

## ***Introduction***

In 1996, when the flat tax was still a relatively obscure idea, the National Union issued a *Flat Tax Primer*. That document discussed the concept in some detail, and showed that the two main advantages cited by flat tax supporters – simplicity and fairness – did not hold up to scrutiny.

We have heard a lot about tax cuts in recent years, but relatively little about the flat tax. True, Republican Steve Forbes ran twice for the U.S. presidency on the issue, but he was badly drubbed on both occasions and not even his own party has shown much interest in the flat tax concept.

In Canada, unfortunately, the flat tax has made more headway, even though it remains as bad a concept as it was in 1996.

A flat tax proposal was recently incorporated into the policy platform of the new Canadian Alliance Party. And in 1999 Alberta Treasurer Stockwell Day, who subsequently became a candidate for the Alliance leadership, committed his province to a flat tax. The Alliance Quebec, under Mario Dumont, is also pushing a flat tax. Even a Liberal MP, Dennis Mills, has been advocating the idea.

Obviously Canadians will be hearing much more about the concept and its alleged benefits in the coming months and years.

So, what exactly is a flat tax and why hasn't such a dubious idea simply faded away?

## ***The Flat Tax – Keeping Government in Line***

The right wing likes tax cuts because they ensure that Canada's social programs, badly damaged during the alleged fight against the deficit, cannot be rebuilt. At the same time, government would become permanently smaller and less effective. Business would face fewer constraints and more opportunity to take over services now provided by government. The wealthy would pay less for the general well being of the country.

In this context **the flat tax would be the ultimate tax cut.**

A recent opinion piece advocating the flat tax had a revealing headline, claiming it "could keep government in line."

As James Travers has written in a Toronto Star article, "a (flat tax) rate of 17% would force the federal government to either plunge back into the dark hole of deficit financing or get out of the business of providing fundamental social services to Canadians".

Travers went on to say that the 17% solution would only work if increases in federal program spending were limited to about \$1 billion a year. But in the real world of population growth and program delivery, that would mean that there

wouldn't be enough money to repair Canada's public health and education systems or to meet the country's defence commitments. For those who worry more about fiscal prudence than spending, Canada's efforts to pay off its massive \$760 billion debt would also be crippled.

Those concerns make flat taxes look a lot like a surreptitious, fifth column tactic to achieve the right-wing goal of small, unintrusive government. Limited by revenues from a single tax system, Ottawa would lose even more of its influence over lower levels of government, as well as its ability to use tax policy to shape social or economic policy.

While that fits nicely with the Canadian Alliance Party's world-view, it is not what most Canadians want.

### ***A Windfall for the Wealthy***

Indeed, like most tax cuts, flat tax proposals are designed to be windfalls for the wealthy.

As Jeffery Simpson put it in the *Globe and Mail*, "the flat tax, ideology aside, is a thoroughly bad idea, which may explain why even most cost-cutting, tax-slashing U.S. Republicans don't like the idea. No one needs a flat-tax proposal to remove low-income individuals from the rolls. The greatest beneficiaries from a flat tax are upper-middle income groups and above."

Frances Russell, in the *Winnipeg Free Press*, wrote, "There's a class war raging in Canada and the most wealthy among us are winning. The flat tax has nothing whatever to do with fairness. It's designed to be a bonanza to the people at the very top."

What Russell calls the dirty little secret of the flat tax is that middle income Canadians would actually end up paying more tax, while the higher earners would pay less. That is because the flat tax would also eliminate many now standard deductions in the name of simplicity, meaning middle-income earners would pay more. Only at, and above, \$60,000, would families begin saving.

### ***Flatter than What?***

Our current **income** tax system is based on progressivity, the notion that tax rates should increase along with one's ability to pay. The reason is simple: even after higher taxes, the more wealthy, with higher incomes, still have way more money in their pockets after paying taxes than those with lower incomes.

The flat tax would replace this progressivity with a standard flat rate so that everyone, whatever their income, would pay the same percentage in tax. This would be accompanied by fewer deductions, making the overall process simpler, more straightforward.

However, income taxes are the only part of our current tax system that have the element of progressivity. Taken as a whole our system is remarkably flat already.

The flat tax of 17% being proposed by the new federal party would be of little benefit to the majority of Canadians, most of whom already pay only 17%. A majority of Canadian taxpayers make less than \$30,000, the income level where the second existing tax bracket kicks in.

More importantly, research indicates that when all taxes – the GST, payroll taxes, property taxes – are considered, Canada already **has** a virtual flat tax.

Most taxes other than income taxes are **regressive** in nature, meaning low-income people pay a greater share of their income than higher-income people. When sales, property, and payroll taxes are added to income taxes, Canadians at all income levels pay about the same share of their income in total taxes.

The GST, which targets consumption, is a highly regressive tax. People at lower income levels, who spend much more of their income, proportionately, on current consumption, are hit more by the GST than higher income earners. If we took the same logic of the flat tax and applied it to the GST, we'd say that everyone should pay the same percentage of income in GST. But of course the wealthy pay far less in GST payments **as a percentage of their income** than the poor.

The end result is that policy changes that move us toward a flat income tax would actually make the overall tax system regressive in nature, and would increase inequality.

### ***Simplicity?***

Let's deal with the alleged main advantage of the flat tax – its simplicity.

The *Income Tax Act*, which began as a 20-page document in 1917, now contains more than 1,400 pages. Very few of us are familiar with the Act, except for some “basics”. The reason is that the average income earner has little chance to benefit from the myriad of loopholes and deductions in the act.

Nevertheless, proponents of the flat tax assure us it would make the tax system far more understandable. Everyone would simply apply the same simple percentage rate - 17% according to the Canadian Alliance - to the same simple definition of income (which conveniently excludes a good portion of high-income earners' incomes). Since there would be no loopholes and no deductions, there would be much less paperwork.

Well, flat tax supporters are right, but in a perverse way. Their tax *would* be simpler - for high-income earners and businesses with different types of income, who have to pay tax lawyers and tax accountants lots of money to interpret the *Income Tax Act* for them.

However, it would not be much simpler for most taxpayers that have fewer sources of income and fewer loopholes at their disposal. Typically, they make use of relatively few sections of the act even now.

That's not to say that tax simplification *isn't* a desirable objective, even for those at the lower end. But if we are really worried about simplifying the tax system, we can do so without implementing the many regressive features inherent in a flat tax system.

## ***Tax fairness***

Those favouring a flat tax allege that "fairness" means that everybody should pay the same proportion of their income in tax. A flat tax would be imposed at a relatively low rate and raise only enough money to finance a very limited range of core public programs.

One of the most basic premises of a flat tax is that "the market" distributes income, wealth, and opportunity in the most appropriate way. Because of that, it is argued that the tax system shouldn't burden people – and distort the market rules – by changing income distributions resulting from the workings of the market. In other words, each person and each income group would claim the same *share* of national income after paying taxes before.

According to this view, people should, for the most part, be responsible for their own welfare, relying on their families and charities for support (when necessary) instead of the state.

By contrast, the concept of fairness under our current progressive tax system recognizes different individual circumstances, and the fact that a person's market income isn't necessarily the final word on economic justice. A progressive system recognizes that market income depends on a variety of circumstances, many of them beyond individual control.

In a progressive tax system, all people pay taxes according to their ability. The system exempts the poor, and provides them with additional income to ensure they have the necessities of life<sup>1</sup>, not to mention their dignity. A progressive system then applies tax rates and relative tax burdens that increase with income.

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<sup>1</sup> There has been increasing debate in Canada about what "necessities of life" should be included in the mix when determining whether people fall above or below the poverty line. Obviously, the Fraser Institute and similar-inclined groups feel the necessities of life should be defined as narrowly as possible, so that fewer people are classified as "poor". In his recent book, *Pay the Rent or Feed the Kids*, author Mel Hurtig quotes a United Nations definition, which says the following:

"Human poverty is deprivation in multiple dimensions, not just income... Food, shelter, water, sanitation, medical care and clothing are necessary for leading a long and healthy life. Schooling and access to information through books, radio, newspapers – and, increasingly, electronic networks – are necessary to acquire language, literacy, numeracy and up-to-date information. Transport and energy are critical inputs to all

In a progressive system, taxes **do** change the market's distribution of income. More equality becomes a social goal and, in an effective system, an economic achievement. This provides the fundamental measure of a progressive tax system: after paying their taxes, those at the top are left with a smaller share of all national income than before, although still far more than the rest of society. Those at the bottom enjoy a larger share than before, although far less than the wealthy.

The theory is that for those at the top, progressive taxes are a reasonable price to pay for the privilege of enjoying a greater level of prosperity. Progressive taxes are also a means of limiting the burden on the vast majority who benefit less from the workings of the economic system than those at the top income levels.

Unfortunately our existing system isn't as progressive as it should be. A 1995 study by the National Union found that our tax system would be a lot more progressive if those with higher incomes weren't eligible for all of the tax breaks they currently enjoy on particular types of income. If these breaks were removed, up to \$4 billion in additional annual income taxes would be generated.

Remember: these figures relate to the current system. And flat tax supporters, as discussed above, would give *additional* tax breaks to these high-income earners.

### ***High exemptions for everybody?***

The Canadian Alliance would give everyone – rich, poor, and those in the middle – high personal exemptions before they are required to pay *any* income taxes. In fact, the party's plan would increase the basic tax exemption to \$10,000. It would also provide high-income earners an additional tax break by cutting the current high-income surtax.

The idea of giving additional tax breaks to high income earners who *already* enjoy many breaks – such as preferential tax rates on capital gains and dividends – is a disturbing proposition in its own right, particularly when combined with the major reduction in public programs and services that would undoubtedly result from the huge tax reductions proposed.

These reductions wouldn't be felt as much by high-income people with the money to purchase private sector options (like additional medical coverage). But they would be felt acutely by those at the lowest end of the income scale, who would be deprived of the wide range of public programs and services that would cut even further as a result of reduced government revenues.

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these things and virtually all other human activity. There is growing evidence that lack of mobility and access lie at the heart of economic and social disempowerment of women."

Cited in Mel Hurtig, *Pay the Rent or Feed the Kids*, page 210.

More fundamentally, the Canadian Alliance's proposed \$10,000 exemption would make little, if any, difference to many low-income Canadians. Why? Many of them don't pay any income tax right now. Of the 20.8 million people who filed a tax return in 1996, only 14.2 million actually paid taxes. The 6.6 million who paid nothing were overwhelmingly at the bottom of the income scale – 98% had incomes of less than \$20,000. In fact, the typical "crossover point" into becoming taxpayers for a two-income, two-child family is between \$25,000 and \$30,000; and in most provinces you can pay no taxes at all until your income exceeds \$30,000<sup>2</sup>.

How would a higher basic exemption benefit people who don't pay taxes under today's system?

### **“Double Taxation”?**

As noted above, certain types of income – namely, the income received from capital gains and income – enjoy preferential treatment under the *Income Tax Act*, which exempts portions of such income from taxation.

In most versions of the flat tax, this treatment would become even *more* preferential. Capital gains, dividend income, and interest income – the majority of which is earned by higher-income individuals – would escape *any* personal taxation whatsoever.

Flat tax supporters argue that people who pay taxes on capital gains, dividends, and interest are subjected to "double taxation" because corporations have already paid taxes on their profits. Therefore, investors who earn capital gains, dividends, or interest resulting in one way or another from corporate profits should not have to pay *any* taxes on that money. To do so, they argue, makes investing in companies unattractive: in fact, they suggest it's probably more desirable to simply spend the money on current consumption.

This argument is nonsense on several levels. But let's start with the most basic: corporations are increasingly not paying their fair share of taxes to begin with. A 1998 study by the Ontario Coalition for Social Justice noted that more than 90,000 corporations, with combined profits of \$18,566 billion, paid no income tax whatsoever in 1995. Figures obtained by the Ontario Federation of Labour from Statistics Canada show that in 1997, 112,008 corporations with combined profits of \$56,242 billion paid no taxes that year.

A significant part of our current tax problem is that the tax burden has been shifted onto the shoulders of individual taxpayers. In 1950, corporate and personal income taxes each accounted for about 22% of the revenues of Canadian government. Now, according to current Statistics Canada data,

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<sup>2</sup> See Bruce Little, "Tax cut promises during elections don't attract all voters", *The Globe and Mail*, June 7, 1999.

corporate income taxes account for a mere 6%, while personal income taxes contribute more than 46%.

It's not just corporate income taxes that follow this pattern. A background study for the federal Mintz Committee on Business Taxation looked at 20 different types of business-related taxes from the 1950s onward. The study showed that the corporate contribution to government revenues declined by about one third over that period (from 37% to 25.6%).

It's obvious that eliminating taxes on corporate revenue like dividends would be a **double tax break**, not at all a solution to a non-existent problem of double taxation.

The flat tax argument is really based on the proposition that *certain types of income shouldn't be taxed at all*. As such, it carries the preferential tax provisions inherent in our current tax system – where certain types of income are taxed at *lower* rates – to the extreme.

The Canadian Alliance's plan makes it absolutely clear who would benefit from changes such as this. According to a story in the January 30, 2000, edition of the *Ottawa Citizen*, "high-flying risk takers" would be rewarded by the party's flat tax system.

### ***The flat tax in the United States***

Former Republican presidential candidate Steve Forbes made the flat tax a centerpiece of his campaign. A number of conservative legislators in the United States – supported by big business lobbyists – have also been quite vocal in promoting a flat tax.

One proposal that emerged in the United States – coincidentally, for a 17% flat tax – would have seen the marginal tax rate for those at the top of the income scale lowered from its current 40%.

Another flat tax proposal would have allowed businesses to immediately deduct from their tax calculations all expenses they currently have to depreciate over many years. This would have reduced their current tax bills considerably.

### ***Cutting off the undeserving***

Flat tax supporters apparently believe, and want us to accept, that money paid to governments in taxes disappears down some deep black hole.

They would have us agree that most of our tax dollars are wasted on "unproductive" government activities – rewarding well-funded special interest groups, paying for some new government boondoggle, or subsidizing some hard up region or citizens' group that should learn to survive on its own resources and initiative.

Supporters say a flat tax would permit taxpayers to see on their simplified tax forms just how much they are paying for the costs of government. Armed with

this knowledge, they would then become more aggressive in questioning how their money is being spent, thereby preventing future waste and transfers to “undeserving” people.

But money contributed to governments does not disappear down a black hole. In the real world, a vigorous public sector – funded mainly through taxes – provides us with vitally needed programs and services, ensuring that:

- high-quality, universal health care is available to protect the sick, and our children, regardless of income or financial status;
- food is inspected, so that it is safe for families to eat;
- a range of programs is provided to help care for seniors;
- counselling and other forms of assistance are provided to people temporarily or permanently in need;
- workers are guaranteed a minimum wage, and safe work sites;
- roads, highways and air transportation systems are secure;
- unemployed workers are helped in their search for jobs;
- the environment is protected from polluters; and,
- young people and workers who have been "adjusted" out of the workforce are provided a range of educational and training opportunities.

These programs also provide direct benefits to the private sector, for example: when governments purchase goods and services; when government workers spend their pay cheques; when social assistance recipients use their benefits to pay their rent and purchase food; and, when roads, bridges, highways, and other infrastructure required by private sector firms to carry out their operations are built and maintained.

The private sector also benefits from such programs as medicare, which allows it to avoid the high costs of private, company health care plans common to firms in the United States.

Tax money is also used to alleviate the inequality between people, groups, and regions, lessening disparities between rich and poor.

Federal and provincial budget cuts during the 1990s have made it far more difficult for governments to address many peoples' needs. So have initiatives to downsize or privatize public services, the imposition of user fees, and so on. A flat tax on top of all this would leave even less money for governments to serve Canadians, and would further weaken our ability to equalize opportunity.

This can be seen in Table 1. It shows the impact of the Canadian Alliance's plan at different income levels, for different types of families. The total loss of government revenues, according to *The Ottawa Citizen*, is \$34 billion per year!

**TABLE 1  
INCOME/PAYROLL TAX IN 2004-2005 UNDER THE CANADIAN ALLIANCE  
PROPOSAL**

Income		Status quo	CA plan	Difference
<b>Single individual</b>	\$20,000	\$ 3,264	\$ 2,710	\$ 554
	\$40,000	\$ 8,703	\$ 7,148	\$1,555
	\$60,000	\$13,927	\$10,548	\$3,379
<b>Single-income family of four</b>	\$20,000	\$ 2,235	\$ 1,217	\$ 1,018
	\$40,000	\$ 7,673	\$ 4,428	\$ 3,245
	\$60,000	\$12,898	\$ 7,828	\$ 5,070
<b>Dual-income family of four</b>	\$20,000	\$ 1,908	\$ 1,044	\$ 864
	\$40,000	\$ 6,528	\$ 4,400	\$ 2,128
	\$60,000	\$11,725	\$ 8,954	\$ 2,771

*Source: Ottawa Citizen, January 30, 2000*

### **Conclusion**

Supporters of a flat tax play on legitimate concerns about the complexity and unfairness of the current tax system to persuade us of its merits. We *do* need a less complex system, but a flat tax would not be fair. Quite the contrary.

If implemented, a flat tax would:

- be of greatest benefit to large corporations and higher income individuals, who would be taxed at lower marginal tax rates, and pay taxes on fewer types of income;
- result in a tax system that is even more unfair than it is today;
- greatly diminish government revenues, and as a result, the public programs and services that average citizens depend on; and
- reduce the power of governments to redistribute income and resources to poorer individuals and regions.

If we really want a fairer tax system, we could achieve it by adopting fairer tax measures. Here are some of the things we *should* be looking into:

- fairer taxes on the world-wide income of large corporations;
- *equal* treatment of income from salaries, wages, interest dividends, and capital gains;

- re-instituting higher tax rates for higher income individuals;
- a tax on large inheritances;
- a tax on currency speculation;
- eliminating the tax deductions for meals and entertainment, and for lobbying expenses;
- imposing a penalty on deferred corporate taxes;
- preventing corporations from writing off individual salaries greater than \$200,000 per year; and/or
- an “excess profits tax” on banks and other financial institutions earning exorbitant profits.