather, I believe that our commentary and analysis point in a different direction.

If it is true – and the issue is by no means clear cut – that corporate decisions relating to where to invest (as opposed to where to report income) are influenced by the corporate tax burden, then this should be taken into account in determining the level of the tax burden. In my view, different sectors should be treated differently on the basis of their relative mobility.

To give a concrete example – retail trade is not very mobile – even if cross-border shopping picked up incredibly, the great bulk of retail purchases will be made in Canadian stores. There is really no reason, then, to tax retail profits on the same basis as those of a light manufacturing company that could pick up and move to the United States relatively easily, while continuing to sell in the Canadian market. Lowering the retail sector rate to the manufacturing rate, as is implied in recommendation 40, extends unnecessarily the downward harmonization set in train by the forces of international competitiveness.

On a similar point – I do not believe that it is desirable in principle to have a tax system that is neutral between sectors. All sectors are not the same in certain key respects. $1 million invested in the manufacturing sector (or in some high-value–added parts of the service sector) will produce significantly more jobs and activities in the economy as a whole than will $1 million invested in parts of the service sector such as the retail trade. In this regard, I would draw attention to the Economic Council study, "Good Jobs, Bad Jobs."

I argue that there is some role in an "active industrial policy" for tax measures to support certain kinds of activities rather than others. The opposite point of view – that the tax system should be neutral in investment decisions – is generally put forward on the basis that the market is much better at steering investment than is the state.

I agree in part with the view that it would be better to have a system of accountable government grants to business than "no strings attached" tax expenditures, because tax expenditures can be a very costly and wasteful way of delivering public support for business investments. However, tax expenditures can be targeted more precisely, and – most importantly – the commission is not advocating a grants-based industrial policy, but, rather, a neutral corporate tax system.

Concluding Comments

In summary, while I recognize that the constraints imposed by capital mobility are real, I would recommend minimizing the impact to the greatest extent possible. Accommodating the tax system to the constraints will shift more of the corporate tax burden to working people.

I have two additional comments. First, our report contains a commentary on training that specifically rejects the position advanced by "several representatives from the labour movement" that tax incentives are necessary to encourage firms to provide training. While rejecting this approach, "we support the general approach to training embodied in the Ontario Training and Adjustment Board legislation and urge the new board to seek an appropriate non-tax mechanism for supporting firms that undertake training and retraining." I supported the non-tax option, because I believe that it will help ensure that training is supported in the public sector as well as the private sector.

Second, we propose that "Ontario should seek the agreement of the federal government to establish and strictly enforce rules applicable to corporate expenditures which provide employees with personal benefits such as meals expenditures." As our commentary in chapter 12 makes clear, the current rules, whereby these expenses are deductible to businesses, but not taxable in the hands of individual employees and business operators, provides these employees with a significant benefit relative to other employees who receive a taxable salary and purchase the same goods and services out of their after-tax income.

This provision is estimated to cost the Canadian tax system some $1 billion in lost revenue. I strongly support the recommendation that the Ontario government take steps to tax the benefit in the hands of the individual, where possible, and to limit deductibility in the hands of the business as a second-best alternative. Like a corporate minimum tax, current deductibility of these expenses is seen in many circles as a symbol that demonstrates the unfairness of the current system.

Given the symbolic importance of this issue, not to mention the fact that the amounts of money involved are considerable, I believe that Ontario should go it alone on this recommendation if it fails to secure the agreement of the federal government.

Payroll Taxes

During our public consultations, representatives of the labour movement argued that the major burden of payroll taxation falls on working people. This argument is supported by commission research that found that, over time, fully 80 per cent of the burden of payroll taxation falls on working people. As a result, the labour movement would not support an increase in payroll taxes that was designed to replace some existing corporate tax.

At the same time, the labour movement believes that a perception on the part of the business community that business shoulders the most significant burden of payroll taxes means that increases in the general level of payroll taxation would have a negative impact on employment.

Finally, the labour movement believes that payroll taxes are only justifiable when they are directly related to benefits and when the benefits relate to employment. The unemployment insurance fund and the Canada Pension Plan are good examples of justifiable payroll taxes that enjoy wide support among workers.

In light of the above, I fully supported the commission's conscious decision against making a specific recommendation for a general increase in payroll taxes. However, I have a number of concerns with the commentary on payroll taxes outlined in our report, because it implied that payroll taxes are justifiable as a general tax.

Moreover, even though the commission specifically rejected a recommendation for an increase in the revenue share provided by payroll taxes, the general commentary points the Ontario government in that direction.

For example, in chapter 33 of our report we state: "Ontario's current payroll tax is low, and in this sense there is room to increase reliance on this tax. However, we have already concluded that the payroll tax, in the long run, is borne by employees (chapter 22). That is of concern to us because the fairness of the tax is compromised. Unlike an income tax that falls on all sources of income, a payroll tax falls only on labour income. Accordingly, we are not prepared to recommend that reliance on the payroll tax be increased to the extent required (at least doubled) to make up for the property tax reduction."

Part of the problem with payroll taxes, as currently constituted in Ontario, is that they are not necessarily related to the benefit they are supposed to provide. As the benefits become divorced from contributions, it becomes less useful to consider the benefits received in tandem with the taxes paid.

From my perspective, the appropriate solution to this problem would be to reconcile the benefit to the tax paid.

We are, like it or not, living in an era during which considerable pressure is being brought to bear on benefit-type programs. Today, politicians of all stripes look at a program like unemployment insurance with a funded budget of between $15 and $20 billion and find it hard to resist funnelling some of the money away from the specific benefit it was intended for. Similar pressure is being placed on the Canada Pension Plan.

While the labour movement is far less enamoured with payroll taxes for general services than it is for specific benefits such as UI and CPP, we generally supported the payroll Employer Health Tax when it was introduced in Ontario because we perceived it to be more progressive than the old premium system. I think our support has been misunderstood.

As a result, I argue that, rather than become the new standard, the Employer Health Tax should be regarded as an aberration. Payroll taxes should not be contemplated or introduced as a general form of taxation, but should provide exclusively a targeted benefit that flows from employment. Our support for the existing Employer Health Tax remains assured; however, support will quickly dissipate if the province attempts to increase the general rate of the tax.

I would like to make two final points with regard to payroll taxes. First, one of the arguments used in the section of our report that deals with the rationale for increased reliance on payroll taxes is that "comparative evidence suggests that it is certainly possible to sustain much higher rates of payroll tax than are typical in Canada without adverse economic impact." The argument implies that corporations do not do their homework and inadequately assess all the costs and benefits of locating in Ontario. I think otherwise.

Second, payroll taxes are particularly justifiable when they relate to individual employment benefits such as unemployment insurance and the Canada/Quebec Pension Plan. Some people would argue that these programs are in need of reform, because they do not redistribute income. It should be made clear that their purpose is not income redistribution and, hence, there is no need for them to be progressive. What they are designed to do is to flatten out the income curve experienced by an individual over his or her working life and into retirement.

Conclusion

As our report notes, "changes in the tax mix are needed to increase progressivity in the tax system beyond what is available through changes in individual tax basis." For the most part, I have little problem with the specific recommendations that are outlined in our report. In the majority of cases, they make the individual tax bases more progressive and hence fairer.

I have some considerable unease with our recommendations when the package of reforms is taken as a whole – when, in short, we look at the relationship between taxes and the general tax mix. My specific concern can be highlighted by any number of quotes from the pages of our tax mix chapter.

We advocate that "Ontario should increase its reliance on revenue from personal income taxes." We also provide the Ontario government with advice that "there is room to increase the retail sales tax rate" and "the payroll tax offers considerable potential for additional revenues." Elsewhere in our report, we advocate dramatically increased user fees, and the introduction of a wealth tax. The only tax on the personal side of the tax system that we advocate be decreased is the residential property tax.

On the other side of the coin, we argue that the share of revenues that is derived from the corporate sector not be increased. I believe that our failure to recommend a more prominent role for corporate tax reform, particularly a corporate minimum tax, will leave many Ontarians with the opinion that a tax system modelled on our recommendations is unfair.

I would reiterate, as well, that with regard to the corporate income tax, I believe our commission accepted, at face value, arguments of international competitiveness and failed to promote innovative tax measures that would generate increased revenue from the corporate sector without adversely affecting our production and employment.

It is altogether too easy to lose sight of the purpose of taxation when considering many of the individual measures that make up the tax system. Those of us in society who support a strong public sector have an added incentive to make sure that the tax system is both fair and seen to be fair.

From my perspective, the working people of Ontario are prepared to pay for quality public services, provided they are assured that others in society are also paying their share. At the present time, the system is skewed to the point that services are being eroded while the tax burden faced by ordinary taxpayers is increasing. This must change. To the extent that our recommendations advance this process, they should enjoy widespread popular support.

Finally, I have had an opportunity to review the comments on our report that were penned by fellow commissioner, Brigitte Kitchen. As my previous comments attest, I am in complete agreement with her when she argues for a minimum corporate income tax.

To a great extent, my commentary has avoided a detailed exploration of the specific recommendations that we made. In short, I preferred to focus on what I perceived to be significant issues of tax design. Notwithstanding this general approach, I should like to take this opportunity to indicate that I concur completely with the commentary on child benefits as outlined so convincingly in Brigitte Kitchen's comment.

Brigitte Kitchen

In most important aspects, the commentary and recommendations of the final report of the commission reflect positions I feel very comfortable in supporting and I am ready to defend.

While I believe it is unusual to comment on process, the innovative process that defined the work of this commission deserves special mention. The minister of finance did not follow the traditional route of previous tax commissions by appointing a group of tax experts. Instead, his goal was to democratize and demystify the tax process by calling on the experience and insights of 10 people from very different professional backgrounds.

Like most commissions, we had to learn to work together in a collegial and cooperative manner. We all had to move beyond our own personal or political views. I believe that those of us who were not tax experts brought an invaluable perspective to our work. Technical information was brought into the larger policy context of tax fairness from the point of view of social justice as opposed to that of sectoral interests based on economic power.

Under the guidance of the chair, and with the benefit of the informative briefing sessions of the staff, the large number of research reports that we commissioned from experts in the field, and a lot of homework, we were able to arrive at informed decisions based on what we considered to be fair tax policies for the majority of taxpayers. For example, I believe the decision to shift a major portion of tax revenue from the regressive property tax base to the progressive personal income tax base represents a major step towards tax fairness.

This report represents our collective judgment on tax fairness.

Corporate Minimum Tax

Having stressed these positive aspects of the commission's work, I do believe that, in not recommending a corporate minimum tax to address the troublesome phenomenon of profitable corporations not paying taxes, the commission did not live up to its mandate of improving the fairness of the tax system. I am most uncomfortable that, at a time when the tax burden of most taxpayers has increased to such an extent that the standard of living of a great many Ontarians and their families has been frozen or declined, the report does not recommend a minimum corporate tax. To be told by the Fair Tax Commission that "through tax expenditures, significant subsidies are delivered to corporations," and that these subsidies are clearly justifiable in a fair corporate tax system, must seem a mockery of the idea of fairness to hard-pressed taxpayers. They know only too well that in today's harsh economic climate, when cash-starved governments are looking for extra revenue if profitable corporations do not pay their fair share, tax revenues will have to come from their pockets.

To justify that profitable corporations can reduce their tax loads to zero in certain situations contradicts the position the commission has stressed throughout the report, that those benefiting from public services should contribute to the payment of such services. Since corporations are major users of the public infrastructure, fairness would demand that they pay their share for it.

For me, and for some other commissioners, the ability of profitable corporations to reduce their tax load to zero is evidence of a flaw in the tax structure which the commission failed to correct. I would have liked the commission to recommend that profitable corporations should never be able to use all their tax-delivered subsidies to reduce their tax liability to zero in a given tax year.

Child Benefits

Also by failing to recommend a tax credit for all families with children, the commission did not restore tax fairness between parents raising children and childless individuals and couples. The Working Group on Women and Taxation argued that "the tax system should ... provide public support to assist with the costs associated with raising children, and recognize the reduced ability to pay of parents compared to individuals and couples without children." The same point was made a number of times at the public hearings we held in various parts of the province.

The absence of recognition of the additional costs of children in all families implicitly endorses the idea of treating children as equivalent to private consumption decisions, like buying a car or a house. To treat a child as if it were a commodity seems absurd. If societies are to continue to exist, we need children. A child benefit for all is the explicit recognition that children are the shared responsibility of their parents and their society. The symbolic recognition of this shared responsibility for children is considerably more important than the actual amount of the benefit or tax credit for all parents.

Furthermore, the targeted approach, at the federal level in providing child benefits to "those who really need it," has meant that about $4 billion could be withdrawn from benefits for families with children over the last nine years. Poor families and their children did not benefit from the removal of all tax or direct transfers from families at higher-income levels. In fact, all families, including the poor, are receiving less income support for raising their children than before the removal of all benefits for higher-paid families.

The evidence from European countries with child benefits for all families, supplemented in many countries by additional support for the children of the poor, is that they have a considerably lower number of children living in poverty. Targeting child benefits to those in need has resulted in Canada having the second highest child poverty rate after the United States among the major industrialized countries.

As Leonard Marsh wrote in 1943, "children's needs should be met as a special claim on the nation, not merely ... on occasions of distress, but at all times." Child benefits have a basic claim in both normal and dependency situations. If this is the case, parents never have to ask themselves whether they will be better off being in the workforce or on public assistance and governments will not have to worry about work disincentive effects in the social security system.

It is for these reasons that I strongly support the recommendation of the Working Group on Women and Taxation calling for a national child tax credit coupled with additional support to bring children out of poverty.

Fiona Nelson

Everyone loves to complain about taxes, but tax policy itself is rarely a rewarding topic of casual conversation. This is unfortunate. How and why we tax is just as much – and just as important – a political decision as how and why we spend public money. Both decisions need to be subjected to full debate. That debate is facilitated when the stakes, and the proposals, are clearly understood. As a politician with 20 years experience in local government, I have learned that whatever I advocate has to be comprehensible and relatively uncomplicated if I expect my constituents to come to any reasonable conclusions. This is not simply pragmatism. If democracy means anything, it means that citizens must be able to offer informed criticism and endorse or reject a course of action. They can only do that when political proposals are transparent.

My dissent, then, is directed as much towards achieving simplicity as it is towards offering alternatives. My comments are based on two premises: 1) that we must get a fair and consistent assessment system that eradicates the gross inequities that have grown up over the years, without handing the fortunes of local government finance over to the caprice of the real estate market; 2) that we must get an education grant formula that responds to the real needs of children, not the growth of local taxable assessment. With a consistent assessment system that fairly allocates taxes according to intelligible criteria, municipal finance would be put on a sound foundation. With a grant formula tailored to the needs of children, education finance will likewise be put on a solid footing. Both actions would simultaneously resolve a number of other problems in local government finance.

Underlying this commentary is a simple observation. In the past three years a number of inquiries have been undertaken into local government. The Royal Commission on Learning is merely the latest. These disparate inquiries, were they taken together, would amount to an unofficial royal commission on local government – its structure, function, and finance. Comprehensive local government reform has been in the making for 25 years now, since the report of the last Ontario investigation into taxation. Little has changed. In the current economic circumstances, the time has come for comprehensive local government reform. The Fair Tax Commission Report has to encourage this.

Principles of Education Finance

The commission's proposals for education finance reform are based on the following principles: 1) students have the right to a comprehensive and challenging education, wherever they might live; 2) education taxes should, as much as possible, reflect a taxpayer's ability to pay, and business taxes should be similar across the province; 3) whatever the funding system, it must guarantee a common minimum level of expenditure, while being flexible enough to accommodate differences in local needs, whether those needs are economic, demographic, social, or linguistic. In other words, equity does not mean equal funding, and a formula that hammers all school boards down to the same spending level does not promote equity.

I endorse these principles, but only as the basis for discussion; they cannot, by virtue of their schematic character, fully encompass the topic. The commission has interpreted these principles to mean:

1 The provincial government should assume full responsibility for funding education and allocate grants on the basis of the needs of the student and the characteristics of the community.
2 The local residential property tax for education should be eliminated and residential property taxes should be reduced, and the ensuing revenue loss should be made up through provincial general revenues; the local non-residential property tax (comprising commercial and industrial assessment, the business occupancy tax, provincial payments in lieu of property taxes, and taxes from

public utilities and farm properties) should be replaced by a provincial tax levied at a uniform rate.

3 The local residential property tax should be limited to a maximum of 10 per cent of the provincial grants allocated to the local school board and used to fund programs over and above what the province considers necessary.

I would interpret these principles as follows:

Provincial Funding

Clearly, the provincial government should accept responsibility for providing adequate funds to educate every child in Ontario. I am skeptical that the province will do so. The last time the province made good on its commitments, in 1971–75, it did so by imposing draconian expenditure limits on school boards. Since 1975, the province has given up on funding any specific proportion of education costs and has left school boards to pry as much as they can from property taxes. I would be ecstatic if the province were to make a commitment – and meet it. Twenty years of a "we'll pay what we can" approach from the province leave me doubtful. But education can't wait until provincial revenues recover (a provincial refrain since 1969). It offends my sense of justice that the education of a child should depend on the meagre resources many school boards must struggle to cobble together. The provincial attitude, that all school boards should spend the same amount per child, regardless of the needs of the child, is equally inadequate. Education requires an unbreakable covenant with the province for adequate financing. Failing that, school boards ought to be able to do what they and their ratepayers find necessary and acceptable.

Fair Taxation and Local Government

From the beginnings of large-scale provincial intervention in education funding, two principles have been at work. The first is that, given the expense of education, it is not possible for education to be entirely locally financed. Education therefore requires provincial support. The second principle is that, since resources vary from community to community, provincial funding must ensure that each school board has the funds to support provincially mandated programs. Provincial funding must "equalize" the resources available to each community for the basic education program.

Commercial and Industrial Assessment

The burden of local finance supported by commercial and industrial properties varies immensely across the province. Businesses do not face a level playing field, either for education or for municipal taxes, when it comes to effective tax rates. This is inequitable. For both education and municipal purposes, the taxes for basic services should be broadly similar throughout the province. This does not, of course, mean the same tax rates; businesses, like other ratepayers, should pay additional amounts for programs that are beyond the basic level of services.

Equity among businesses will not be achieved until there is a province-wide reassessment. Existing business assessments reflect "bonusing" decisions, or implicit tax abatements, made before the province took over assessment in 1970.

To date, the province has compensated for the overassessment or underassessment of businesses on a community by community basis. It has applied "equalization" factors, to try to put businesses on the same footing, regardless of their location. To date, "equalization" factors have not worked. In pooling the local commercial and industrial education taxes on a province-wide basis, it is highly unlikely the province will renounce "equalization" factors. The system is already in place. It will, however, only enshrine inequities.

The alternative – province-wide reassessment of commercial and industrial properties – would ensure that businesses are assessed equivalently. As a result, they would pay a standard tax for provincially mandated education programs. Ironically, this would also eliminate the need for province-wide pooling.

As for the differences in resources among the assessment bases of public school boards and separate and French school boards commonly ascribed to differences in commercial and industrial assessment, the solution is two-fold. Among boards that share the same assessment area, co-terminous boards, there should be a sharing of assessment. Between boards in different assessment areas, provincial equalization grants should make up shortfalls between necessary and available resources.

Co-terminous pooling and adequate provincial equalization grants would simplify the local role in education funding considerably. Apart from simplicity, there is another principle at stake. Property taxes are, and remain, the sole dedicated local source of funding. They serve as a community charge for projects a community ordains important. They cannot be expropriated, exported, or diverted from the area in which they are raised without violating fundamental canons of fairness and democracy.

The Local Residential Levy

The commission's proposal to limit the size and application of the local levy also violates the canons of fairness and democracy. Were the province to fund education fully, there would be little reason for a local levy on property taxes. For reasons I've stated before, it is doubtful the province will fund education adequately. To limit the local levy, then, would prevent local communities from making up the shortfall in education finance. But even apart from that, to impose a limit on a local levy is a rather crude act of paternalism that suggests that "father," in this instance the province, knows best. On the evidence of recent history, it does not.

Hence, my objection to the local levy for education is twofold. It should not be limited simply to residential taxpayers. Although there are arguments for a province-wide policy on business taxation, this overlooks the fact that businesses do benefit from local services. That is why the commission retains the municipalities' freedom to tax commercial and industrial assessment, even though the property tax is not quite a benefits tax. There is thus no reason not to include businesses in a local levy which is, in fact, a general community charge. Beyond that, the education infrastructure of a community is an important factor in business location.

Nor should the amount to be raised locally be limited in any way. Local politicians are just as responsible as provincial or federal politicians in raising the appropriate amount of money for the appropriate services. They may even be more responsible. They certainly undergo a more frequent performance review, in the form of fixed triennial elections.

Property taxes are the single most visible tax, which is why they raise such a furore. Yet, they enjoin local ratepayers to participate in local politics, precisely because they are visible. In turn, this encourages a much greater degree of accountability than can be expected on the federal or provincial level. There is no hiding of misappropriation or poor judgment on the local level.

The visibility of property taxes has a particular virtue; it induces and legitimates the kind of local input that is necessary to ensure that the education program reflects local needs. Even if schools must adhere to provincial standards in core subjects, local education programs have to go beyond provincial standards. Local employment and demographic and linguistic needs vary from region to region. To a degree, the commission's recommendations acknowledge this, and they recognize the need for a local levy to make up for the inevitable imperfections in whatever provincial grant system is devised to meet the needs of children.

To limit the local levy is to ensure that only those needs of children the province recognizes will be met. The Toronto Board of Education began kindergarten classes in 1887; the province made them compulsory only in the next century. The Toronto Board of Education instituted school-based day care in 1890; the province even now formally requires them only of new schools. It is too much to expect a government of 10 million people to respond quickly to every need that occurs, especially when needs only gradually spread from one community to another. That is why we have local governments.

Constitutional Considerations

Under the terms of the Separate Schools Act of 1863, popularly known as the Scott Act, dissentient ratepayers, primarily Roman Catholics, were given the right to direct their property taxes, both as householders and as shareholders, to separate schools. This right was enshrined in section 93 of the British North America Act, 1867, and confirmed in section 93 of the Constitution Act, 1982, which replaced it. Section 93 essentially confirms to Roman Catholics the rights they enjoyed before Confederation.

These rights pose two difficulties. First, it may well be unconstitutional to limit the right of Roman Catholics to levy taxes for school support. Second, it may well be unconstitutional to pool assessment of Catholic shareholders for education in general. The Catholic share of commercial and industrial assessment most likely must be directed to separate school support. An additional consideration is that separate school boards (and French-language ones as well) also enjoy constitutional protection to exist (while public boards do not).[1]

It is clear that the province cannot extinguish these rights without receiving assent not only from Catholic school trustees and ratepayers, but also from school boards and parents.

Formalizing the Role of Local Government

Communities, and not parliaments or provincial legislatures, are the foundations of the nation's life. Communities find expression in local government. It is local services that citizens demand most; more than that, many provincial and federal services are best delivered locally. Local government is the foundation of democracy. Accountable, responsible local democracy is Canada's oldest form of democracy. Local governments were accountable for their decisions, and subject to electoral defeat, long before provincial politicians made the executive power answerable. These two traditions – community service and community democracy – should be granted explicit recognition in provincial policy. Local governments are creatures of provincial statute and, as such, have a comparatively contingent existence. Yet they are essential agents in provincial policy. It is time to build a more effective and permanent relationship, one that is clearly spelled out for both sides. Such would be accomplished through comprehensive negotiations between the province and local government, aimed at establishing a quasi-constitutional charter of rights and responsibilities for both sides.

[1] Brian A. Kelsey and William S. Challis, memorandum re: Constitutional Considerations in Property Taxation (unpublished).

Comparison of Recommendations Referred to in this Dissent

FTC Recommendations	Nelson Recommendations
74 The provincial government should assume responsibility for the funding of education to a provincial standard, allocating funds to school boards based on per-student cost, student needs, and community characteristics which affect education costs, such as poverty and language.	The provincial government should assume the bulk of education funding through a formula based on student needs and weighted for community wealth and literacy
75 Ontario should replace the local residential property tax as a source of core funding for education with funds raised from provincial general revenues.	Local residential property taxes should be reduced as the source of core funding for education in Ontario. Funds raised from provincial general revenues should provide a much higher level of support for education – at least enough to cover all mandated programs. The revenues raised from commercial and industrial properties for education should be pooled and shared among the school boards whose co-terminous boundaries are within the jurisdiction, county, or municipality.
77 Ontario should permit school boards to raise funds to support local discretionary spending through a local levy on the residential property tax base. The amount of this local levy for each board should be restricted to a fixed percentage – not greater than 10 per cent – of the total amount of provincial funding provided to that board.	School boards should be permitted to raise supplementary funds for education, from both residential and commercial and industrial property owners, without restriction.

82 Residential assessment of individual properties for local taxation purposes should be based on the following factors:

- size of building,
- dimensions of lot, and
- type of building.

Weighting factors used in combining the factors of size of building and dimensions of lot for each type of building should be designed to ensure that the resulting assessments reflect variations in the value of properties in their current use, as shown in their rental value.

Weighting factors would be permitted to vary, based on location, subject to the following requirements:

- Without differential weighting factors based on location, it would be impossible to achieve assessments which reflect value in current use.
- Assessment areas could not be smaller than geographically contiguous areas which carry the same zoning designation for planning purposes.

Residential assessment should be based on unit value, defined as a summation of building and lot sizes, and weighted according to the zoning regulations in force in an area.

85 Non-residential property should be assessed on the basis of the rental value of the property – the price that would be paid for property of that class and type for the right to employ the property in its current use.	Agree.
115 Ontario should establish a provincial property tax on commercial and industrial property, levied at a uniform effective rate across the province, to replace the revenue raised by the local education levy on non-residential property and the education share of the business occupancy tax.	To the degree that property taxes remain an integral part of the education formula, they should be levied at a uniform effective rate across the province, once the assessment system has been changed from market value to unit/rental value. Ontario should call a provincial-local constitutional conference to establish a charter of local government rights and responsibilities, including the allocation of residual powers.
135 Ontario should locate all of the functions related to local government finance in one ministry.	A lead ministry should be established to deal with provincial-local government affairs. Ontario should centralize data on local government affairs, and ensure local governments ready access to them. Short-term reforms should be implemented by a committee of elected local government officials and provincial representatives. Long-term reform should be negotiated through periodic provincial-local conferences

Satya Poddar

While I agree with many of the commission's recommendations, there are some parts of the report I do not support. In particular, I have serious reservations about the proposal to increase personal income taxes by $3 billion to replace funding of education by property taxes. The relative share of personal income taxes in total revenues has increased significantly over the past eight years owing to the partial de-indexing of the personal income tax system and the surtaxes imposed by federal and provincial governments. A further increase in personal income taxes through the replacement of property taxes would put a significant strain on the system and could lead to erosion of compliance by taxpayers.

I am also concerned about the adverse impact (and technical feasibility) of some proposals in the commission's report. For example, the proposal to convert the deduction for pension and retirement savings plan contributions into a flat rate tax credit would be extremely disruptive, as it would require complex changes in the legislation and a major redesign of virtually all existing employer pension plan arrangements.

References

Major Data Sources and Models

The following is a list of the major data sources and models utilized in this report. Brief descriptions are provided for sources and models that may not be familiar to readers or were developed by the commission in the course of its work. References to standard published statistical series are not listed here.

Statistics and analyses in this report are generally based on data available to the commission as of mid July 1993.

Provincial Models and Databases

Municipal Databases

The Municipal Analysis and Retrieval System (MARS)

This database contains financial and other statistics for each municipality in Ontario since 1977. It is maintained by the Ministry of Municipal Affairs. Much of the data in MARS is compiled from the financial information returns submitted annually to the ministry by all municipalities in the province.

Municipal data for years prior to 1977 were from *Municipal Financial Information* and *Local Government Finance in Ontario* published by the Ministry of Treasury, Economics, and Intergovernmental Affairs.

Ontario Ministry of Education, Administrative Data

Data collected in Ministry of Education surveys of school boards.

Ontario Ministry of Finance, Corporate Database

Ministry of Finance officials developed a database and model to analyse 1989 corporate income taxes based on a sample of returns from Ontario corporations. The commission shared in the cost of developing this model and analytical results (on an aggregated basis to maintain confidentiality) were made available to the commission.

Ontario Ministry of Finance, Mining Tax Database

Ministry of Finance officials developed a database and model to analyse 1987-91 mining taxes based on a sample of Ontario mining companies accounting for the majority of mining tax revenue. The commission shared in the cost of developing this model, and analytical results (on an aggregated basis to maintain confidentiality) were made available to the commission.

Income Tax and Assessment Record Matching Project

To maintain confidentiality, Ministry of Finance officials matched data from 1990 personal income tax returns with property assessment data for a sample of households in selected Ontario municipalities. Analyses using this matched database were conducted for the commission by the Ministry of Finance to determine the relationships between income and property tax payments of Ontario households.

Other Models and Databases

Social Policy Simulation Database and Model (SPSD/M)

The SPSD/M is a microcomputer-based product designed to analyse the impacts of changes in the tax and cash transfer systems between governments and households. It is developed and updated by the Analytical Studies Branch of Statistics Canada. The database is a statistically representative sample of the Canadian population. The sample relating to Ontario households was used in the commission's analyses. A full description of the SPSD/M is provided in Michael

Bordt, Grant J. Cameron, Stephen F. Gribble, Brian B. Murphy, Geoff T. Rowe, and Michael C. Wolfson, 1990, "The Social Policy Simulation Database and Model: An Integrated Tool for Tax/Transfer Policy Analysis," *Canadian Tax Journal*, 38 (1): 48–65.

FOCUS and FOCUS-ONTARIO Models

These macroeconomic models of the Canadian and Ontario economies are maintained by the PEAP program of the Institute for Policy Analysis, University of Toronto. FOCUS is a medium-scale model of the national economy used for policy analysis and medium-term projections. FOCUS-ONTARIO is an expenditure-based quarterly model of the Ontario economy with extensive fiscal detail.

Revenue Canada, Taxation Microdata File

This data file contains a representative sample of personal income tax returns (T1 forms) filed by Canadian tax filers. For reasons of data confidentiality, analyses using these data were undertaken for the commission by authorized officials in the Ministry of Finance. Tables from this database are published annually by Revenue Canada Taxation in *Taxation Statistics*, popularly referred to as the Greenbook.

Ernst & Young Wealth Report

This database estimates household asset and liability components of household wealth at the end of 1989. It provides information on the distribution of wealth by asset categories and in relation to income and various demographic characteristics. It is estimated that the items included in the report account for 95 per cent of total household wealth. In the commission's work, these data were used along with other data to estimate the distribution and potential revenue yields from a variety of potential wealth tax models.

Works Cited

Aaron, Henry J., and Alicia H. Munnell. 1992. "Reassessing the Role for Wealth Transfer Taxes." *National Tax Journal*, XLV (2): 119–43

Advisory Group on Taxation of Cooperatives. 1993. "Report." Report prepared for the Fair Tax Commission. Mimeo. Toronto

Alberta. Treasury. 1993. *A Financial Plan for Alberta: Budget '93. Budget Speech.* Presented in the Legislative Assembly of Alberta, 6 May 1993

Allingham, M.G., and A. Sandmo. 1972. "Income Tax Evasion: A Theoretical Analysis." *Journal of Public Economics*, 1: 323–38

Arthur, John, and William H. Shaw, eds. 1978. *Justice and Economic Distribution.* Englewood Cliffs, N.J.: Prentice-Hall

Auerbach, Alan J., and James M. Poterba. 1987. "Why Have Corporate Taxes Declined?" *National Bureau of Economic Research Working Paper No. 2118.* Washington: NBER

Auld, D.A.L. 1993. "Evaluating the Options for Fiscal Stabilization Policy at the Provincial Level." In *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, 171–200. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Auld, D.A.L., and Lorraine Eden. 1987. "A Comparative Evaluation of Provincial-Local Equalization." *Canadian Public Policy*, 13(4): 515–28

Baker, David. 1992. "Learning from the Best: Lessons for Ontario from the Employment Programs for Disabled People in Germany and Sweden." A report to the Chief Commission, Office of the Employment Equity Commission, Ministry of Citizenship. 19 February

Bale, Gordon. 1989. *Wealth Transfer Taxation: An Important Component of a Good Tax System.* Victoria, N.Z.: Institute of Policy Studies

Ballard, C.L., J.B. Shoven, and John Whalley. 1985. "General Equilibrium Computations of the Marginal Welfare Costs of Taxes in the United States." *American Economic Review*, 75: 128–38

Bank of Canada. 1993. *Bank of Canada Review*. Ottawa

Battle, Ken, and Sherri Torjman. n.d. "The Interaction of the Welfare and Tax Systems in Ontario." In *Taxation and the Distribution of Income*, ed. Allan J. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

– 1993. "The Interaction of the Welfare and Tax Systems in Ontario: Full Report." Final report prepared for the Fair Tax Commission. Mimeo. Toronto

Bernstein, Jeffrey I. 1986. "The Effect of Direct and Indirect Tax Incentives on Canadian Industrial R&D Expenditures." *Canadian Public Policy*, 12(3): 438–48

– 1989. "The Structure of Canadian Interindustry R&D Spillovers and the Rates of Return to R&D." *Journal of Industrial Economics*, 37(3): 315–28

Betcherman, Gordon. 1991. *Employment in the Service Economy*. Ottawa: Economic Council of Canada

– 1992. "The Disappearing Middle." In *Getting on Track: Social Democratic Strategies for Ontario*, ed. Daniel Drache, 124–35. Montreal and Kingston: McGill-Queen's University Press

Birch, Thomas D. 1988. "Justice in Taxation: An Appraisal of Normative Tax Theory." *Social Sciences Quarterly*, 69(4): 1005–13

Bird, Richard M. 1972. "Death Duty or Other Wealth Tax for Canada: Pros and Cons." In *Report of the Proceedings of the Twenty-Third Tax Conference, 1971*, 6–24. Toronto: Canadian Tax Foundation

– 1986. *Federal Finance in Comparative Perspective*. Toronto: Canadian Tax Foundation

– 1992. *Tax Policy and Economic Development*. Baltimore: Johns Hopkins University Press

– 1993. "Threading the Fiscal Labyrinth: Some Issues in Fiscal Decentralization." *National Tax Journal*, 46(2): 207–27

Bird, Richard M., and Enid Slack. 1993. *Urban Public Finance in Canada*. 2nd ed. Toronto: John Wiley & Sons

Blair Commission. *See* Ontario. Ministry of Treasury, Economics and Intergovernmental Affairs. 1977

Blanchflower, David G., and Andrew J. Oswald. 1991. "Does Access to Capital Help Make an Entrepreneur?" *National Bureau of Economic Research Working Paper No. 3252*. December. Cambridge, Mass.: NBER

Block, Sheila, and Allan M. Maslove. n.d. "Ontario Tax Expenditures." In *Taxes as Instruments of Public Policy*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Block, Sheila, and Richard Shillington. n.d. "Incidence of Taxes in Ontario in 1991." In *Taxation and the Distribution of Income*, ed. Allan M. Maslove. Fair

Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Boadway, Robin W. 1986. "Federal-Provincial Transfers in Canada: A Critical Review of the Existing Arrangements." In *Fiscal Federalism*, research coordinator Mark Krasnick, 1–47. Royal Commission on the Economic Union and Development Prospects for Canada, Collected Research Studies, vol. 65. Toronto: University of Toronto Press

Boadway, Robin W., and Frank Flatters. 1991. "Federal-Provincial Fiscal Relations Revisited: Some Consequences of Recent Constitutional and Policy Developments." In *Provincial Public Finances: Plaudits, Problems, and Prospects*, ed. Melville McMillan, vol. 2. Toronto: Canadian Tax Foundation

Boadway, Robin W., and Paul A.R. Hobson. 1993. *Intergovernmental Fiscal Relations in Canada.* Canadian Tax Paper, no. 96. Toronto: Canadian Tax Foundation

Boadway, Robin W., and Harry M. Kitchen. 1984. *Canadian Tax Policy.* 2nd ed. Toronto: Canadian Tax Foundation

Boadway, Robin W., Kenneth J. McKenzie, and Jack M. Mintz. 1989. *Federal and Provincial Taxation of the Canadian Mining Industry: Impact and Implications for Reform.* Kingston: Centre for Resource Studies

Boskin, Michael J. 1977. "An Economist's Perspective on Estate Taxation." In *Death, Taxes and Family Property*, ed. Edward C. Halbach, 56–66. St Paul, Minn.: West Publishing

– 1988. "Tax Policy and Economic Growth: Lessons from the 1980s." *The Journal of Economic Perspectives*, 2 (4): 71–97

Boskin, Michael J., and William G. Gale. 1987. "New Results on the Effects of Tax Policy on the International Location of Investment." In *The Effects of Taxation on Capital Accumulation*, ed. Martin Feldstein, 201–22. Chicago: University of Chicago Press

Bossons, John. n.d. "Residential Property Tax Incidence." In *Financing Local Government*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Bossons, John, Harry Kitchen, and Enid Slack. "Local Government Finance: Principles and Issues." In *Financing Local Government*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Brean, Donald S. 1992. "International Taxation: Source and Residence Principle." In *Taxation to 2000 and Beyond*, ed. R.M. Bird and J.M. Mintz. Canadian Tax Paper, no. 93. Toronto: Canadian Tax Foundation

Brennan, Geoffrey, and James Buchanan. 1980. *The Power to Tax: Analytical Foundations of a Fiscal Constitution.* Cambridge: Cambridge University Press

– 1983. "Normative Theory for a Federal Policy: Some Public Choice Preliminaries." In Charles E. McLure, Jr, *Tax Assignment in Federal Countries*. Canberra: Australian National University, Centre for Research on Federal Financial Relations

Breton, Albert. 1985. "Supplementary Statement." In Royal Commission on the Economic Union and Development Prospects for Canada, *Report*, vol. III, 486–526. Ottawa: Minister of Supply and Services Canada (2.6)

– 1993. "Fiscal Federalism in a Competitive-Public Sector Setting." In *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, 44–80. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

British Columbia. Department of Environment. 1990a. "An Evaluation of Alternative Beverage Container Recovery Programs for British Columbia"

– 1990b. "Pricing Pollution: Revising British Columbia's Waste Discharge Permit Fees"

Brooks, Neil, and Anthony Doob. 1990. "Tax Evasion: Searching for a Theory of Compliant Behaviour." In *Securing Compliance: Seven Case Studies*, ed. M.L. Friedland, 120–64. Toronto: University of Toronto Press

Brown, Robert A., and Robert C. Strother. 1991. "Self-Government and the Taxation of Aboriginal People in Canada." Paper delivered at "Indian Governments and Tax: A Conference Exploring the Nature and Power of Tax." 12–15 November. Whistler, B.C.

Calvert, John. 1991. "Developing Sound Public Policy on Landfill Ownership, Tipping Fees and Disposal Revenues in Ontario." Policy paper prepared for the Canadian Union for Public Employees

Campbell, Bruce. n.d. "Changes in the World Economy and Fiscal Implications for Canada and Ontario." In *The Economic and Social Environment for Tax Reform*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Canada

1988. *The Canada-U.S. Free Trade Agreement*. Ottawa: Minister of Supply and Services

1991. *Prosperity through Competitiveness*. Ottawa: Minister of Supply and Services

Department of Energy, Mines and Resources, Mineral Policy Sector

1993. *The Canadian Minerals Industry: Economic Situation and Current Issues*. Ottawa

Department of Finance

1984. *A New Direction for Canada: An Agenda for Economic Renewal*. Ottawa: Supply and Services Canada

1985a. *The Budget, 1985*. Ottawa

Canada. Department of Finance (cont.)
1985b. *A Minimum Tax for Canada.* Ottawa
1989a. *The Budget: The Goods and Services Tax* Ottawa
1989b. *Goods and Services Tax.* Ottawa
1989c. *Goods and Services Tax Technical Paper.* Ottawa
1991a. *The Budget, 1991; Budget Papers Tabled in the House of Commons ... February 26, 1991.* Ottawa
1991b. *Disability Tax Credit: Evaluation of Recent Experience.* Ottawa
1991c. *Federal - Provincial Tax Collection Agreements Discussion Paper.* Toronto: CCH Canadian Ltd
1991d. *Personal Income Tax Coordination: The Federal-Provincial Tax Collection Agreements.* Ottawa
1992a. *The Budget, 1992; Budget Speech Tabled in the House of Commons ... February 25, 1992.* Ottawa
1992b. *Economic and Fiscal Statement.* Ottawa
1992c. *Government of Canada Personal Income Tax Expenditures.* Ottawa
1993a. *The Budget, 1993; Tabled in the House of Commons ... April 26, 1993.* Ottawa
1993b. "Interim Measure to Limit the Deductibility of Provincial Payroll and Capital Taxes." Information release 93-013, 2 March 1993. Ottawa
1993c. *Jewellery Tax Evaluation Report.* Ottawa
1993d. *A Working Paper on Indian Government Taxation.* Ottawa

Department of Justice, Bureau of Review
1990. *Evaluation of the Divorce Act: Phase II, Monitoring and Evaluation.* Ottawa

Environment Canada
1992. *Economic Instruments for Environmental Protection: Discussion Paper.* Ottawa: Supply and Services Canada

Health and Welfare Canada
1993. "Health Expenditures in Canada, Fact Sheets." March. Ottawa: Policy, Planning and Information Branch, Health and Welfare Canada

House of Commons
1983. Parliamentary Task Force on Pension Reform. *Report.* Ottawa
1987. Standing Committee on Finance and Economic Affairs. *Report on the White Paper on Tax Reform.* Ottawa
1993. Parliamentary Standing Committee on Human Rights and the Status of Disabled Persons. *As True as Taxes: Disability and the Income Tax System.* Ottawa

Canada (cont.)
Revenue Canada
1970–92. *Taxation Statistics.* Ottawa
1990. *Taxation Statistics: Analyzing 1988 T1 Individual Tax Returns and Miscellaneous Statistics.* Ottawa: Revenue Canada Taxation
1992. "Taxation Statistics for 1990." Unpublished data

Royal Commission on Aboriginal Peoples
1993. *Partners in Confederation.* Ottawa

Royal Commission on Dominion-Provincial Relations (Rowell-Sirois Commission)
1940. *Report.* Ottawa: Queen's Printer

Royal Commission on Financial Management and Accountability
1979. *Final Report.* Ottawa: Department of Supply and Services

Royal Commission on Taxation
1966. *Report* (Carter Report). 3 vols. Ottawa: Queen's Printer

Royal Commission on the Economic Union and Development Prospects for Canada (Macdonald Commission)
1985. *Report.* 3 vols. Ottawa: Minister of Supply and Services Canada

Statistics Canada
1970–1992. *Income Distributions by Size in Canada.* Cat. 13-207. Ottawa
1986. *The Distribution of Wealth in Canada, 1984.* Cat. 13-580. Ottawa: Ministry of Supply and Services
1987. *Income Distributions by Size in Canada 1986.* Cat. 13-207. Ottawa: Minister of Supply and Services
1989. *Labour Force Annual Averages, 1981–1988.* Cat. 71-529. Ottawa: Minister of Supply and Services
1990a. *Advance Statistics of Education.* Cat. 81-220. Ottawa: Minister of Supply and Services Canada
1990b. *Highlights: Disabled Persons in Canada.* Health and Activity Limitation Survey, Cat. 82-602. Ottawa: Minister of Regional Industrial Expansion
1990c. *A Portrait of Seniors in Canada.* Cat. 89-519. Ottawa: Minister of Supply and Services
1991a. *Canadians in the Pre-retirement Years: A Profile of People Aged 55–64.* Cat. 89-521E. Ottawa: Minister of Industry, Science and Technology
1991b. "Pension Plans in Canada, January 1, 1990." *The Daily,* 19 July, 9–10

Canada. Statistics Canada (cont.)
1991c. *Provincial Economic Accounts, Annual Estimates, 1986-1990.* Cat. 13-213. Ottawa: Minister of Supply and Services Canada
1992a. *Canada's Men: A Profile of their 1988 Labour Market Experience.* Cat. 71-206. Ottawa: Minister of Industry, Science and Technology
1992b. *Canada's Women: A Profile of their 1988 Labour Market Experience.* Cat. 71-205. Ottawa: Minister of Industry, Science and Technology
1992c. *Families: Number, Type and Structure.* Cat. 93-312. Ottawa: Minister of Industry, Science and Technology
1992d. *Income Distributions by Size in Canada 1991.* Household Surveys Division, Cat. 13-207. Ottawa: Minister of Supply and Services
1992e. *Public Finance Historical Data, 1965/66–1991/92.* Cat. 68-512. Ottawa: Minister of Industry, Science and Technology
1992f. *Quarterly Demographic Statistics.* Cat. 91-002. Ottawa: Minister of Industry, Trade and Technology
1992g. *Report on the Demographic Situation in Canada, 1992.* Cat. 91-209E. Ottawa: Minister of Industry, Science and Technology
1993a. *Book Publishing, 1991–92.* Cat. 87-210. Ottawa: Minister of Industry, Science and Technology
1993b. *Consumer Prices and Price Indexes,* 18(4). Cat. 62-010. Ottawa: Minister of Industry, Trade and Technology
1993c. *Earnings of Men and Women, 1991.* Household Surveys Division, Cat 13-217. Ottawa: Minister of Industry, Science and Technology
1993d. *Employment Income by Occupation.* Cat. 93-332. Ottawa: Minister of Industry, Science and Technology
1993e. *Families: Social and Economic Characteristics.* 1991 Census of Canada. Cat. 93-320. Ottawa: Minister of Industry, Science and Technology
1993f. *Historical Labour Force Statistics, 1992.* Cat. 71-201. Ottawa: Minister of Industry, Science and Technology
1993g. *Labour Force Activity of Women by Presence of Children.* Cat. 93-325. Ottawa: Minister of Industry, Science and Technology
1993h. *Labour Force Annual Averages, 1992.* Cat. 71-220. Ottawa: Minister of Industry, Science and Technology
1993i. *National Income and Expenditure Accounts.* Cat. 13-001. Quarterly. Ottawa: Minister of Industry, Trade and Technology
1993j. *Periodical Publishing, 1991–92.* Cat. 87-203. Ottawa: Minister of Industry, Science and Technology
1993k. *Provincial Economic Accounts, Annual Estimates.* Cat. 13-213. Ottawa: Minister of Industry, Trade and Technology
1993l. *Provincial Gross Domestic Product by Industry, 1984–1992.* Cat. 15-203. Annual. Ottawa

Canada. Statistics Canada (cont.)
1993m. *Statistics Canada Low Income Cut-offs.* Household Surveys Division. Ottawa: Minister of Industry, Science and Technology
1993n. *Women in the Workplace.* 2nd ed. Cat. 71-534. Ottawa: Ministry of Industry, Trade and Technology

Canada Consulting Group. 1992. "Under-funding the Future: Canada's Cost of Capital Problem." Paper prepared for the National Advisory Board on Science and Technology
Canadian Advisory Council on the Status of Women. 1987. *Brief on Tax Reform Presented to the Standing Committee on Finance and Economic Affairs and Analysis of the Committee Findings.* Ottawa: Canadian Advisory Council on the Status of Women
Canadian Association of Community Living. 1993. Brief to the Fair Tax Commission, 14 May 1993
Canadian Booksellers Association. 1993. "Brief to the Ontario Fair Tax Commission Concerning Retail Sales Taxes on Reading Materials and Business and Property Taxes on Bookstores." Submitted 17 May 1993
Canadian Federation of Independent Business. 1991. *The Small Business Sector in Ontario.* Toronto: CFIB
Canadian Institute for Research. 1981. *Matrimonial Support Failures: Reasons, Profiles and Perceptions of Individuals Involved.* Edmonton: University of Alberta Institute of Law Research and Reform
Canadian Tax Foundation. 1991. *National Finances, 1990.* Toronto
Canadian Tax Foundation. 1992a. *The National Finances, 1992.* Toronto
Canadian Tax Foundation. 1992b. *Provincial and Municipal Finances, 1991.* Toronto
Caragata, Patrick. 1991. "An Analysis of the Cost Effectiveness of the Profits Based Royalty Regimes in Ten Canadian Jurisdictions and Australia's Northern Territory." Wellington, N.Z.: Ministry of Commerce
Carey, David, Jean-Claude Chouraqui, and Robert P. Hagemann. 1993. "The Future of Capital Income Taxation in a Liberalized Financial Environment." *Economics Department Working Paper No. 126.* Paris: Organisation for Economic Co-operation and Development
Carter, George E. 1973. "Federal Abandonment of the Estate Tax: The Intergovernmental Fiscal Dimension." *Canadian Tax Journal*, 21: 232–46
Carter Report. *See* Canada. Royal Commission on Taxation
Cassin, A. Marguerite. 1993. "Equitable and Fair: Widening the Circle." In *Fairness in Taxation: Exploring the Principles*, ed. Allan M. Maslove, 104–34. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press
CCH. *See* Commerce Clearing House

Chen, Duanjie, and Jack Mintz. 1993. "Taxation of Capital in Ontario and Canada: An Interindustry and Interprovincial Comparison." In *Business Taxation in Ontario*, ed. Allan M. Maslove, 3-42. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

CH2M Hill Engineering Ltd., with Synergic Resources Corporation. 1992. "A CRD–Wide User-Pay System for Solid Waste." Study prepared for British Columbia, Department of Environment

Cnossen, Sijbren. 1989. "The Technical Superiority of VAT over RST." In *Australian Tax Reform in Retrospect and Prospect*, ed. J.G. Head. Sydney: Australian Tax Research Foundation

– 1992 "Misunderstanding VAT: A Comment on 'The Presumed Technical Superiority of VAT.'" *Australian Tax Forum*, 9(3)

Coalition of Provincial Organizations of the Handicapped. 1989. "Presentation to Standing Committee on Finance, Goods and Service Tax." September. Mimeo

Coe, David. 1991. "Structural Determinants of the Natural Rate of Unemployment in Canada." *IMF Staff Papers* (March), 94–115

Commerce Clearing House (CCH). 1992. *Tax Reporter*.

Commerce Clearing House (CCH). 1993. *State Tax Guide*.

Commission of the European Communities (CEC). 1992. *Conclusions and Recommendations of the Committee of Independent Experts on Company Taxation*. Luxembourg: Office for Official Publications of the European Communities

Conference Board of Canada. 1993. *Canadian Outlook: Economic Forecast*, 8(4), summer

Conklin, David, and John Whalley. n.d. "The Ontario Tax System in the Global Economy of the 1990s." In *The Economic and Social Environment for Tax Reform*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Coopers & Lybrand Canada. 1993. *Tax Facts and Figures 1993*.

Corporate Minimum Tax Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

Courchene, Thomas J., and Arthur E. Stewart. 1991. "Provincial Personal Income Taxation and the Future of the Tax Collection Agreements." In *Provincial Public Finances: Plaudits, Problems, and Prospects*, ed. Melville McMillan, vol. 2. Toronto: Canadian Tax Foundation

Couzin, Robert. 1992. "Tax Options for Competitiveness." In *1991 Conference Report*, 7:1–7:21. Toronto: Canadian Tax Foundation

Dahlby, Bev. 1993. "Payroll Taxes." In *Business Taxation in Ontario*, ed. Allan M. Maslove, 80-170. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Daigneault, Jean. 1993. "Putting Aside Budget Secrecy." *Policy Options*, 14(5): 21–24

Daly, Michael. 1992. "Harmonization of Corporate Taxes in a Single European Market: Recent Development and Prospects." *Canadian Tax Journal*, 40(5): 1051–85

Daly, Michael, Pierre Mercier, and Thomas Schweitzer. 1989. *The Taxation of Income from Capital in Canada*. Ottawa: The Economic Council of Canada

Davies, James. n.d. "Equity and Tax Mix: Theoretical Perspectives." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Davies, James, and David Duff. n.d. "Wealth Tax Proposals: Distributional Impact and Revenue Potential." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press, Forthcoming

Day, Kathleen M., and Stanley M. Winer. n.d. "Internal Migration and Public Policy: An Introduction to the Issues and a Review of Empirical Research on Canada." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Diamond, Peter, and James Mirrlees. 1971. "Optimal Taxation and Public Production, I: Production and Efficiency; II: Tax Rules." *American Economic Review*, 61: 8–27, 262–78

Dobson, Wendy. 1992. "North American Economic Integration in the 1990s." In *Long Term Prospects for the World Economy*, 101–17. Paris: Organisation for Economic Co-operation and Development

Doern, G. Bruce. n.d. "Fairness, Budget Secrecy and Pre-Budget Consultation in Ontario." In *Taxing and Spending: Issues of Process*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Doern, G. Bruce, Allan M. Maslove, and Michael Prince. 1988. *Budgeting in Canada: Politics, Economics and Management*. Ottawa: Carleton University Press

Donner, Arthur, and Fred Lazar, n.d. "The Economic Effects of an Environment Tax." In *Taxes as Instruments of Public Policy*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Douglas, Alan. 1990. "Changes in Corporate Tax Revenue." *Canadian Tax Journal*, 38 (January/February): 66–81

Drache, Daniel, ed. 1992. *Getting on Track: Social Democratic Strategies for Ontario*. Montreal and Kingston: McGill–Queen's University Press

Due, John F. 1957. *Sales Taxation*. London: Routledge and Kegan Paul

– 1986. "The Choice Between a Value-Added Tax and a Retail Sales Tax." In *Report of Proceedings of the Thirty-seventh Tax Conference*, 16: 1–10. Toronto: Canadian Tax Foundation

Duff, David G. 1993. "Taxing Inherited Wealth: A Philosophical Argument." *Canadian Journal of Law and Jurisprudence*, VI (1) 3–62

Dungan, Peter. n.d. "The Economic Environment for Tax Reform in Ontario." In *The Economic and Social Environment for Tax Reform*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

–´n.d. "The Macroeconomic Impacts of Harmonizing the Ontario Retail Sales Tax with the Federal GST: Simulations with the Focus-Ontario Model." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Economic Council of Canada. 1987a. *Innovation and Jobs in Canada*. Ottawa

– 1987b. *Road Map for Tax Reform: The Taxation of Savings and Investment*. Ottawa: Supply and Services Canada

– 1990. *Globalization and Canada's Financial Markets*. Ottawa: Supply and Services Canada

Eden, Lorraine. n.d. *Transfer Pricing, Taxes, and Free Trade in North America*. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Eisenstein, Louis. 1956. "The Rise and Decline of the Estate Tax." *Tax Law Review*, 11: 256, 223–59

Environment and Taxation Working Group. 1992a. *First Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

– 1992b. *Final Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

Erard, Brian, and François Vaillancourt. 1993. "The Compliance Costs of a Separate Personal Income Tax System for Ontario." In *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, 37–170. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Ernst & Young. 1990. *The Wealth Report*. 2 vols. Toronto: Ernst & Young Management Consultants

– 1993a. "Corporate and Personal Tax Comparisons." Research paper prepared for the Fair Tax Commission. Mimeo. Toronto

– 1993b. The Impact of Taxes on Business Locations." In *Business Taxation in Ontario*, ed. Allan M. Maslove, 171–211. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

– 1993c. *Jewellery Excise Tax Study*. Toronto

Ernst & Young and Ministry of Natural Resources, Forest Values Staff. 1992. *Comparative Approaches to Funding Forest Management Activities*. Ontario: Queen's Printer for Ontario

Etzioni, Amitai. 1993. "Deficit Reduction in a Populist Age: How to Sell Shared Sacrifice." *Challenge*, 36(2): 22–25

Fagan, Drew. 1993. "A Walk through the Land of GATT." *Globe and Mail* (Toronto), 12 December, B4

Fair Tax Commission. *See* Ontario. Fair Tax Commission

Federal/Provincial/Territorial Family Law Committee (Canada). 1992. *The Financial Implications of Child Support Guidelines: Research Report*. Ottawa: The Committee

Fédération des Caisses populaires de l'Ontario Inc. 1993. "Commission sur l'équité fiscale, Mémoire." Submitted 2 June 1993

Fitzgerald, J.D., T.P. Quinn, B.J. Whelan, and J.A. Williams. 1988. *An Analysis of Cross-Border Shopping*. Dublin: The Economic and Social Research Institute

Galarneau, Diane. 1993. "Alimony and Child Support." *Canadian Social Trends*, 28: 8–11

General Agreement on Tariffs and Trade (GATT). 1992. *Trade Policy Review: Canada, 1992*. Geneva

George, H. [1879] 1975. *Progress and Poverty*. Reprint. New York: Robert Schalkenbach Foundation

Gillespie, W. Irwin. 1991. *Tax, Borrow and Spend: Financing Federal Spending in Canada, 1867-1990*. Ottawa: Carleton University Press

Goelman, Hillel, et al. 1993. *Where are the Children? An Overview of Child Care Arrangements in Canada*. Canadian National Child Care Study. Statistics Canada Cat. 89-572E. Ottawa

Good, David. 1980. *The Politics of Anticipation: Making Federal Tax Policy*. Ottawa: Carleton University School of Public Administration

Goode, Richard. 1991. "Should Reformers Aim at on Improved Income Tax or at an Expenditure Tax?" *Australian Tax Forum*, 8

Gordon, Roger H. 1992a. "Canada – U.S. Free Trade and Pressures for Tax Coordination." In *Canada – U.S. Tax Comparisons*, ed. John Shoven and John Whalley, 75–96. Chicago: University of Chicago Press

– 1992b. "Can Capital Income Taxes Survive in Open Economies?" *Journal of Finance*, 47(3):1159–80

Graham, John F. 1991."The Place of the Property Tax in the Fiscal System." In *Retrospectives on Public Finance*, ed. L. Eden, 149–67. Durham, N.C.: Duke University Press

Gray, John A. 1992. "Forest Revenue Mechanisms and Pricing Policies." Ontario: Ministry of Natural Resources

Green, Leslie. 1993. "Concepts of Equity in Taxation." In *Fairness in Taxation: Exploring the Principles*, ed. Allan M. Maslove, 87–103. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Gunderson, Morley, and Leon Muszynski. 1990. *Women and Labour Market Poverty*. Ottawa: Canadian Advisory Council on the Status of Women

Gunderson, Morley, and Wayne Thirsk. n.d. "Tax Treatment of Human Capital." In *Taxes as Instruments of Public Policy*, ed. Allan M. Maslove. Fair

Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Gusen, Peter. 1978. *The Role of Provincial Governments in Economic Stabilization: The Case of Ontario's Auto Sales Tax Rebate.* Ottawa: Conference Board of Canada

Haig, R.M. 1921. *The Federal Income Tax.* New York: Columbia University Press

Hamermesh, D.S. 1980. "Factor Market Dynamics and the Incidence of Taxes and Subsidies." *Quarterly Journal of Economics,* 95: 751–64

Hamilton, Bob, Chun-Yan Kuo, and Satya N. Poddar. 1988. "Considerations for the Tax Mix." *Osgoode Hall Law Journal,* 26(2): 159–285

Hare, R.M. 1978. "Justice and Equality." In *Justice and Economic Distribution,* ed. J. Arthur and W. H. Shaw, 116–31. Englewood Cliffs, N.J.: Prentice Hall

Hartle, Douglas G. 1971. *Taxation of the Incomes of Married Women.* Royal Commission on the Status of Women in Canada, Studies, 5. Ottawa: Information Canada

– 1983. *A Separate Personal Income Tax for Ontario: An Economic Analysis.* Toronto: Ontario Economic Council

– 1993. "The Federal-Provincial Tax Collection Agreements: Personal Income Tax Coordination, A Background Report." In *Taxation in a Sub-National Jurisdiction,* ed. Allan M. Maslove, 81–136. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Hatch, James, Larry Wyant, and Mary Jane Grant. 1983. "Federal Lending Programs for Small Business: No Longer Needed." *Canadian Public Policy,* 9(3)

Head, John G. 1993. "Tax-Fairness Principles: A Conceptual, Historical, and Practical Review." In *Fairness in Taxation: Exploring the Principles,* ed. Allan M. Maslove, 3–62. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Hill, Roderick, and Michael Rushton. 1993. "Harmonizing Provincial Sales Taxes with the GST: The Problem of Interprovincial Trade." *Canadian Tax Journal,*41(1): 101–22

Hobson, P.A.R. 1991. "Local Government in Canada: Creature, Chameleon, Consort." In *Provincial Public Finances: Plaudits, Problems, and Prospects,* ed. Melville McMillan, vol. 2. Toronto: Canadian Tax Foundation

Holland, Douglas A. 1992. "Issues Paper on Not-for-Profit Co-operatives." Report prepared for the Fair Tax Commission. Mimeo. Toronto

Hopcroft Committee. *See* Ontario. Ministry of Municipal Affairs. 1991

Ingerman, S., and R. Rowley. 1993. "Tax Expenditures for Retirement Savings: An Appraisal." Working Papers in Economics, McGill University

Innes, Stephanie, and Danielle Bochove. 1992. "Cross-border Shopping Is Over for Now." *Globe and Mail* (Toronto), 14 December

Institute for Fiscal Studies. 1978. *The Structure and Reform of Direct Taxation: Report of a Committee chaired by Professor J.E. Meade*. London: George Allen & Unwin

Intergovernmental Working Group on the Mineral Industry. 1992a. *Canada's Mineral Taxation System Compared*. Background Study No. 13 on The Canadian Mineral Investment Climate. Ottawa: Minister of Energy Mines and Resources

– 1992b. "The Canadian Mineral Industry in a Competitive World: A Report On Canada's Mineral Industry and the Global Investment Climate." Submitted for discussion at the Mines Ministers' Conference, Whitehorse, Yukon. Ottawa: Minister of Energy, Mines and Resources

International Bureau of Fiscal Documentation. 1993. *Bulletin for International Fiscal Documentation*. Amsterdam

International Energy Agency. 1992. *Energy Prices and Taxes (Third Quarter 1991)*. Paris: Organisation for Economic Co-operation and Development

Ip, Irene K. 1991. *Big Spenders: A Survey of Provincial Government Finances in Canada*. Toronto: C.D. Howe Institute

Ip, Irene K., and Jack M. Mintz. 1992. *Dividing the Spoils: The Federal–Provincial Allocation of Taxing Powers*. Toronto: C.D. Howe Institute

Iqbal, Mahmood. 1993. *Canada–U.S. Tax Competitiveness in Manufacturing Industries*. Ottawa: Conference Board of Canada

Jackson, Chris. 1992. "The Value of Household Work in Canada, 1986." *Canadian Economic Observer*. Statistics Canada, Cat. 11-010. June, 3.1–3.19

James, S., and C. Nobes. 1983. *The Economics of Taxation*. Oxford: Philip Allan

Johnson, Barry W. 1990. "Estate Tax Returns, 1986–1988." *Statistics of Income Bulletin*, 9(4): 27–61

Kesselman, Jonathan R. n.d. "Compliance, Enforcement, and Administrative Factors in Improving Tax Fairness." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies.Toronto: University of Toronto Press. Forthcoming

– 1993. "Evasion Effects of Changing the Tax Mix." Centre for Research on Economic and Social Policy, Discussion Paper No. 93-01. Department of Economics, University of British Columbia. Vancouver

Killingsworth, Mark R., and James J. Heckman. 1986. "Female Labour Supply: A Survey." In *Handbook of Labour Economics*, ed. Orley Ashenfelter and Richard Layard, vol. 1, 103–204. Amsterdam: North Holland

Kitchen, Harry. 1987. "Property Tax as a Tax on Wealth: Some New Evidence." *Canadian Tax Journal*, 35(4): 953–63

– 1992. *Property Taxation in Canada*. Canadian Tax Paper, no. 92. Toronto: Canadian Tax Foundation

Kitchen, Harry, and Melville L. McMillan. 1985. "Local Government and Canadian Federalism." In *Intergovernmental Relations*, ed. Richard Simeon. Royal Commission on the Economic Union and Development Prospects for Canada, Collected Research Studies, vol. 63. Toronto: University of Toronto Press

Kitchen, Harry, and Enid Slack. n.d. "The Taxation of Non-Residential Property." In *Financing Local Government*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

KPMG Peat Marwick Thorne. 1992. "Wealth Transfer Taxation: Planning and Avoidance Techniques." Research paper prepared for the Fair Tax Commission. Mimeo. Toronto

Krever, Rick, and Neil Brooks. 1990. *A Capital Gains Tax for New Zealand*. Wellington, N.Z.: Victoria University Press

Kroft, Edwin G. 1989. "Splitting and Shifting Tax Benefits: A Guide for the Perplexed Practitioner." In *Report of Proceedings of the Fortieth Tax Conference Convened by the Canadian Tax Foundation*, 32:1–32:94. Toronto: Canadian Tax Foundation

LaForest, Gerard V. 1981. *The Allocation of Taxing Power under the Canadian Constitution*. 2nd ed. Toronto: Canadian Tax Foundation

Lahey, Kathleen A. 1992. "The Tax Unit Debate: Basic Structural Choices." Research Paper prepared for the Fair Tax Commission. Mimeo

La Novara, Pina. 1993. "Changes in Family Living." *Canadian Social Trends*, summer. Statistics Canada, Cat. 11-008E

Lazear, Edward P., and Robert T. Michael. 1990. "Real Income Equivalence among One-Earner and Two-Earner Families." *American Economic Review*, 70(2): 203 – 208

Leccisotti, Mario, and Mauro Mare. 1992. "On the Presumed Technical Superiority of VAT." *Australian Tax Forum*, 9(3): 259–76

Leong, G.S., J.C. White, A.W. Ahern, and P.J. Neff. 1992. *Facts and Figures on Government Finance, 1992 Edition*. Washington, DC: Tax Foundation

Leslie, Peter M. 1993. "The Fiscal Crisis of Canadian Federalism." In Peter M. Leslie, Kenneth Norrie, and Irene K. Ip, *A Partnership in Trouble: Renegotiating Fiscal Federalism*. Toronto: C.D. Howe Institute

Lindquist, Evert A. n.d. "Improving the Scrutiny of Tax Expenditures in Ontario: Comparative Expenditures and Recommendations." In *Taxing and Spending: Issues of Process*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

– 1985. *Consultation and Budget Secrecy*. Ottawa: Conference Board of Canada

Low Income Tax Relief Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

MacDonald, W.A., and G.E. Cronkwright, eds. 1993. *Income Taxation in Canada*. Scarborough, Ont: Prentice-Hall

Macdonald Commission. *See* Canada. Royal Commission on the Economic Union and Development Prospects for Canada

Mackenzie, Brian W., and Michael D. Doggett. 1992. *Economic Potential of Mining in Manitoba: Developing Taxation Policy.* Technical Paper No. 12. Kingston: Centre For Resource Studies

Mackenzie, J., Roger Dower, and Donald Chen. 1992. *The Going Rate: What It Really Costs to Drive.* Washington: World Resources Institute

McKenzie, Kenneth J. 1991. "The Taxation of Non-renewable Resources: An Overview of the Literature." Study prepared for the Ontario Fair Tax Commission. Mimeo

McKeough, W. Darcy. 1978. "Remarks by the Honourable W. Darcy McKeough, Treasurer of Ontario, on Property Tax Reform." Toronto: Ontario Ministry of Treasury, Economics and Intergovernmental Affairs

MacKnight, Robin J. 1991. "Square Pegs and Round Holes: Environmental Cost under the Income Tax Act." Toronto: Gowling, Strathy and Henderson. Mimeo

Magee, Joanne E. 1992. "Personal Tax Planning: Tax Planning for the Disabled and Elderly and Their Caregivers." *Canadian Tax Journal*, 40 (6): 1364–83

Maloney, Maureen n.d. "What is the Appropriate Tax Unit for the 1990s and Beyond." In *Issues in the Taxation of Individuals*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

– 1987. *Background Paper: Women and Income Tax Reform.* Ottawa: Canadian Advisory Council on the Status of Women

– 1988. "Distributive Justice: That Is the Wealth Tax Issue." *Ottawa Law Review*, 20(3): 601–35

– 1989. "Women and the Income Tax Act: Marriage, Motherhood, and Divorce." *Canadian Journal of Women's Literature*, 3(1): 182–210

– 1991. "The Case for Wealth Taxation." *Canadian Public Administration*, 34(2): 241–59

Marshall, Koenig & Associates. 1991. "Background Study on the Pricing of Water and Sewer Services." Prepared for the Ontario Ministry of Municipal Affairs. Mimeo

Maslove, Allan M. 1992. "Reconstructing Fiscal Federalism." In *How Ottawa Spends, 1992*, ed. F. Abele, 57–77. Ottawa: Carleton University Press

– ed. 1993. *Fairness in Taxation: Exploring the Principles.* Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Maslove, Allan M., Michael Prince, and G. Bruce Doern. 1985. *Federal and Provincial Budgeting.* Royal Commission on the Economic Union and Development Prospects for Canada, Collected Research Studies, Vol. 41. Toronto: University of Toronto Press

Mercredi, Ovide. 1991. Special address to "Indian Governments and Tax: A Conference Exploring the Nature and Powers of Tax." *Highlights Report*, 12–15 November. Whistler, B.C.

Millyard, Kai. 1992. "Preliminary Assessment of the Impact of Proposed Changes to the Ontario Tax for Fuel Conservation." Toronto: Ontario Global Warming Coalition

Mintz, Jack M. 1990. "Corporate Tax Holidays and Investment." *The World Bank Economic Review*, 4: 81–102

Mintz, Jack M., and Jesús Seade. 1989. *Cash Flow or Income? The Choice of Base for Company Taxation*. PPR Working Paper. Washington D.C.: World Bank, Country Economics Department

Mintz, Jack M., and Thomas A. Wilson. 1991. "The Allocation of Tax Authority in the Canadian Federation." In *Economic Dimensions of Constitutional Change*, ed. Robin W. Boadway, Thomas J. Courchene, and Douglas D. Purvis, vol. 1. Kingston: John Deutsch Institute for the Study of Economic Policy

Mowery, David C., and Nathan Rosenberg. 1989. *Technology and the Pursuit of Economic Growth*. New York: Cambridge University Press

Municipal Finance Officers' Association of Ontario. 1989. "Business Assessment and Taxation in Ontario: Future Options." Submitted to the Business Assessment Review Committee

Munnell, Alicia H. 1980. "The Couple Versus the Individual under the Federal Personal Income Tax." In *The Economics of Taxation*, eds. Henry J. Aaron and Michael J. Boskin, 247–78. Washington, D.C.: The Brookings Institution

– 1992. "Taxation of Capital Income in a Global Economy: An Overview." *New England Economic Review*, September/October, 33–52

Murphy, Brian B., and Michael C. Wolfson. n.d. "Pensions, Deficits, and Ageing: Impacts for Ontario's Residents." In *The Economic and Social Environment for Tax Reform*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Murphy, Brian B., Michael C. Wolfson, and Ross Finnie. n.d. "A Profile of High-Income Ontarians." In *Taxation and the Distribution of Income*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming

Musgrave, Peggy B. 1991. "Fiscal Coordination and Competition in an International Setting." In *Retrospectives on Public Finance*, ed. L. Eden, 276–305. Durham, N.C.: Duke University Press

Musgrave, Richard A. 1959. *The Theory of Public Finance*. Toronto: McGraw-Hill

– 1985. "A Brief History of Fiscal Doctrine." In *Handbook of Public Economics*, ed. A.J. Auerbach and M. Feldstein, vol. 1. Amsterdam: North Holland

Musgrave, Richard A., and Peggy B. Musgrave. 1993. "Tax Equity with Multiple Jurisdictions." In *Taxation in a Sub-National Jurisdiction*, ed. Allan M. Maslove, 3–43. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Musgrave, Richard A., Peggy B. Musgrave, and Richard M. Bird. 1987. *Public Finance in Theory and Practice.* 1st Canadian ed. Toronto: McGraw-Hill Ryerson

Nakamura, A., and M. Nakamura. 1981. "A Comparison of Labour Force Behaviour of Married Women in the United States and Canada, with Special Attention to the Impact of Income Taxes." *Econometrica,* 49(2): 451–89

National Book Committee. 1993. Submission to the Chancellor of the Exchequer. Excerpted in *The Bookseller,* 19 February

Nelson, J. 1991. "Tax Reform and Feminist Theory in the United States: Incorporating Human Connection." *Journal of Economic Studies,* 18(5/6): 11–29

Norrie, Kenneth. 1993. "Intergovernmental Transfers in Canada." In *A Partnership in Trouble: Renegotiating Fiscal Federalism,* 87–129. Policy Study 18. Toronto: C.D. Howe Institute

Nowlan, D.M. 1993. "Local Taxation as an Instrument of Policy." In *The Changing Canadian Metropolis,* ed. F. Frisken. Forthcoming

OECD. *See* Organisation for Economic Co-operation and Development

Ontario

1970 to 1993. *Ontario Budget.* Toronto: Queen's Printer for Ontario

1985. *Report of the Commission on the Financing of Elementary and Secondary Education in Ontario.* Chair, Ian H. Macdonald. Toronto: Queen's Printer for Ontario

1992. *An Industrial Policy Framework for Ontario.* Toronto: Queen's Printer for Ontario

Advisory Committee on Succession Duties (Langford Committee)

1973. *Report.* February 23. Toronto: Ministry of Revenue.

Committee on Taxation (Smith Committee)

1967. *Report.* 3 vols. Toronto: Queen's Printer for Ontario.

Fair Tax Commission

1991. "Position on the Federal Discussion Paper on Personal Income Tax Co-ordination." Mimeo. Toronto

1993. *Discussion Paper: Searching for Fairness.* Toronto: Fair Tax Commission

Legislative Assembly. Standing Committee on Finance and Economic Affairs

1987–92. *Pre-Budget Consultation.* Reports for 1987 to 1992

Ministry of the Attorney General

1992. "Family Support Plan Information Sheet, April 2, 1992." Mimeo

Ontario (cont.)
Ministry of Citizenship
1990. *Statistical Profile of Disabled Persons in Ontario.* 2 vols. Toronto: Queen's Printer for Ontario

Ministry of Community and Social Services
1988. *Transitions.* Report of the Social Assistance Review Committee. Toronto: Queen's Printer for Ontario
1992a. *Child Care Reform in Ontario, Setting the Stage: A Public Consultation Paper.* Toronto: Queen's Printer for Ontario
1992b. *Summary of Consultations on Child Care Reform.* Toronto: Queen's Printer for Ontario

Ministry of Education
1971-92. "School Boards Financial Statements 1970 to 1992." Mimeo

Ministry of Environment
1988. *The Extra-Strength Sewer Surcharge to Regulate Industrial Sanitary Sewer Users.* Toronto: Queen's Printer for Ontario
1991a. *The Physical and Economic Dimensions of Municipal Solid Waste Management in Ontario.* Toronto: Queen's Printer for Ontario
1991b. *Water and Sewer Financing in Ontario: Issues and Options.* Toronto: Queen's Printer for Ontario
1993a. *Market Assessment of 3Rs Activities in Ontario.* Toronto: Queen's Printer for Ontario
1993b. *True Costs of Municipal Waste Management.* Toronto: Queen's Printer for Ontario

Ministry of Finance
1993a. *1993 Ontario Budget.* Toronto: Queen's Printer for Ontario
1993b. *Improving Tax Fairness: A Corporate Minimum Tax for Ontario. Supplementary paper, 1993 Ontario Budget.* Toronto: Queen's Printer for Ontario

Ministry of Finance. Office of Economic Policy
1992. *Literature Survey: Relationship between R&D and Productivity.* Toronto
1993. "Economic Conditions: Labour Markets." 8 October. Mimeo

Ministry of Municipal Affairs. *Municipal Financial Information. See* Data Sources

Ontario (cont.)
Ministry of Municipal Affairs
1988. *Summary of Ontario Municipal Statistics: 1977–1986.* Toronto: Queen's Printer for Ontario
1990. *1990 Financial Information Return.* Toronto: Queen's Printer for Ontario
1991. *Report of the Advisory Committee to the Minister of Municipal Affairs on the Provincial-Municipal Financial Relationship* (Hopcroft Committee). Toronto: Queen's Printer for Ontario
1992a. *Municipal Financial Information (1990).* Toronto: Queen's Printer for Ontario
1992b. *Municipal Waste Management Powers in Ontario: A Discussion Paper.* Toronto: Queen's Printer for Ontario

Ministry of Natural Resources
1993a. "Forestry Program Expenditures." Mimeo
1993b. "Ontario Timber Revenues: The Present System and Its History." Draft. Toronto

Ministry of Revenue
1991a. "Changing Federal-Provincial Partnerships: A Comparison of the Terms and Provisions of the Canada-Quebec GST Agreement and the Federal-Provincial Tax Collection Agreement." In "Aspects of Personal Income Taxation in Ontario, Paper #4." Toronto
1991b. "Property Assessment Program Organization, Operations, and Current Issues." Background briefing note

Ministry of Treasury and Economics
1971 to 1992. *Public Accounts, 1971–72 to 1991–92.* Toronto: Queen's Printer for Ontario
1985. *Reforming the Budget Process: A Discussion Paper.* Toronto: Queen's Printer for Ontario
1986. *Ontario Statistics 1986.* Toronto: Queen's Printer for Ontario
1989a. *Economic Outlook and Fiscal Review.* Toronto: Queen's Printer for Ontario
1989b. *1989 Ontario Budget.* Toronto: Queen's Printer for Ontario
1991a. "Corporate Tax Competitiveness: A Case Study Approach." Toronto: Taxation Policy Branch
1991b. *1990–1991 Public Accounts of Ontario,* vol. 1. Toronto: Queen's Printer for Ontario
1991c. *1991 Ontario Budget.* Toronto: Queen's Printer for Ontario
1991d. *Ontario's Economic Outlook.* Toronto: Queen's Printer for Ontario

Ontario. Ministry of Treasury and Economics (cont.)
1991e. "Overview of the Ontario Tax System." Draft. 20 March. Mimeo
1992a. "Budget Paper D: Federal-Provincial Programs: The Need for Change." In *1992 Ontario Budget*. Toronto: Queen's Printer for Ontario
1992b. *1992 Ontario Budget*. Toronto: Queen's Printer for Ontario
1992c. *Ontario's Fiscal Outlook*. Toronto: Queen's Printer for Ontario
1992d. *Public Accounts of Ontario 1991–1992*. 3 vols. Toronto: Queen's Printer for Ontario

Ministry of Treasury and Economics. Taxation Policy Branch
1992. "FTC Presentation: Low-Income RST and Property Tax Assistance Programs." Mimeo

Ministry of Treasury, Economics, and Intergovernmental Affairs
1977. *Report of the Commission on the Reform of Property Taxation in Ontario* (Blair Commission). Toronto: Queen's Printer for Ontario

Office of the Provincial Auditor
1992. *1992 Annual Report*. Toronto: Queen's Printer for Ontario

Ontario Training and Adjustment Board
1991. *Skills to Meet the Challenge: A Training Partnership for Ontario*. November

Premier's Council on Economic Renewal
1992. *Comparative Indicators of Ontario's Performance*. Toronto: Premier's Council on Economic Renewal
1993. *Ontario 2002: A Report of the Task Force to Review the Ontario Technology Fund in the Context of an Innovation-Based Society* ... Toronto

Premier's Council on Technology
1988. *Competing in the New Global Economy*. Toronto: Premier's Council

Public Accounts. See Ontario Ministry of Treasury and Economics

Treasurer of Ontario
1992. *The 1992 Ontario Budget Guidebook*. Toronto: Ministry of Treasury and Economics

Treasury
1961. *Budget Statement*. Toronto

Ontario Restaurant Association. 1992. Submission to the RST/GST Working Group. 13 February 1992

Ontario Round Table on Environment and Economy. 1992. *Restructuring for Sustainability*. Toronto: Ontario Round Table on Environment and Economy

Organisation for Economic Co-operation and Development (OECD). 1988. *Taxation of Net Wealth, Capital Transfers and Capital Gains of Individuals*. Paris: OECD

– 1992a. *Industrial Policy in OECD Countries, Annual Review 1992*. Paris: OECD

– 1992b. *OECD Economic Surveys, Canada 1991/92*. Paris: OECD

– 1992c. *Revenue Statistics of OECD Member Countries, 1965–1991*. Paris: OECD

Osberg, Lars. 1993. "What's Fair? The Problem of Equity in Taxation." In *Fairness in Taxation: Exploring the Principles*, ed. Allan M. Maslove, 63–85. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Osten, James A., George Vasic, and David West. 1991. *Carbon Dioxide Emissions and Federal Energy Policy: A Discussion of the Economic Consequences of Alternative Taxes*. Prepared for Imperial Oil Ltd. Toronto: DRI/McGraw-Hill

O'Toole, R.P., and A.L. Walton. 1982. "Intergenerational Equity as It Relates to Conservation and Coal Extraction Standards." *Natural Resource Journal*, 22: 53–69

Panitch, Leo. 1993. "Beyond the Crisis of the Tax State? From Fair Taxation to Structural Reform." In *Fairness in Taxation: Exploring the Principles*, ed. Allan M. Maslove, 135–59. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Pannell Kerr Forster. 1992. "Market Value Re-assessment: An Analysis of the Implications and Impacts of Re-assessment on Hotels in Metropolitan Toronto, October 1992." Prepared for the Hotel Association of Metropolitan Toronto. Mimeo

Park, Norman. 1991. "Child Care in Ontario." In *The State of the Child in Ontario*, ed. R. Barnhorst and L. Johnson, 48–62. Toronto: Oxford University Press

Parsons, Robert B. 1991. *Canadian Mining Taxation*. Toronto: Price Waterhouse

Pechman, Joseph. 1987. *Federal Tax Policy*. 5th ed. Washington, D.C.: Brookings Institution

Pence, Alan R., ed. 1992. *Canadian National Child Care Study, Canadian Child Care in Context: Perspectives from the Provinces and Territories, Vol. 1*. Statistics Canada, Cat. 89-500A. Ottawa

Perry, David. 1986. "The Relative Importance of Personal and Corporate Income Taxation." *Canadian Tax Journal*, 34: 460–67

Poddar, Satya. 1988. "Issues in the Integration of Federal and Provincial Sales Taxes: A Canadian Perspective." Paper presented at the NTA-TIA Annual Symposium, Arlington, Virginia, 16–17 May

– 1992. "Taxation and Regulation." In *Taxation to 2000 and Beyond*, ed. Richard M. Bird and Jack M. Mintz. Toronto: Canadian Tax Foundation

Poddar, Satya, and Nancy Harley. 1989. "Problems in Moving from a Flawed to a Neutral and Broad-Based Consumption Tax." *Australian Tax Forum*, 6(3): 303–26

Porter, Michael, and the Monitor Company. 1991. *Canada at the Crossroads: The Reality of a New Competitive Environment.* Ottawa: Supply and Services Canada

Premier's Council. *See* Ontario. Premier's Council

Property Tax Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

Public Policy Forum. 1993. "Making Government Work." Ottawa. Mimeo

Quinn, J., and C. Gagnon. 1986. "Will Services Follow Manufacturing into Decline?" *Harvard Business Review*, 86 (November/December): 95–103

Rachamalla, K.S. 1992. "Comparison of the Federal Income Tax Act with the Ontario Corporations Tax Act and the Ontario Mining Tax Act." Prepared for Revenue Canada Taxation National Coordinating Meeting, 18 June, by the Mining Tax Office, Ontario Ministry of Revenue. North York

Ram, B. 1990. "Women's Employment and Child Care." In *Current Demographic Analysis: New Trends in the Family*. Statistics Canada, Cat. 91-535E. Ottawa: Minister of Supply and Services

Razin, Assaf, and Efraim Sadka. 1990. "Capital Market Integration: Issues of International Taxation." *National Bureau of Economic Research Working Paper No. 3281*. Washington: NEBR

Reich, Robert B. 1988. "Policy Making in a Democracy" In *The Power of Public Ideas*, ed. R. Reich, 123–56. Cambridge: Ballinger Publishing

– 1991. *The Work of Nations: Preparing Ourselves for the 21st Century*. New York: Alfred A. Knopf

Research Institute of America. 1993. *Highlights of Revenue Reconciliation Act of 1993*. Valhalla, N.Y.

Resource Information Systems, Inc. 1992. *Ontario Forest Products and Timber Resource Analysis*, vol. 1. Bedford, Mass.: Resource Information Systems, and Corvallis, Ore.: Resource Economics Inc.

Retail Sales Tax/Goods and Services Tax Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission

Ricardo, David. [1821] 1951. *On the Principles of Political Economy and Taxation*, ed. P. Sraffa and M.H. Dobb, vol. 1. Reprint. Cambridge: Cambridge University Press

Roeher Institute. 1992. "Comprehensive Disability Income Security Reform." Mimeo. Toronto

Rounds, Taryn A. 1992. "Tax Harmonization and Tax Competition: Contrasting Views and Policy Issues in Three Federal Countries." In *Publius: The Journal of Federalism*, 22(4): 91–120

Rowell-Sirois Commission. *See* Canada. Royal Commission on Dominion-Provincial Relations

Royal Bank of Canada. 1992. *Cross Border Shopping: Causes and Cures.* June

Ruggeri, G.C., R. Howard, D.Van Wart. 1993. "Structural Imbalances in the Canadian Fiscal System." *Canadian Tax Journal*, 41(3): 454–72

Ruggeri, G.C., D. Van Wart, G.K. Robertson, and R. Howard. 1993. "Vertical Fiscal Imbalance and the Reallocation of Tax Fields in Canada." *Canadian Public Policy*, XIX (2): 194–215

Rushton, Michael. 1992. "Tax Policy and Business Investment: What Have We Learned in the Past Dozen Years?" *Canadian Tax Journal*, 40: 639–55

Sabourin, David, Stephen Gribble, and Michael Wolfson. 1993. "Ontario's Corporate Income Tax: An Analysis of Effective Tax Rates." In *Business Taxation in Ontario*, ed. Allan M. Maslove, 43–79. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press

Sandford, C.T. 1973. *The Hidden Costs of Taxation.* London: Institute for Fiscal Studies

Sandford, C.T., J.R.M. Willis, and D.J. Ironside. 1973. *An Accessions Tax.* London: Institute for Fiscal Studies

– 1975. An Annual Net Wealth Tax. London: Heinemann

Schwindt, Richard. 1987. "The British Columbia Forest Sector: Pros and Cons of the Stumpage System." In *Resource Rents and Public Policy*, ed. Thomas Gunton and John Richards, 181–215. Halifax: Institute for Research on Public Policy

Sheppard, Anthony F. 1985. "Taxation Policy and the Canadian Economic Union." In *Fiscal Federalism*, ed. Mark Krasnick. Royal Commission on the Economic Union and Development Prospects for Canada, Research Studies, vol. 65. Toronto: University of Toronto Press

Sherman, David M. 1989. *Income Tax and the Disabled.* Toronto: Law Society of Upper Canada Continuing Legal Education

Simons, Henry C. 1938. *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy.* Chicago: University of Chicago Press

Slack, Enid, and Richard M. Bird. 1991. "Financing Urban Growth through Development Charges." *Canadian Tax Journal*, 39(5): 1288–1304

Slemrod, Joel. 1990. "Tax Principles in an International Economy." In *World Tax Reform*, ed. M.J. Boskin and C.E. McClure, 11–24. San Francisco: ICS Press

– 1992. "What Makes a Nation Prosperous, What Makes it Competitive, and Which Goal Should We Strive for?" *Australian Tax Forum*, 9(4): 373–86

Smith Committee. *See* Ontario. Ontario Committee on Taxation
Social Planning Council of Metropolitan Toronto. 1992. *Guides for Family Budgeting, 1991.* Toronto
Spicer, Michael W. 1986. "Civilization at a Discount: The Problem of Tax Evasion." *The National Tax Journal*, 39(1): 13–20
Spiro, Peter. 1993. "Evidence of a Post-GST Increase in the Underground Economy." *Canadian Tax Journal*, 41(2): 247–58
Sproule-Jones, Mark. n.d. "User Fees." In *Taxes as Instruments of Public Policy*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming
Srinirasan, T.N. 1973. "Tax Evasion: A Model." *Journal of Public Economics*, 2: 339-46
Statistics Canada. *See* Canada
Surrey, Stanley S., and Paul R. McDaniel. 1985. *Tax Expenditures*. Cambridge. Mass.: Harvard University Press
Swan, Neil. 1991. *Economic and Social Impacts of Immigration.* Ottawa: Economic Council of Canada
Tax Treatment of Real Estate Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Fair Tax Commission
Teja, Ranjit, and Barry Bracewell-Milnes. 1991. *The Case for Earmarked Taxes: Government Spending and Public Choice.* London: Institute of Economic Affairs
Thirsk, Wayne R., and Richard M. Bird. n.d. "Earmarked Taxes in Ontario: Solution or Problem?" In *Taxing and Spending: Issues of Process*, ed. Allan M. Maslove. Fair Tax Commission, Research Studies. Toronto: University of Toronto Press. Forthcoming
Thompson, A.E.J. 1984. "Administrative Costs." In *A Separate Personal Income Tax for Ontario: An Economic Analysis*, ed. Douglas G. Hartle. Toronto: Ontario Economic Council
Thurow, Lester C. 1992. "Who Owns the Twenty-First Century?" *Sloan Management Review* (spring), 5–17
Townson, Monica. 1993. *Tax Facts: What Every Woman Should Know.* Ottawa: Canadian Advisory Council on the Status of Women
Trott, E., A. Dunbar, and H. Friedenberg. 1991. "Gross State Product by Industry, 1977 – 89." *Survey of Current Business* (December), 43–50
United Chiefs and Councils of Manitoulin. 1993. Submission to the Fair Tax Commission
United States. Department of Commerce. Bureau of the Census. 1990. *State Government Finances in 1989*. Washington, D.C.
– Department of Commerce. Bureau of the Census. 1991. *State Government Finances in 1990*. Washington, D.C.
– Department of Commerce. Bureau of the Census. 1992. *Statistical Abstract of the United States, 1992*. 112th ed. Washington, D.C.

– Department of Commerce. Bureau of Economic Analysis. 1991. *Survey of Current Business*, December. Washington, D.C.
– Department of the Treasury. Internal Revenue Service. 1991. *Excise Taxes for 1992*. Cat. 150141. Publication 510. Washington, D.C.
– General Accounting Office (GAO). 1992. *Tax Policy Administration: Luxury Excise Tax Issues and Estimated Effects*. Washington, D.C.: United States General Accounting Office
United Steelworkers of America. 1992. *Empowering Workers in a Global Economy*. Toronto
Vaillancourt, François. 1992. "Subnational Tax Harmonization, Canada and the United States: Intent, Results, and Consequences." In *Canada – U.S. Tax Comparisons*, ed. John B. Shoven and John Whalley, 323–57. Chicago: University of Chicago Press
Vallante, V.A., and P.J. Vopni. 1991. "Environmental Options for Wine and Spirits Bottles." Prepared for Pollution Probe Foundation and the University of Toronto
Vanasse, Pierre. 1992. *Harmonizing Provincial Retail Sales Tax with GST, Financial Institutions and Sales Taxes*. Ottawa: Conference Board of Canada
Wagner, Richard E. 1977. *Inheritance and the State: Tax Principles for a Free and Prosperous Commonwealth*. Washington, D.C.: American Enterprise Institute for Public Policy Research
Wealth Tax Working Group. 1993. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission
Webber, Carolyn, and Aaron Wildavsky. 1986. *A History of Taxation and Expenditure in the Western World*. New York: Simon and Schuster
Weiss, Edith Brown. 1984. "The Planetary Trust: Conservation and Intergenerational Equity." *Ecology Law Quarterly*, 11(4): 495–581
Westin, Richard A. 1990. "Mining and Environmental Taxes." Paper prepared for the German Foundation for International Development
Whalley, John, and Deborah Fretz. 1990. *The Economics of the Goods and Services Tax*. Canadian Tax Paper no. 88. Toronto: Canadian Tax Foundation
Winter, John O. 1991. "Cross-border Shopping out of Ontario." Paper presented to the Ontario Legislative Assembly, Standing Committee on Finance and Economic Affairs, 4 April
Wolfson, Michael, and J.M. Evans. 1990. *Statistics Canada's Low Income Cut-Offs: Methodological Concerns and Possibilities*. Statistics Canada, Research Paper Series. Ottawa
Women and Taxation Working Group. 1992. *Report*. Prepared for the Treasurer of Ontario. Toronto: Ontario Fair Tax Commission
Wood, Peter, Yves Albert Desjardins, and Jean Lanoue. 1992. *Quebec Sales Tax*. Toronto: Canadian Institute of Chartered Accountants, and Ernst & Young

Woolley, Frances. 1991. "Women and Taxation: A Survey." Research paper prepared for the Women and Taxation Working Group of the Fair Tax Commission. Mimeo. Toronto

World Commission on Environment and Development. 1987. *Our Common Future.* Toronto: Oxford University Press

Zweibel, Ellen B. 1992. "Canadian Income Tax Policy Regarding Child Support Payments: Old Rationales Are Still Being Applied to New Realities." Draft paper prepared for the Research and Policy Workshop on the Single-Parent Family. Lake Louise, Alberta, 18–21 March

Commission Staff

Hugh Mackenzie
Executive Director

Allan M. Maslove
Director of Research

Dianna Rienstra
Director of Communications

Barbara Ostroff
Director of Consultation

Robert Cooke
Director of Administration

Research

Matthew Akman
Travis Armour
Brett Baker
Sheila Block
Scot Blythe
John Bossons
Sarah Bradshaw
Michael Cassidy
David G. Duff
Chinn Duong
Ana Ferraro
Dana Gougeon
Moira Hutchinson
Jeanne Jabanoski
Mary Kelly
Anne Lloyd
Marguerite Martindale
Ann McGowan
Dagny Mofid
Leon Muszynski
Stuart O'Grady
Linda Perry
Mark Polley
Elaine Rowe
Richard Shillington
Bob Spencer
Almos Tassonyi
Stephanie Turner
Susan Van Der Hout
Jean Claude Zabbal
Khalid Zafar

Communications

Catherine Clement
Mary Liston
David Sharp
Michael Teversham

Consultation

Eva Allen
Robin Clyke
Gerard Coffey
Raymond Dawson
Gordon DiGiacomo
Denise Edwards
Catherine Glen
Ann Hankinson
Colombe Hinse
Paulette Laberge
Samantha Lam
Chuck Lamers
Patricia Lane
Maria Teresa Larrain
Dennis Lewycky
Marina Lundrigan
Roger Mawdsley
Rosemary Moffitt
Deborah O'Connor
Rachel O'Reilly
Harry Shankowsky
Lesley Silver
Alena Sleziak
Jan Vandermeer
Margaret Wanlin
Allan Whittle

Administration

James Allicock
Christine Avery Nuñez
Lynette Bunsee
Don DesRoches
Jan Dutton
Maria Flores
Gina Gordon
Rajkumar Jadon
Joanne Mastrotucci
Jo Mrozewski
Mary Rampersad
Theresa Wojtasiewicz
Min Wong

Advisers from the Ontario Public Service

Margaret Allan
Brian Lenglet
Natalie Prince
Kumara Rachamalla
Bill Robson
David Roote

Editors

Shipton, McDougall Maude Associates:

Mary McDougall Maude
Rosemary Shipton
Dan Liebman

Fair Taxation in a Changing World
Report of the Ontario Fair Tax Commission

The Ontario Fair Tax Commission has challenged the trend in tax reform by focusing on fairness instead of exclusively on changes necessary to promote economic efficiency. In the first general inquiry into taxation in 25 years, the 10-member commission has made recommendations that represent fundamental change in the structure of the province's tax system. Taken together, the recommendations call for a strong endorsement of a more progressive tax system.

In rethinking the tax mix, the commission came to the conclusion that changes should be made to improve the relationship between taxes and the ability to pay, and to make the overall system more progressive. Recommendations are made concerning all the major sources of provincial revenue, including a major overhaul of the property tax. The commission also discusses the potential role for wealth taxes and environmental taxes in a reformed Ontario tax system. However, the limits both Ontario and Canada face in the taxation of sources of income that are mobile, such as capital, are real and cannot be ignored. As a result, the commission has taken into consideration the constraints faced by Ontario as a subnational jurisdiction in an open economy currently undergoing significant structural change.

The Fair Tax Commission was established in 1991 by Ontario's minister of finance to provide the government with advice on how to design and implement a more equitable tax system. Following a mandate to broaden public participation in discussions of tax issues, the commission designed an innovative consultation program that culminated in a series of public hearings across the province.

The report is available in French through Publications Ontario.

University of Toronto Press
ISBN 0-8020-7572-X
Cover design: Valerie Cooke

ISBN 0-8020-7572-X
90000
9 780802 075727