Who pays for Canada? Taxes and Fairness.

2018 Annual Conference of the
McGill Institute for the Study of Canada (MISC)

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About the McGill Institute for the Study of Canada

Established in 1994 thanks to an innovative agreement between the Bronfman family and McGill University, the McGill Institute for the Study of Canada (MISC) runs an academic program at McGill University, supports an active research environment, and organizes a variety of large-scale, public events on matters of interest to Canadians, including MISC's Annual Conferences, which attract a great deal of attention from policy-makers, media, and the general public. While the Institute itself is non-partisan, MISC is no stranger to debate and controversy.

Who pays for Canada? Taxes and Fairness - Conference summary

From February 21 to 23 2018, the McGill Institute for the Study of Canada (MISC) held its annual conference on the theme of taxation and tax fairness in Canada, marking the centenary of the income tax in Canada. Crucial public policy questions were addressed. How does Canada deals with issues of tax evasion and tax avoidance? Is the Canadian tax system fair? Who bears the tax burden? What are taxes paying for?

This report is a selection of highlights drawn from presentations and discussions held during the conference. For additional resources and coverage, please consult the MISC website.

Tax avoidance, tax evasion and tax competition

Following the Panama papers and other massive scandals concerning tax havens, issues of tax competition, tax avoidance and tax evasion have been at the forefront of the conference. Since the implementation of the income tax system in Canada, tax avoidance has been a major issue for policymakers. Indeed, as Robert Raizenne and Jack Mintz put it, because capital tax levels have always been lower than labour income taxes, individuals have incentives to shift parts of their labour income into capital income. A large part of the history of the Canadian income tax is about governments trying to adjust the tax code to limit tax avoidance. Still, the Canadian government has had a crucial role to play in the history of tax competition. Alain Deneault reminded the audience of the crucial role that Canadian banks, with the support of the Canadian government, played in the creation of tax havens in the Caribbean. These banks helped rewrite local laws to transform some small islands into tax havens. The Canadian government even sent troops in the Caribbean to pacify local insurrections against Canadian banks!

Peter Dietsch presented a thought-provoking argument about tax competition and its impact on government's fiscal autonomy. There are three types of tax competition: 1) tax evasion, an illegal tactic of attracting portfolio capital in secret accounts in tax havens, 2) tax avoidance, which is the use of legal methods to pay the least amount of taxes as possible and 3) luring, which involves attracting foreign capital with low tax rates on capital and corporations (like Ireland does for example).

While there is a consensus about the unfairness of tax evasion and tax avoidance, luring is widely considered a legitimate right of states. States can lure corporations, but also high-income individuals, as Stephen Gordon argued. There could be a "brain drain" of Canada's economic elite if the country had much higher taxes on high-income individuals than its American neighbour. Gordon argued that Canadian high-income earners were able to use the "brain drain" threat to bargain for higher wages when top marginal tax rates were lowered in the 1980s in the United States. However, we don't know if that threat is real or an empty one. Capital has no feelings, but people do: it is less likely that high-income earners already having a good job in Canada would leave for another country only because taxes would be lower. Familial or cultural ties are strong motivations for one to stay in her home country, even if the neighbour's taxes are lower.

Dietsch argued that all types of tax competition, even luring, are unfair because they limit other states' fiscal autonomy. When a state lowers its taxes on corporations or high-income individuals, it becomes more competitive than other jurisdictions and thereby puts a downward pressure on the tax rates of other countries seeking to remain competitive. This limits other states' *de facto* sovereignty on fiscal matters by preventing them from choosing their preferred level of tax and public good provision.

Solutions to tax competition

As Kevin Page argued in his keynote speech, transparency is the name of the game in debates about tax competition. Promoting transparent fiscal rules both in Canada and in other countries is the basic solution to tax competition. Transparency can be related to fiscal cooperation between countries. The movie The Price We Pay, presented during the first evening of the conference, stressed the importance of fiscal cooperation between states to limit tax competition.

However, international cooperation on tax competition involves a prisoner's dilemma: if a government chooses to increase taxes on capital or even to simply legislate to close possibilities of tax avoidance, it risks losing capital investment to other countries offering tax avoidance opportunities and lower capital tax rates. As

Deneault suggested, governments could partially overcome the free-riding problem by putting special clauses in anti-tax competition laws: an anti-tax competition law would come into force only when a sufficient number of other countries implemented similar laws, hence, the first mover would not be penalized. Dietsch suggested prohibiting strategic fiscal policies to lure foreign capital. Like government subsidies prohibited under the rules of the World Trade Organization, strategic tax policies create an unfair competition between countries. For Allison Christians, another solution to tax competition is to compel individuals and corporations to pay taxes in the jurisdiction where they work or produce. However, both these solutions are technically difficult to implement and would require strong international cooperation.

Taxation and fairness

One of the main themes of the conference was tax fairness. As Allison Christians put it: "If society does not care about equity, what would be the point of taxing? We care about fairness and that's why we tax, and that's why it's the focus of so much discourse." It was very pertinent to hear diverging points of view across disciplinary boundaries, as both philosophers and economists debated issues around the meaning of fairness. Peter Dietsch and Rima Mosquera argued that we cannot think only about tax fairness within the tax system of a single country, but also between countries. Indeed, we need to ask whether a tax policy affects other governments and whether it impacts poor and rich countries evenly. For example, it seems that tax competition has more detrimental effect on the revenue levels of developing countries than of developed economies.

One of the most discussed topics in relation to fairness was tax incidence: who pays the tax burden? Both Jack Mintz and Joseph Heath deliberated about what type of economic activity should be taxed: work, income, or savings? Mintz argued that an income tax is "unfair" to people who save in contrast to those consuming all their income. If a taxpayer saves and it generates future return, this future consumption will be taxed more heavily than the taxpayer's current consumption. Heath's argument was that an income tax has an indirect incidence on consumption. Also, one could argue that most poor and middle-class households don't have enough income to maintain significant savings, hence an income tax could be considered as "fair" since high income people have more savings. On the other hand, consumption taxes have an intuitive appeal because they tax what people take out (consume) rather than what they take in the economy (work and savings).

Concerning taxes on the wealthy, both Stephen Gordon and Jack Mintz discussed tax incidence on corporations and high-income individuals. Since corporations are not people, they cannot bear a tax; a real person has to pay for a corporate tax. But who pays the corporate tax? In the short term, corporate taxes do fall on profits and share prices, that is, mostly on high income earners, but they also fall on everyone having some pension savings. In the medium term, corporate taxes can be shifted back on consumers (by raising prices) or on wages. This is especially likely if corporations can move to another country: in this case, corporations can push workers to lower their wages to remain competitive when facing higher corporate taxes. In general, we should conceive tax incidence as the capacity of those with high-bargaining power to shift the tax burden to those with lower bargaining power. Hence, as Stephen Gordon suggested, governments wishing to increase economic equality should focus on altering the bargaining power, notably by changing corporate governance policies.

Paying for what?

We cannot separate taxes from debates about public spending. In the postwar period, the creation of a modern welfare state involved a broadening of the income tax from a narrow tax base resting on the shoulders of few high-income citizens to a larger tax base reaching a sizeable proportion of the population. As Shirley Tillotson reminded the audience, this bargain between taxpayers and the state involve the provision of considerably more public services in exchange for significantly higher taxes. This bargain has always been contested and the question of what taxes are paying for is a political one. This section looks at four themes concerning what are taxes paying for: unconditional basic income, democracy, private foundations as well as environmental protection via carbon taxes.

An unconditional basic income?

Nowadays, many propose a new way to convert taxes into government transfers: an unconditional basic income (UBI). Such a program would replace most means tested cash transfers to low income households with an unconditional benefit offered to all, whose level would progressively phase out with income. A UBI is currently tested as a pilot project in Ontario. Associated with left-libertarian principles of justice, the main objectives of a UBI are to eliminate poverty, promote individual autonomy and to "decommodify" labour: it gives individuals more autonomy from the market and gives them the right to choose not to work if they prefer. In a thought-provoking presentation, Vida Panitch highlighted important trade-offs inherent to a UBI: if the level of a UBI is high enough to "decommodify" labour, it will reduce the size of the tax base, decrease incentives to work and might diminish public support to fund the program. Secondly, if a basic income is very comprehensive and generous, it would be very expensive and should in theory replace most public services (like health and education), which would be offered in a private market. Hence, while in principle the UBI is desirable, in practice, it might lead to unintended detrimental consequences.

Democracy and sovereignty

Taxes can be conceived as a contract between the ruled and the rulers: citizens who pay taxes receive services and can also expect governments to be accountable. Indeed, by using the historical example of taxes on water use in Montréal in the 19th century, Michèle Dagenais showed that paying taxes is inherently related to citizenship and democratic accountability. In an era where universal suffrage remained a radical and almost inconceivable idea in Canada and in most western countries, heads of household who paid the water tax had the right to vote in Montreal's municipal elections. Taxes were the key to citizenship, those who didn't pay the water tax lost the right to vote.

In his keynote address, David Paul argued that taxation is a necessary condition for sovereignty and for a nation-to-nation relationship between the Canadian state and Indigenous communities. Paul argued that a government cannot be sovereign if its revenues depend on the goodwill of other governments. First Nations need a revenue-based fiscal relationship, as the provinces have, instead of the transfer-based one that currently exists. It followed, for Paul, that if we want First Nations to be autonomous and prosperous, we need to provide them with real taxation powers. Fiscal autonomy can also be considered as a necessary condition for the capacity of First Nations' governments to foster an investment-friendly environment.

Private Foundations

After tackling the problem of tax havens in the movie *The Price We Pay*, Brigitte Alepin now has a new target: private foundations. She argues that private foundations' existence depends on very generous tax credits given to the founding donors (which also helps the transmission of a fortune). Additionally, their non-profit status prevents private foundations to pay income taxes. She proposes that since private foundations are not subject to tax competition, government should increase taxes on the initial donation and increase the disbursement quota. Currently in Quebec, the disbursement quota is 3.5% of a private foundation's capital per year. Alepin suggests increasing the disbursement quota to 5%. In Quebec, this would represent an investment of 150 million$ per year by private foundations in society.

Sustainable environment

Christopher Ragan explained why carbon taxes are the most efficient tool to reduce our ecological footprint and to respect our commitments to the Paris agreement on climate. Carbon taxes reduce greenhouse gas emissions because people modify their consumption and production behaviour when goods and services' prices change. If the price of carbon-intensive products rises, people will use them less. The Ecofiscal Commission, of which Ragan is the president, has found that carbon taxes are less costly (in terms of economic growth) than regulations against pollution, even if regulation's upfront cost is "free" for the public purse. Finally, carbon taxes are not necessarily about larger government; carbon taxes can increase government's total revenues, or not. A government could choose to implement a revenue-neutral carbon tax, or it could offer rebates to households and businesses to smooth their ecological transition. Giving a cash transfer to households as a tax rebate would also make a carbon tax more progressive by compensating the tax increase for low and middle-income households. Thus, carbon taxes can please both the left and the right and this is reflected in the composition of the Ecofiscal commission which regroups former politicians from the NDP, the Liberals and the Conservatives.

Taxes as a source of democratic conflict

Interest groups against the majority?

Interest groups have a crucial role to play in the politics of taxation. As we were reminded by Bill Curry and Bill Watson, it is difficult to impose a tax reform on groups with concentrated interests. The case of the Morneau reform, which sought to close expensive tax credits benefiting a narrow number of businesses and high-income professionals, is a formidable example of the role of interest groups in tax politics. This reform was bringing substantial amounts of tax revenues into the treasury by targeting high income earners. It should have been very popular, since the majority of citizens support taxes that are targeted on other groups than themselves, especially when those targets are high earners. Still, after the strong reaction of interest groups and their allies in the Conservative opposition, the government backed down. Why did the government back down from a tax reform targeting mostly taxpayers in the top 1% of the income distribution?

Curry argued that the tax reform was complex for both journalists and the public to understand and that the government did not communicate the means and goals of the reform properly. Interest groups representing citizens and businesses affected by the reform became the dominant voice in the debate and the government was not able to mobilize stakeholders that could have supported the reform. Curry suggested that such a tax reform could be easier to sell if the government tied it to an increase in public spending on any kind of popular program. This would make a tax reform more popular and potentially supported by influent stakeholders.

Taxes on "the rich", taxes on the "middle class"

Luc Godbout presented the findings of his recent research. He showed that most citizens don't know where they fit in the income distribution. If we define the middle class with some objective criteria, like earning between 75% and 150% of the median wage, around 40% of the population is in the middle class, while the income of around 35% of citizens is lower and 25% is above (in Quebec). However, while lower-income people tend to accurately consider themselves as low income earners, a vast majority (80%) of high income earners (those in the richest quarter of the population) perceive themselves as being in middle class. This does explain why politicians always appeal to the middle class, since even the rich think they fit in the middle class. It is fairly easy to call on higher taxes on the rich, because very few people consider themselves as rich, even if they objectively are rich relative to other citizens. This explains why both in Godbout's surveys and in international surveys, a large majority of citizens believe that taxes on "the rich" are too low and should be increased, but few people want to increase taxes on the middle class, simply because everybody believes to be part of it.

As David Tough reminded the audience, progressive tax reformers in Canada wanted to shift the tax burden on other groups than those they belonged to. This is a sad truth: few people agree to raise their own tax burden, even those who want more public services. However, citizenship, social spending and public infrastructure are not free and have to be funded by a broad tax base. It is illusory to believe that more government spending can only be paid for by other groups like "the rich", corporations or tax evaders. At some point, people have to pay for what they receive from the state.

Taxes, gender and race

Gender and taxation

Kathleen Lahey, David MacDonald and Frances Woolley were part of a fascinating panel on the relationship between tax systems and gender equality. The tax and transfer system under-benefit women with low income and penalize informal and unpaid work, like care and housework, that women are still doing more than men. In general, women tend to be poorer than men and are overrepresented in lower deciles of the income redistribution. Therefore, policies reducing income inequality are necessarily related to gender equality. In general, if governments decrease their tax revenues and impose austerity measures to restore budget balance, it impacts women more than men because of their over-representation as beneficiaries of public services and cash transfers.

All three panelists pointed out to features of the Canadian tax system that disproportionately benefit men and penalize women. The design of tax credits tends to benefit men, especially high-income men, more than women. David MacDonald pointed out that men benefit the most from expensive tax credits, like RRSPs, stock option deductions and capital tax deductions. In contrast to tax credits, cash transfers, like transfers for children for example, have more direct benefits to women than men.

The panelists also discussed individualizing all tax measures and benefits instead of using households as the tax unit, because it penalizes women's paid work and savings. As Woolley argued, pooling taxes within one household assumes that households are harmonious and that decisions are taken jointly, but with higher income comes higher bargaining power within the couple. In general, Kathleen Lahey argued, joint taxation or income splitting decreases incentives for transferring the control over income and assets to the lower-income spouse. The individualization of the tax and transfer system alters bargaining power dynamics within households in favour of gender equality.

Taxation, First Nations and Racial Issues

The panel on taxation and "race" provided a bleak account about how tax institutions reproduce racial disparities. All three speakers, Laura Madokoro, Chelsea Vowel and Barrington Walker, saw hard-wired patterns of racism in Canadian tax history as in Canadian history more generally. Madokoro noted, in both her talk and her paper published on the Wilson Institute blog, that though the exclusionary Head Tax story is well known, the ways in which Chinese Canadians in Canada were affected by taxes—not just the head tax but also racist municipal taxes—deserves attention. Barrington Walker saw similar predatory and exclusionary tactics deployed against Black school children seeking admission to schools. Their papers dovetailed with Michele Dagenais's findings on tax-fuelled voter suppression of the poor in Montreal. Indigenous people, Chelsea Vowel noted, also suffered from voter suppression that was justified by inaccurate claims of tax exemption.

Vowel directly answered the question “who pays for Canada” by pointing out that settlers have not paid their debt to Canada, while Indigenous communities paid for Canada in many different respects. She presented a counterargument to those proposing that Aboriginal communities don’t pay their fair share of taxes. Indigenous communities have already paid for Canada with their land and resources and even with their children, by sending them to residential schools. The question should not be about whether these communities pay their fair share of taxes but how the Canadian government and settlers are going to compensate them for their stolen lands.

Key take-away messages from the conference

- Solutions to tax competition and tax avoidance are complex and involve international co-operation.

- There is an intrinsic relationship between taxes, services, democracy and even the environment.

- Tax fairness is not only about higher taxes the rich: tax incidence is complex, and some taxes intended to hit high income earners miss their target.

- Most groups and individuals prefer to shift the tax burden on other groups than themselves and well-organized groups can resist taxation quite effectively.

- Tax policies affect the bargaining power of different groups and individuals and reflect power relationship within society. Gender and racial relations are directly affected by tax institutions.

Conference panels and presentations

FEBRUARY 21, 2018

Special Event
Screening of the documentary 'The Price We Pay', inspired by Brigitte Alepin's book, *La Crise fiscale qui vient.*
Keynote by Brigitte Alepin, École des sciences de la gestion, Université du Québec à Montréal

FEBRUARY 22, 2018

Words of Welcome
Elsbeth Heaman, Interim Director McGill Institute for the Study of Canada | Suzanne Fortier, Principal and Vice-Chancellor, McGill University

Evolution of Canadian Tax Policy
Moderated by Jack Jedwab, Association for Canadian Studies
Panelists: Jack Mintz, Founding Director, School of Public Policy, University of Calgary | Robert Raizenne, Associate, McGill Faculty of Law & Partner at Osler, Hoskin & Harcourt | Shirley Tillotson, History, Dalhousie University

Philosophies of Fairness
Moderated by Andrew Potter, Associate Professor, McGill Institute for the Study of Canada, McGill University
Panelists: Peter Dietsch, Philosophie, Université de Montréal | Vida Panitch, Philosophy, Carleton University | Daniel Weinstock, James McGill Professor, Faculty of Law & Director, McGill Institute for Health and Social Policy

Tax Incidence
Moderated by Martin Petitclerc, Département d'histoire, Université du Québec à Montréal
Panelists: Stephen Gordon, Département d'économique, Université Laval | Joseph Heath, Philosophy, University of Toronto | Michèle Dagenais, Histoire, Université de Montréal

Keynote address: First Nations Taxation in Canada: Reconciling the Interests of Tax Payers
David Paul, Deputy Chief Commissioner at the First Nations Tax Commission
Introduced by Christa Scholtz, Department of Political Science, McGill University

FEBRUARY 23, 2018

Words of Welcome
Elsbeth Heaman, Interim Director McGill Institute for the Study of Canada | Christopher Manfredi, Provost and Vice-Principal (Academic)

Political Spaces of Fairness
Moderated by Juliet Johnson, Professor, Department of Political Science, McGill University
Panelists: Brigitte Alepin, École des sciences de la gestion, Université du Québec à Montréal | Alain Deneault, Collège international de philosophie

Fairness and Inequality: Gender/Family
Moderated by Stephanie Paterson, Department of Political Science, Concordia University
Panelists: Kathleen Lahey, Professor, Faculty of Law, Queen's University | David Macdonald, Senior Economist, Canadian Centre for Policy Alternatives | Frances Woolley, Department of Economics, Carleton University (presented by Elsbeth Heaman)

Tax Debates and Public Opinion
Moderated by Anne Lagacé Dowson, Communications, McGill University
Panelists: Bill Curry, Journalist, Globe & Mail | Jonathan Farrar, School of Accounting and finance, Ryerson University | David Tough, Trent Community Research Centre, Trent University

Keynote address: Taxation and Transparency
Kevin Page, President and CEO, Institute of Fiscal Studies and Democracy, University of Ottawa
Introduced by Christopher Ragan, Director, Max Bell School of Public Policy, McGill University

Fairness and Inequality: National Taxation
Moderated by Sébastien Breau, Department of Geography, McGill University
Panelists: Luc Godbout, Directeur, Département de fiscalité, Université de Sherbrooke | Irma Mosquera, Associate Professor, Tax Law Department, Leiden University | William Watson, Economics, McGill University

Fairness and Inequality: "Race"
Moderated by Allan Downey, History and Classical Studies, McGill University
Panelists: Laura Madokoro, History, McGill University | Chelsea Vowel, MA student, University of Alberta, Indigenous Activist & Author | Barrington Walker, History, Queen's University

Taxes and Fairness into the 21st Century
Moderated by Shirley Tillotson, History, Dalhousie University
Panelists: Allison Christians, H. Heward Stikeman Chair in Tax Law, Faculty of Law, McGill University | Christopher Ragan, Economics, McGill University, Director, Max Bell School of Public Policy