Failing marks given to Ottawa's proposed tax policies

Opinion: High-income earners stand to gain the most from ideas that will cost millions of dollars

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Failing, failing, poor, and poor. Those are the marks that I would assign to the four tax proposals advanced by the Conservative Party of Canada in the last election campaign that are becoming fiscally viable with the projected return to surplus in 2015.

The two big tax proposals in terms of foregone federal revenues are income splitting for couples with children and a doubling of the contribution limits to Tax-Free Savings Accounts. These proposals along with the other two — doubling the children's fitness tax credits and instituting an adult fitness tax credit — all suffer from being tilted toward higher-income households. But their deficiencies do not end with that.

The income-splitting proposal would allow couples with one or more children to shift up to $50,000 per year from the higher-earning to the lower-earning partner for tax purposes. If the two partners were in different tax-rate brackets, some savings in their combined taxes would result.

Who would not benefit from this proposal? Well, according to research by the C.D. Howe Institute's Alexandre Laurin and myself, fully 85 per cent of all Canadian households: single persons, sole parents, low-earning couples, childless couples and even higher-income couples with children where both partners are in the same tax bracket.

Who would gain? Our estimates show the benefits would accrue disproportionately to higher-income one-earner couples. More than 40 per cent of total benefits would go to the top quartile of families by income, with the largest annual tax savings of $6,500 going to one-earner couples with taxable incomes above $185,000.

Thus, the income-splitting proposal would direct most benefits to couples who least need support for their children (high income with one spouse at home) and minimal if any benefits to families with the greatest need. Even worse, by raising their effective tax rate, the scheme would discourage married women from entering or remaining in the workforce, thus reinforcing traditional gender roles.

At an estimated annual cost to federal revenues of $2.7 billion, the funds from income splitting could be much more effectively and equitably spent on refundable tax credits for daycare or direct funding to the provinces to improve daycare provision. That is, if the true intention is to assist families with the greatest need in raising their children.

Next up: the proposal to double the annual contribution limit for TFSAs from its current $5,500 level. My analysis in the 2012 Canadian Tax Journal found the benefits would also be disproportionately captured by the highest income earners and wealth holders. At its current level, the TFSA along with tax provisions for savings in workplace pensions and RRSPs is more than adequate to cover the retirement needs of low, moderate, and middle-income earners — if they save to the full allowed limits.

The main gainers from a doubled TFSA limit would be individuals with incomes above $180,000 who are constrained by existing tax-sheltered limits. And many of them would simply shift existing taxable assets into tax-sheltered TFSAs rather than increase their total savings. So any stimulus to investment in the Canadian economy is likely to be similarly muted.

The revenue cost of doubling the TFSA limits? While beginning small in the early years, the cost would rise steadily over time as more funds accumulated tax-free in TFSAs, with the ultimate figure running into multiple billions of dollars annually as calculated by UBC economist Kevin Milligan.

What about the proposals to double the tax credit for children's fitness and begin a new tax credit for adult fitness? These are smaller-ticket items, as the children's credit is currently worth at most $75 per year for a child incurring at least $500 in expenses. The proposed adult credit would be equivalent to the current level of the child credit.

Even if the revenue cost of the fitness credit proposals is modest, one has to ask about who uses it and the benefits to society. As these credits are non-refundable, they provide nothing to lower-income households below the taxable threshold, and the average benefits rise with income levels.

An article in the current Canadian Tax Journal concludes, "It remains unclear whether the availability of the CFTC actually does increase participation in physical activity." A similar concern affects the proposal for an adult fitness tax credit.

The fitness tax credits would entail additional record keeping and tax filing burdens with dubious effects on actual behaviour. They also reflect an attempt to micro-manage people's lives in a way that seems uncharacteristic for a "conservative" government.

With failing marks for the two big tax proposals and poor marks for the two smaller tax credit proposals, what comments should the professor write at the bottom of this exam? Clearly "much more study is needed — the looming fiscal surplus can be put to much better use than these proposals. Retake the exam well before 2015 rolls around!"

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