BACKGROUNDER
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Harper's Tax Boutique

Rethinking tax expenditures in a time of deficit

By Ben Sand and
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FRONTIER CENTRE FOR PUBLIC POLICY

Executive Summary

...25% of individual tax filers report an annual income over $50,000...

- In an era of fiscal austerity, it makes sense to scrutinize Ottawa's tax expenditures (tax credits and deductions) with as much rigour as one uses to scrutinize direct government spending. Tax expenditures related to personal income tax total $100-billion per year.
- This report briefly surveys the tax policies of the Harper government and takes a closer look at the targeting and effectiveness of two 'boutique' tax breaks: the Public Transit Tax Credit and the Children's Fitness Tax Credit. Both are non-refundable tax credits. Non-refundable tax credits provide a greater benefit to higher income tax filers.
- While only 25 per cent of individual tax filers report annual income above $50,000, this income group represents a disproportionate percentage of claimants for these two boutique tax breaks. For the Children's Fitness Tax Credit, 65 per cent of claimants have income above $50,000. For the Public Transit Tax Credit, 39 per cent have income above $50,000. These tax breaks are thus skewed toward middle- and upper-income earners. While the existence of such tax credits may create a political benefit for the federal government, this alone does not represent an appropriate use of taxpayers' resources.
- The tax breaks also fail to meet their stated policy objectives. The Children's Fitness Tax Credit was shown to have limited effectiveness in encouraging greater physical activity by children, particularly those from low-income families. The Public Transit Tax Credit has been criticized for failing to reduce greenhouse gas emissions, which is its objective.
- Eliminating these two poorly targeted and ineffective boutique tax breaks could save the federal government $164-million annually. This money could then be put toward deficit reduction, more-efficient forms of tax relief or policies that better target lower income Canadians. Far greater changes would be possible with the elimination of a broader selection of tax expenditures.

Introduction

In his 2010 budget, Finance Minister Jim Flaherty vowed to "increase restraint on government spending … [and] aggressively review all departmental spending to ensure value for money and tangible results." With the goal of eliminating the deficit over five years, he promised to reduce planned government spending by $17.6-billion.

However, direct government spending is only one aspect of overall government outlays. Equally significant is the role of tax expenditures – benefits or credits provided to particular classes or groups of taxpayers for a variety of purposes. Tax expenditures represent potential revenue not collected by government. Tax expenditures vary widely in size: from $7-billion for Registered Retirement Savings Plans to $5-million for the Infirm Dependent Credit. For 2010, the Department of Finance lists over $100-billion in personal income tax expenditures.

Despite the significance of tax expenditures as a share of total government spending, there appears to be little interest within government to review tax expenditures. The 2010 budget made no promise to scrutinize tax credits in the same manner as direct government spending is scrutinized.

Tax expenditures should be considered on an equal footing with direct government spending. A tax expenditure that fails to meet its stated objective should be eliminated. Consider a tax credit intended to encourage some beneficial activity, such as planting trees. If evidence shows this credit is irrelevant to a taxpayer's decision to plant trees, it should be abandoned and the tax reduction rolled back.

Further, it seems reasonable that tax expenditures should be targeted toward those families most in need. Evidence that certain tax breaks disproportionately benefit middle- or upper-income brackets violates the concept of effective targeting and raises the possibility that such tax breaks exist for purely political reasons.

Finally, the elimination of all or most tax expenditures would simplify the tax code and provide an opportunity for a substantial reduction in basic rates. This would greatly enhance the efficiency of our tax system.

This backgrounder investigates the Harper government's boutique taxes and the extent to which these tax innovations meet their stated objectives.

"A tax expenditure that fails to meet its stated objective should be eliminated."

Overview of the Harper Government's tax policy

Many of these programs are seen as being politically motivated strategies...

The Harper government has made numerous changes to tax policy. Perhaps the most visible is the two-percentage point cut in federal GST and the recent harmonization of the GST with provincial retail sales taxes in Ontario and British Columbia. In addition, there have been general tax rate reductions for personal and corporate tax filers. The implementation of the Working Income Tax Benefit has proven to be a significant tax policy for low-income Canadians.

The Harper government has also introduced a wide variety of other changes to the tax system that are more difficult to defend. Chief among these are so-called boutique tax benefits: tax expenditures aimed at a particular demographic or that are otherwise limited in their applicability. Many of these programs are seen as being politically motivated strategies designed to win the voting favour of the middle class.

The list of boutique tax breaks created or enlarged by the Harper government is lengthy and diverse:

Public Transit: The cost of up to 12 monthly public transit passes can be claimed as a tax credit. Some passes of other durations are also eligible. A monthly transit pass in Vancouver, for example, can cost $151. This benefit has been available since 2006.

Child Fitness Tax Credit: Filers can claim a maximum of $500 per child for fees paid regarding prescribed fitness programs, including hockey registration, kung fu lessons, etc. This benefit is allocated on a family basis. It has been available since 2007.

Canada Employment Amount: Originally set at $250, this benefit was subsequently increased to $1,044. It can be claimed against employment expenses (such as work uniforms or a home computer) for anyone with employment income in excess of the benefit amount. No receipts are necessary. Self-employed individuals cannot claim this amount. It was introduced in 2006.

Tradespersons' Tool Deduction: This provides a maximum $500 deduction for tools purchased by tradespersons in the course of their employment. It has been available since 2006.

Textbook Amount: This benefit is worth up to $65 per month for full-time students and $20 per month for part-time students. No receipts are necessary, so it functions as an additional Education Amount benefit. It has been available since 2006.

Dependant Children under 18 Years: Tax filers can claim $2,089 for each child under 18. Generally, either parent can claim the amount. It has been available since 2007.

Spousal Amount: This non-refundable tax credit was made equivalent to the basic personal amount in 2007. It is currently worth $10,320.

Home Renovation Tax Credit: Available for the 2009 tax year only, it allowed homeowners to claim a maximum tax credit of $1,350 for home repairs or renovations up to $10,000.

> *"...a non-refundable tax credit is only used to lower the taxes owed to zero."*

A detailed look at two boutique tax credits

This backgrounder selects two boutique tax credits for closer examination: the Public Transit Tax Credit and the Child Fitness Tax Credit.[1] Both are non-refundable. This is significant for lower income claimants, as a non-refundable tax credit is only used to lower the taxes owed to zero. An example is helpful to understand the implications of non-refundable tax credits.

Consider a low-income individual who owes $100 in federal taxes. The introduction of a $500 non-refundable tax credit will reduce his or her taxes owed to zero, but this individual cannot claim or access the remaining $400 in potential benefits. In contrast, a high-income tax filer who owes $20,000 in taxes will be able to claim the full $500 value of the tax credit. A tax filer with low income may not be able to use all the available tax benefits. In fact, almost one-third of all 2009 tax filers received no benefits despite their eligibility for non-refundable tax credits.[2] Non-refundable tax credits are a poor policy tool for helping people with low incomes. Fully refundable tax credits, as is the case with the GST/HST tax credit, generally deliver greater benefits to low-income earners.

To what extent do our selected boutique tax breaks benefit middle- and upper-income tax filers?

For simplicity, this study adopts the common shorthand definition of middle class as income between $50,000 and $100,000 per year. This provides a rather generous definition of lower income ($0 to $50,000) and ensures that any results that look at low-income shares will be robust. Seventy-five per cent of all Canadians report annual income of

1. Due to the way the federal government releases its data, not all tax expenditures can be considered separately. The examples were chosen because they can be considered individually, and they are typical of tax expenditures in general.
2. Milligan, Kevin. "What have four Conservative budgets done to personal income taxes?", Page 4.

less than $50,000 on their tax returns. Upper income is $100,000 and above.

Table 1: Canadians claiming selected boutique tax credits by middle- and upper-income grouping

(Number of claimants and percentage of total claimants.)

Tax Credit	$50,000-$100,000	$100,000 and Up	Combined Total
Public Transit	296,350 - 31%	73,600 - 8%	369,950 - 39%
Children's Fitness	548,850 - 46%	230,390 - 19%	779,240 - 65%

The numbers refer to the taxable returns that include the indicated claims. Source: Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html.

...a significant skewing of claimants for both tax credits towards middle- and upper-income catagories...

Table 1 shows the disaggregation of tax filers for the selected tax credits by income group. For the Children's Fitness Amount, 46 per cent of all claimants come from the middle-class category of tax filers. Together with those having an income greater than $100,000 per year, approximately two-thirds of all claimants can be considered middle class or above. Similarly, 39 per cent of all claimants of the Public Transit Amount are from the middle- and upper-income categories. As only 25 per cent of individual tax returns report income above $50,000 per year, this suggests a significant skewing of claimants for both tax credits toward middle- and upper-income categories.

Table 2: Value of total claims made by Canadian tax filers by middle- and upper-income grouping

(Dollar value and percentage of total dollars claimed. All figures are in $-millions.)

Tax Credit	$50,000-$100,000	$100,000 and Up	$50,000 and Up
	Value - Per cent	Value - Per cent	Value - Per cent
Public Transit	$241 - 34%	$64 - 9%	$305 - 43%
Children's Fitness	$285 - 47%	$147 - 24%	$432 - 71%

Source: Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html.

Table 2 shows the value of the total claim amounts for each income category.[3] In both cases, the size of the tax claim is proportionately greater than the share of claimants in the middle- and upper-income

3. The dollar value of the actual tax credits to tax filers is calculated by multiplying total claims by the minimum tax rate.

categories, as shown in Table 1. This is because non-refundable tax credits inevitably deny lower income claimants the full value of the available benefit, as discussed previously.

With respect to the Child Fitness Amount, 71 per cent of the total value of all claims under the Children's Fitness Amount accrues to middle- and upper-income groups. The Public Transit Amount is also heavily skewed toward middle- and upper-class income filers. In times of fiscal austerity, it seems reasonable that tax expenditures should target families most in need. This is clearly not the case. As Appendix 1 shows, middle- and upper-income tax filers receive $107-million of the $190-million in tax expenditures for these two credits.

Boutique tax credits also fail the test of effectiveness.

Boutique tax credits also fail the test of effectiveness. A study by the University of Alberta's faculty of physical education and recreation surveyed approximately 1,000 Canadian parents with children aged two to 18.[4] More than half the respondents reported that they had enrolled their children in physical activities and one-quarter claimed the Children's Fitness Amount. However, the survey revealed that higher income families were far more likely to claim the tax break. Among those with children enrolled in physical activities, 55 per cent of families in the top half of the income spectrum claimed the credit, while only 28 per cent of families in the bottom income quartile did so.

The survey also asked parents whether the existence of the tax credit increased the likelihood of their child participating in physical activities. Among the top-income quartile, only 10 per cent of families agreed. Among the bottom-income quartile, agreement was 37 per cent. This suggests the Children's Fitness Tax Credit is largely redundant across all income categories. The vast majority of all families make decisions on physical activities without considering this tax benefit. According to the study, "families at the lower end of the income continuum cannot afford the costs associated with organized [physical activity] and are less likely to be able to take advantage of a tax credit."

Similarly, the goal of the Public Transit Amount was to persuade commuters to switch from cars to public transit in order to reduce greenhouse gases. The 2008 report of the Commissioner of the Environment and Sustainable Development notes that the federal government originally claimed that the Public Transit Tax Credit would lead to the reduction of 220,000 tonnes of greenhouse gases.[5] However, this estimate was later revised to 35,000 tonnes.

Given such a dramatic reduction in the proposed effectiveness of the tax credit, the Commissioner's report stated, "[T]he program will have a negligible impact on Canada's greenhouse gas emissions." The fact

4. Spence, John C., Nicholas L. Holt, Julia K. Dutove and Valerie Carson. "Uptake and effectiveness of the Children's Fitness Tax Credit in Canada: the rich get richer," in BMC Public Health. 2010 10:356.

5. Commissioner of the Environment and Sustainable Development, Report to the House of Commons, December 2008.

that almost half the claimants of this tax credit have incomes of over $50,000 per year further underlines its apparent redundancy.

If both tax credits are largely irrelevant to their alleged goals, what would be gained by their elimination? Table 3 shows that removing the Public Transit Amount would yield $97.8-million in tax expenditure savings, and eliminating the Children's Fitness Amount would produce $66.8-million in savings. Combined, these two poorly targeted and ineffective boutique tax credits are worth $164.6-million annually. Further details regarding these calculations are available in Appendix 1.

Table 3: Cost savings from eliminating non-refundable tax credits

Non-refundable Tax Credit	Tax Savings (in millions of dollars)
Public Transit Amount	$ 97.80
Children's Fitness Amount	$ 66.80
Combined	$ 164.60

Source: Statistics Canada: Public Use Survey of Labour and Income Dynamics 2007 and Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html. Author calculations using Canadian Tax and Credit Simulator. See http://faculty.arts.ubc.ca/kmilligan/ctacs/download.htm.

Data limitations preclude a comprehensive savings total for all boutique tax breaks. However, Appendix 2 suggests that eliminating the Canada Employment Amount in addition to the Public Transit and Children's Fitness amounts would create a net tax expenditure savings of over $2-billion. This would be enough to fund a 0.75 percentage point reduction in the lowest tax bracket to 14.25 per cent. Alternatively, it could permit a $900 increase in the basic personal exemption for all taxpayers to $10,480. Both options would provide greater benefits to low-income taxpayers than does the current boutique tax system, and it would enhance the overall efficiency of the tax system.

Conclusion

Despite government rhetoric about providing broad-based tax relief for Canadians, many of the tax changes implemented by the Harper government have a narrow and politically driven target audience.

Among the selected boutique tax breaks examined in this study, the evidence suggests our two examples predominately benefit taxpayers in the middle- and upper-income categories. In a time of fiscal austerity, it is necessary to demand more effective targeting of tax expenditures toward lower income Canadians. Boutique tax breaks thus fail the test of targeting.

Further, boutique tax breaks are ineffective in achieving their stated goals. The Public Transit Tax Credit has not had any noticeable impact on greenhouse gas emissions. Similarly, the Children's Fitness Tax Credit cannot lay claim to significantly increasing the number of children involved in physical activity. Combined, these two boutique tax credits represent more than $164-million in unnecessary and indefensible federal tax expenditures.

If the Harper government is serious about reviewing government expenditures and cutting ineffective programs, it should take a much closer look at its tax expenditures and, in particular, eliminate the boutique tax benefits.

"In a time of fiscal austerity, it is necessary to demand more effective targeting..."

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APPENDIX 1:

Calculating net savings from eliminating non-refundable tax credits

Table A estimates the amount spent on two boutique tax credits across listed income categories. This is derived by multiplying the fraction of claims made by income groups by the actual tax expenditures as reported by the Department of Finance.

Table A: Tax expenditure by program, 2007 (in millions of dollars)

Tax Credit	Total Tax Expenditure	Percentage Claimed by Middle- and Upper-income Groups	Estimated Accruing to Middle- and Upper-income Group
Public Transit	$ 100	44%	$ 44
Children's Fitness	$ 90	70%	$ 63

Source: Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html and Department of Finance Tax Expenditures and Evaluations: 2009. See www.fin.gc.ca/taxexp-depfisc/2009/taxexp0901-eng.asp.

The Public Transit Amount and Children's Fitness Amount deliver $44-million and $63-million respectively to tax filers who earn more than $50,000 per year. Combined, these two boutique tax credits provide $107-million in tax breaks to families in the middle- and upper-income categories. Because low-income tax filers are less likely to receive the full value of their non-refundable tax credit, as compared to middle- and upper-income tax filers, we may consider this a lower-bound estimate of the tax savings available.

To derive net tax savings from eliminating the Public Transit and Children's Fitness amounts requires use of Statistics Canada's Survey of Labour and Income Dynamics (SLID) microdata and the Canadian Tax and Credit Simulator. The calculation of net savings from removing a specific non-refundable tax credit is complicated by the progressivity of the tax system and the fact tax credits and benefits often interact. Since SLID does not include all necessary information, some data have been assigned to individuals based on income categories from the 2009 Canada Revenue Agency Income Statistics and calibrated to approximate aggregated figures from national Income Statistics. This may produce a slight overestimate of federal taxes.

Basic federal tax receipts are calculated for a baseline tax system to use as a reference. Then total tax receipts are recalculated as various items are eliminated from the tax menu. The difference between counterfactual and reference receipts is an estimate of the total cost of the program in question. Baseline federal tax for 2007 is estimated to be $112.3-billion.

Table B: Cost savings from eliminating non-refundable tax credits

Non-refundable Tax Credit	Tax Savings (in millions of dollars)
Public Transit Amount	$ 97.80
Children's Fitness Amount	$ 66.80
Combined	$ 164.60

Source: Statistics Canada: Public Use Survey of Labour and Income Dynamics 2007 and Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html. Author calculations using Canadian Tax and Credit Simulator. See http://faculty.arts.ubc.ca/kmilligan/ctacs/download.htm.

From Table B, the Public Transit Amount represents a gross expenditure of $97-million, and the Children's Fitness Amount costs the federal treasury $66-million. Combined, the elimination of these two tax credits is worth $164-million.

APPENDIX 2:

Removing the Canada Employment Amount

The Canada Employment Amount is the largest boutique tax break created by the Harper government. Table C shows the impact of eliminating this tax expenditure in addition to the Public Transit and Children's Fitness amounts. The total of $2-billion in net savings could provide a 0.75 percentage point reduction in the lowest tax bracket to 14.25 per cent. Alternatively, it could allow for a $900 increase in the basic personal exemption to $10,480. Either option would be revenue neutral and improve the overall efficiency of Canada's personal tax system.

Table C: Cost savings from eliminating non-refundable tax credits, including Canada Employment Amount

Non-refundable Tax Credit	Tax Savings (in millions of dollars)
Public Transit Amount	$ 97.80
Children's Fitness Amount	$ 66.80
Canada Employment Amount	$ 1,921.70
Total	$ 2,087.20

Source: Statistics Canada: Public Use Survey of Labour and Income Dynamics 2007 and Canada Revenue Agency Income Statistics. See www.cra-arc.gc.ca/gncy/stts/gb07/pst/fnl/tbls-eng.html. Author calculations using Canadian Tax and Credit Simulator. See http://faculty.arts.ubc.ca/kmilligan/ctacs/download.htm.

FURTHER READING

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Why Canada Needs a Balanced Budget

http://www.fcpp.org/publication.php/2553

June 2008

On Amending the Proposed Balanced Budget Law - Bill 38

http://www.fcpp.org/pdf/PH%20JUne5%202008%20testimony%20Bill%2038final.pdf

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