Intelligence MEMOS

From: Duncan Munn and Alexandre Laurin

To: Canadian Tax Policy Watchers

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Re: **Time for a Bold Tax Reform Agenda for a Stronger Canada**

Canada is more divided than ever, but there is one objective all political parties should strive for: increasing income for Canadians. Tax Reform can help get us there.

While Canada boasts a good standard of living, inflation is eroding our purchasing power. This affects individuals and challenges business on a number of levels including making the capital investments necessary to enhance competitiveness, ultimately leading to job creation and the ability to offer better wages.

Meanwhile, Canada is a small open economy representing just 1 percent of global GDP. We are next to the US, the world's largest and most dynamic economy, and thus relentlessly exposed to stiff competition for investment and talent.

If we pan back a bit, the tax-to-GDP ratio is a gauge of a nation's tax revenue relative to the size of its economy. The US has a tax-to-GDP ratio of 26.6 percent. Ours is 33.2 percent.

We tax more, having lost our competitive edge on the corporate income tax side, and remaining uncompetitive on the individual side. When companies and entrepreneurs look for a platform, Canada is not necessarily the obvious first choice. It is time to do better.

But Canada's approach is characterized by fragmented tax strategies, driven by reactive measures or political exigencies. This has resulted in an excessively intricate tax code that lacks coherence and clarity and certainly competitiveness is not a driving force. And there has been no comprehensive review of the system since 1967's Carter Commission.

To address these issues, the C.D. Howe Institute is hosting a major two-day conference this week, chaired by Jack Mintz, Canada's preeminent tax policy expert.

Canada needs fresh ideas and a consensus goal to put growth at the forefront.

The first major discussion will revolve around the role of income taxes in reducing inequality. We will explore whether redistribution has gone too far and whether the tax system is effective at encouraging work, savings, entrepreneurial initiatives, and training.

Over the past decade, we have seen significant increases in the top tax rates, coupled with reductions in the middle and lower rates. This raises questions about the appropriateness of these top rates and the effectiveness of various credits in wealth redistribution.

Another important consideration is the simplification of the personal tax system. Tax complexity imposes significant administrative and other costs. Given the abundance of new tax credits promised in every election, are there ways to reduce this complexity? Is there a flat tax solution?

The taxation of investment income and capital gains has sparked huge debate. While the Carter Commission's underlying philosophy treated all income equally, it failed to acknowledge the adverse economic impact of taxing capital income. It's time for policy makers to explore whether a dollar of capital income should be treated just like a dollar of ordinary income, amongst other issues.

Shifting our focus to Canada's tax mix – heavily reliant on income and property taxes and less on consumption and payroll levies – we should ask whether that is optimal.

Canada must also focus on business taxation.

We must revisit insights from the 1997 Technical Committee on Business Taxation and see what has been accomplished and what is new and needs addressing. Is full integration of the personal and corporate income tax systems still necessary or are there better alternative?

Since corporate taxes paid cannot be compensated when dividends are paid in registered accounts, they fail to fulfill their withholding purpose. Other paths need exploration. Canada must address these pivotal questions shaping the business tax system.

Competitiveness in attracting investments is another crucial element to designing the corporate income tax system. It is time to assess the competitiveness of the Canadian system, taking into account the potential impact of the new "global minimum tax" for multinational companies.

If reform is deemed necessary for the corporate income tax system, we must explore alternate approaches and evaluate the experience of countries that have introduced fundamental reform.

At the end of the day, we need fresh insights as to how the tax system can best stimulate investment and, ultimately, productivity. That, after all, is the main driver of living standards.

The C.D. Howe Institute will get its oar into the water early with ideas and solutions to these thorny issues, challenging policy makers to join the conversation and put the welfare of Canadians front and centre of the tax system by focusing more squarely on empirically sound tax reform ideas.

Canada cannot rely on subsidies as a path to prosperity, nor can it solely rely on taxing wealth to generate wellbeing. We need to demand a higher level of accountability from the political class, one guided by evidence-based decision-making and a commitment to designing a tax system that places national wellbeing above partisan interests. Let the debate begin.

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