

Roadblock to prosperity



Our income tax system punishes those who save, those who build — and the poor. Time for a radical new model, says business dean **ROGER MARTIN**

Though beloved by all tax-paying Canadians and all political parties, the roadblock to prosperity, especially for the poor, is the Basic Personal Amount (known as the BPA), which makes the first \$7,412 of income for all Canadians completely tax free. The BPA is both mind-numbingly expensive and pathetically ineffective — the biggest loser in our generally perverse tax system. To increase prosperity and give the poor a better chance of enhancing their prospects, we need to transform the BPA and with it the entire income tax system.

If everybody loves the BPA so much, what's the problem? First, it is a very costly "tax expenditure," that is, it represents forgone revenues that would otherwise be collected. In the case of the BPA, that's the difference between the tax rate we would have otherwise paid (16 per cent) on the first \$7,412 of income and the BPA rate of 0 per cent.

It amounts to just under \$1,200 per taxpayer, which costs the federal government just under \$20-billion in lost personal-tax revenues. Since federal personal income tax revenues are about \$80-billion (actually \$75.9-billion last year), this 25-per-cent loss is a very big number.

But shouldn't we be thrilled to have these extra dollars in our pockets, not the government's? Not necessarily, because Ottawa needs to get that \$20-billion a different way, and that way is the problem. It gets the money by charging much higher rates on the rest of our income — 16 per cent on the next \$23,000, 22 per cent on the subsequent \$30,000, 26 per cent on the next \$40,000 and 29 per cent on any remaining amount above \$100,000.

As a country, we swap avoiding tax on the first dollars we earn in exchange for subjecting ourselves to higher rates on the last dollars we earn. But it is the tax rate on the last dollar we earn that strongly influences whether we work an extra hour, save an extra dollar and invest an extra dollar. The higher the tax rate on the last (or marginal) dollar, the less likely we are to work an extra hour, the more likely we are to spend — not save — the next dollar and the less likely we are to invest in ways that grow the economy.

So our national swap of \$20-billion of tax relief on our first (and non-marginal) income for \$20-billion worth of higher rates on our marginal income is a trade directly against the prosperity of our country.

The federal Liberals raised the BPA in the last mini-budget, making the swap worse still. Progressive Conservatives advocate raising the BPA even higher than the Liberals. And under the Alliance flat-tax proposal, the BPA would have been raised higher still.

The primary rationale for the BPA is that it helps the poor to not pay tax on the first \$7,412 of their income; getting rid of it would hurt the poor and be "regressive." In fact, eliminating the BPA is in the category of Canadian undiscussables: Only nasty people who don't care about the poor talk about it. But it is important to discuss it, particularly on behalf of the poor it supposedly helps.

We would all agree that a non-dependent adult making \$8,400 per year is a desperately poor Canadian. Thanks to the BPA, we give this person a \$1,200 tax break on their first \$7,412 of earnings.

This may seem nice and generous at first blush, but remember that we give Ken Thomson or Galen Weston a \$1,200 tax break on their first \$7,412 of earnings too.

Under the BPA, we give \$1.25 for every person making over \$50,000 in taxable income for every \$1 we give for every person making under \$15,000. So it is an extremely inefficient way to help the poor. But worse, on the remaining \$1,000 that this poor person earns, we tax it federally at \$160 and in Ontario, for example, add another \$63 of taxes.

And we attempt to make up for taking money away from desperately poor people in basic income tax by giving them money through lots of other programs like the Child Tax Credit, GST rebates, subsidized housing, etc. However, all of these programs are means-tested and "clawed back" as the income of the poor person rises. As a consequence, poor taxpayers in Canada face extremely high marginal effective tax rates — higher than the richest Canadians — and thereby have the least encouragement in Canada to work, save, invest and grow their way out of poverty.

So the BPA doesn't really help poor Canadians prosper. It helps keep them poor and dependent. Simultaneously, it produces a tax structure that dulls incentives for all Canadians to work, save, invest and create greater prosperity for Canada. It is the roadblock to prosperity.

There is an alternative that is far better for Canada's poor and enhances prosperity for all Canadians. It requires transforming the BPA and the tax structure from an annual income taxation structure to a lifetime taxation structure — that is, rather than a \$7,412 annual BPA, there should be a \$300,000 lifetime BPA. Rather than taxing the next \$23,000 annually at 16 per cent, we would tax the next \$600,000 lifetime at 15 per cent, the next \$600,000 at 20 per cent and so on. (The exact rates and ranges would have to be massaged to achieve tax neutrality.)

Poor Canadians would be dramatically better off and have better prospects for

advancement. For years, even decades, they would face a zero marginal tax on work, savings and investment, rather than a combined federal-provincial rate of more than 20 per cent. Facing zero tax, they would have greater incentive and greater capacity to grow out of poverty. And even when their lifetime BPA expires, they would face a lower marginal rate than currently because under this structure the marginal tax rate for every Canadian taxpayer would fall.

How can this be: How can everyone face lower tax rates and still produce the same revenues? It is because we can take \$20-billion of grotesquely ineffective non-marginal tax breaks and apply them to lowering marginal tax rates for all and improving the prospects of our most needy.

The approach would have the highly beneficial side effect of fighting the brain drain by making Canada a tax-attractive place to stay for young Canadians graduating from university and entering their first job — a tax-free job for their first \$300,000 of earnings.

Some may argue that switching to such a system would be unfair to older Canadians who would lose their BPA. But thanks to extensive tax records, every Canadian's lifetime income could be recalculated and their tax position properly recalibrated. Others may argue that it would favour new immigrants over hard-working, lifetime Canadians. But every immigrant could be assigned a starting lifetime income based on age and the lifetime income of a median Canadian at that age. Last, some may ask the prototypically Canadian question: "But has this ever been tried elsewhere?" No. But that doesn't make it a bad idea. That makes it an innovation.

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