**THE CASE AGAINST TAX CREDITS AND OTHER EXPENDITURES (CONDENSED)**

**A B S T R A C T from Neil Brooks PDF** (page 65)

One of the distinguishing features of the Harper Conservatives’ tax policy was the enactment of a series of so-called boutique tax credits. Although the Canadian income tax was riddled with tax expenditures before the election of the Conservatives in 2006, a number of reasons can be identified that explain the Harper government’s particular fondness for boutique tax credits. In addition to reviewing these explanations, this article defends three claims. First, boutique tax credits, along with almost all other tax expenditures, impair the legitimacy of the tax system and hobble it in the pursuit of its primary functions—raising revenue and redistributing income. Second, analyzed as spending programs, which they are, tax expenditures, particularly boutique tax credits, violate almost every criterion of a well-designed spending program. Third, the enactment of tax expenditures circumvents almost all of the accountability and control mechanisms of sensible budgetary policy making and thus imperils democratic governance for the common good.

**THE RISE OF BOUTIQUE TAX EXPENDITURES** (page 67)

More than 100 tax expenditures were introduced or substantially amended by Stephen Harper’s Conservative government over the decade (2006 to 2015) during which it was in power. This aspect of the Conservatives’ tax agenda has drawn considerable commentary, particularly the government’s apparent fondness for what have become widely known as “boutique tax expenditures.” Although the phrase does not have a settled meaning, most commentators use it to refer to the tax expenditures introduced by the Conservatives that were targeted at relatively narrowly defined groups of potential Conservative voters.

**Problem 1** - Boutique Tax Credits initiated by the Progressive Conservative Party under Stephen Harper **purposely target traditional family values**. The party never gives a definition of traditional family values or who is included in the traditional family. They talk about the family unit as ‘essential to the well-being of individuals and society’. a reflection of their belief in the importance of the role of the traditional family in society, another objective was to privilege single-earner families through the tax system. (The Attraction of Boutique Tax Credits-page 76)

**Most tax expenditures are skewed toward the better off and therefore make the tax system much less redistributive than it otherwise would be. Although most of the boutique tax credits are regressive, particularly over low- and middle-income ranges, they are not as significantly regressive, particularly at the top of the income scale, as other changes introduced by the Conservatives—for example, the enrichment of the dividend tax credit, the introduction of TFSAs, the enrichment of the lifetime capital gains exemption, the changes to the capital gains exemption for in-kind charitable donations, pension income splitting, and the family tax cut. (page 95)**

The pension income-splitting scheme (introduced in 2007) is a clear example. It benefits almost exclusively middle- and high-income seniors and only those who have pensions. The parliamentary budget officer has estimated that the lower half of Canadian senior households have received less than 20 percent of the financial benefits from the pension income-splitting scheme: The pension income tax credit, and liberalizing the rules relating to registered retirement income funds (RRIFs) (by extending the age at which withdrawals must begin, to 71 from 69, and by decreasing the minimum withdrawal rates)—appear to be unjustified. (page 97)

Only the political clout of seniors explains its retention. **And of course the cost and inequity of the credit was increased with the enactment of pension income splitting, since now both spouses can claim the credit even though only one has pension income.** (page 97)

The income splitting and child care benefit tax credits were meant to target families with children and favoured households where one spouse stays home to care for the children. Check page number

(Blog author’s comment: The credits were financially discriminatory , in particular income splitting, for poor families who could not afford to have one spouse stay home, single parents with children who could not use the income splitting credit, and **ever singles who could not use any of these credits.)**

**Problem 2** -tax expenditures introduced by the Conservatives of Boutique Tax Credits were **targeted at relatively narrowly defined groups of potential Conservative voters**. (The Rise of Boutique Tax Expenditures -page 67). This is what the author of this blog calls **‘selective’ democratic socialism**. Instead, their purpose is to provide an implicit subsidy to persons who behave in ways that the government wishes to encourage or to persons who are deemed to be entitled to some form of relief because of their circumstances. These types of provisions are now widely referred to as tax expenditures. They take the form of special tax exemptions, deductions, credits, lower rates of tax, or provisions that allow taxes to be deferred. (Definition and Classification of Tax Expenditures-page 69).

**Problem 3** - Tax Credits and Expenditures ignore traditional tax criteria that apply to technical tax provisions, namely, equity, neutrality, and simplicity….. Regardless whether the measure is implemented as a direct spending program or as a tax expenditure, the government must raise additional revenue equal to the amount of the subsidy, reduce other expenditures by the same amount, or incur a debt of the same amount (or some combination of these three actions). (Definition and Classification of Tax Expenditures-page 69)

**Problem 4** - Conservatives were “pleasing their electoral base with . . . dollars in pockets for boutique programs rewarding **wealth and socially conservative values** (Definition and Classification of Tax Expenditures-page 69).

(Blog author;s comment: An example is pension splitting where wealthy married/coupled persons benefit the most, poor and married/coupled persons with equal incomes benefited to a lesser extent.  **Ever singles and divorced/separated persons are not able to use this tax credit).**

**Problem 4 -** Harper government had three broad objectives in its approach to the tax system. **First,** as an integral part of the Conservatives’ agenda to reduce the size of the federal government, and as a reflection of their dislike of taxes generally, an overriding objective was simply to reduce federal taxes. **Second,** as a reflection of their belief in the importance of the role of the traditional family in society, another objective was to privilege single-earner families through the tax system. **Third,** in order to encourage savings and investment, a further objective was to substantially reduce the tax burden on income from capital. (The Attraction of Boutique Tax Credits-page 76).

Problem 5 - **Tax Expenditures Can Serve as a Bribe to Potential Voters** (page 77)

By enacting these tax expenditures, as opposed to across-the-board tax cuts, the Conservatives were able, at a much lower cost, to favour middle-class families with children, middle-income and well-to-do seniors, and other much more narrowly targeted groups.

In 2011, the average taxpayer with an income between $100,000 and $150,000 paid $3,633 less in taxes. The average taxpayer with a very modest income of between $20,000 and $25,000 saw only $475 back in the same period. These numbers are before the impact of the new Family Tax Cut and the doubling of the Child Fitness Tax Credit – both of which are likely to accelerate the same trend. ([/canada2020](http://canada2020.ca/robson-boutique-tax-credits/)). Poor families and ever singles including seniors are least likely to benefit. (add link Senior Singles Pay More)

Problem 6 - It is very **difficult to get rid of tax expenditures or tax credits once they are implemented.** Political parties are reluctant eliminate them even if they are discriminatory for fear of losing votes. Also, tax expenditures are extremely hard to repeal, even the truly awful ones, since eliminating a tax expenditure will be framed as a tax increase. It is other taxpayers who pay for the subsidy.  **(Tax Expenditures Can Be Framed as Tax Cuts-page 78).**

(Blog author’s comments: Will it ever be possible to eliminate the pension splitting from which wealthy families benefit the most? And, who is paying for this, ever singles are subsidizing many of these credits and expenditures).

**Problem 7** - tax expenditures that are relief measures transfer income from one group of individuals to another (page 80). Ok Instead of these relief measures targeting lower income individuals and families, many have benefited wealthy families the most.

**Problem 8** - **Psychological impact of tax credits or expenditures** (The Public Appears to Favour Policies Framed as Tax Breaks-page 83). people’s psychological biases predispose them to favour tax expenditures, certainly over direct spending programs…...label—tax relief versus direct outlay—matters.” These studies are also consistent with other survey results in which respondents admit to have benefited from tax expenditures and yet deny ever having used a government social program.

(Blog Author’s comments: The **reverse effects** of Tax Credits and Expenditure are often not discussed, that is, **the anger and financial despair that some citizens feel towards those that are receiving more of the benefits without, for example, application of income-testing principles).**

**Problem 9 - Tax Expenditures Reduce the Political Pressure for Public Programs (**page 84)

One of the Conservatives’ major political goals has been to resist the public provision of social programs. Hence, another explanation for the popularity of tax expenditures under the Conservatives is that they were a step forward in implementing a broader political project, a private-sector welfare state.Tax credits for private caregiving work reduce the political pressure for publicly provided long-term care facilities.. …. Supplementing the wages of low-income workers with a tax credit reduces the pressure to offer public service jobs to the unemployed…..The tax subsidization of tuition fees, textbooks, and interest on student loans reduces the political pressure for more direct government support for universities.

**Problem 10 - Tax Expenditures Make the Tax System Less Transparent** (page 94) and **Tax Expenditures Divert the Resources of the CRA and Create Administrative Problems That Damage Its Reputation** (page 94)

An income tax system riddled with tax expenditures makes it difficult for laypersons and even those administering the tax system, including tax lawyers and judges, to discern the principles that underlie the technical tax rules.

One of the most serious costs that tax expenditures impose on the tax system is their consumption of resources that the CRA could more productively use in carrying out its central function of raising revenue. Instead of concentrating its efforts on ensuring that taxpayers accurately report their income and comply with the technical rules of the income tax, the CRA must spend a good deal of time and resources in designing workable administrative practices for the application of the tax expenditure provisions, providing assistance to taxpayers who want to claim these credits and deductions, and ensuring that only eligible taxpayers receive them. Often these tasks require specialized expertise that goes beyond the training of CRA employees *(during a period when its staff and budgets were being reduced* (page 94).

In short, unlike the public response to the deliberate and contrived abuse of direct spending programs, no moral opprobrium attaches in most social circles to tax avoidance. Another factor accounting for the large amount of abuse involved in the delivery of tax expenditures is the fact that tax lawyers and accountants become intimately involved in their implementation. (page 112)

One of their functions is to minimize the tax liabilities of their clients, and that often involves the creative use of tax expenditures (page 112).

Most programs need adjustment and reassessment as they are implemented, since it is almost impossible to anticipate all the problems that may arise in the delivery of the program. When a program is delivered through the tax system, however, unlike a direct spending program, it cannot be monitored on an ongoing basis. [I]n the past, so little information about tax expenditure claims was asked for on tax returns that it was often impossible to monitor the use of these programs

(page 114).

**TAX EXPENDITURES ARE USUALLY BADLY DESIGNED SPENDING MEASURES**

(page 96)

Since tax expenditures are spending measures, not tax measures, they should not be evaluated using the traditional tax criteria of equity, neutrality, and simplicity. They should be evaluated using budgetary criteria, the same criteria used in evaluating all spending measures.

**Tax Expenditures Often Do Not Serve Important Objectives of Government Policy**

(page 97)

Although the objectives of governments are varied, tax expenditures are primarily used by governments for two broad purposes: to achieve a more efficient allocation of resources and to achieve a more just distribution of resources than that which would result from market forces alone.

Tax expenditures are most commonly used in attempts to correct for externalities. An externality

is the benefit (or cost) that arises from an activity and does not accrue to the party or parties carrying out the activity (example: higher education). The first-time home buyer’s tax credit, which the Conservatives enacted in 2009, and the enrichment in the same year of the home buyer’s plan associated with RRSPs, are part of a full suite of tax expenditures that the Act provides in support of home ownership.

Eligible taxpayers will be able to claim a tax credit for costs of up to $10,000 incurred in making their home more accessible or secure. However, even though many seniors and people with disabilities have low or modest incomes and hence pay little or no income tax, the credit was not made refundable. Thus, a high-income senior will be entitled to be reimbursed for part of the costs of making his or her home more accessible, but a low-income senior who undertakes identical renovations will not. (page 106)

(Blog author’s comment: It is prudent to mention that home ownership Tax Credits and Expenditures are more likely to help families and married/coupled persons as they are more likely to own their homes. The poor and singles are unlikely to be able to use these credits as there is less affordable housing for singles and they are more like to rent than to own.)

**Tax Expenditures Often Do Not Achieve Their Objectives Equitably** (page 104)

A question that has to be asked about all government spending programs, even those that are effective in serving legitimate and priority government objectives, is whether they are **equitable.**

For the budget in 1981. The analysis found that the benefits of tax expenditures accrued overwhelmingly to the rich: taxpayers with an annual income between $10,000 and $15,000 received an average tax saving of $771 from tax expenditures, while those with income over $100,000 received an average saving of $46,000. In many ways, it was this document that motivated the 1981 budget’s ill-fated attempt to repeal countless tax expenditures and that in 1988 led to the conversion of many tax expenditures from tax deductions to tax credits.

As a result of the growing appreciation of the **upside-down effect of tax deductions** in the **1988 tax reform exercise, most tax expenditures that took the form of tax deductions were converted to tax credits (page 104).**

**But a credit that can be offset against a taxpayer’s tax liability is of no value to a low-income person who has no tax liability because his or her income is less than the amount of the basic personal tax credit, for example. Hence, all tax credits should be refundable.** (page 104)

**Problem 11** - Education - **Recently, all newly enacted tax expenditures have taken the form of tax credits.** However, tax expenditures that take the form of tax deductions and exemptions continue to be enriched. For example, the **Conservatives completely exempted certain scholarships and fellowships from tax in their first budget in 2006. The exclusion of a $10,000 scholarship for a low-income student who has no other income provides that student with no implicit subsidy. However, the same exclusion will provide an implicit subsidy of $2,200 to a higher-income student in the 22 percent tax bracket. If the point of the exclusion was to benefit needy students, this upside-down effect is perverse.** If scholarships are to be subsidized through the tax system, a more appropriate method of doing so would be to require students to include scholarships in their income and then income and then provide them with a tax credit equal to the desired subsidy (page 105).

**Problem 12** - **A credit that can be offset against a taxpayer’s tax liability is of no value to a low-income person who has no tax liability because his or her income is less than the amount of the basic personal tax credit, for example. Hence, all tax credits should be refundable** (page 106).

Finally, in terms of delivering subsidies equitably through the tax system, if the primary purpose of a tax credit is to incentivize or assist low- or middle-income individuals, entitlement to the credit should be income-tested so that it vanishes when a taxpayer’s income reaches a certain amount. (page 108).

regressivity is defined. Since, by the most basic measure, the top 50 percent of income earners claim a greater percentage of the benefits than the bottom 50 percent of income earners, that is almost certainly the case (page 108).

one of the most regressive changes the Conservatives made to personal tax expenditures is the **elimination of the capital gains tax on accrued gains on publicly listed securities donated to a charity.** (Although this tax expenditure is not often categorized as a boutique tax credit, it has the same characteristics) (page 108).

important to look at their distribution from the perspective of gender and race….tax expenditures tend to favour men over women. Kathleen Lahey has estimated that women receive only about 40 percent of the benefits of tax expenditures (page 111).

the fairness of the tax system for lower-income individuals, all tax credits should be made refundable and this reform should be funded by making all tax credits income-tested, so that they will vanish as an individual’s income increases. (page 108)

**Problem 13** - Finally, the proliferation of tax expenditures, such as the boutique tax credits, gives rise to significant rent-seeking social costs and encourages relevant interest groups to lobby for analogous tax expenditures. (page 114)

**TAX EXPENDITURES SHOULD BE INTEGRATED INTO THE BUDGET PROCESS** (page 125)

The proliferation of tax expenditures will not be halted until they are subject to the same budgetary control and parliamentary scrutiny as direct spending programs and there are therefore no political incentives that might tend to favour one form of spending policy instrument over another without regard to their effectiveness in achieving the government’s policy priorities.

Also, the distributional tables s**hould show beneficiaries by income class, gender, household type, age cohort, and geographical region.**

**THE URGENT NEED FOR (TAX) SPENDING REFORM** (page 128)

The basic point made at the outset of this essay was that the income tax is composed of two distinct types of provisions, technical tax provisions and tax expenditures. This has important implications for a range of issues related to the tax system, as illustrated throughout. **However, the most profound implication of this insight is that much of what has traditionally been called tax reform is really spending reform.**  The rhetoric of tax reform continues to be applied to tax expenditures, and tax expenditures continue to be treated as if they were part of the tax system. Yet tax reform and reforming tax expenditures are entirely different exercises. In terms of the two-cheque nature of tax expenditures, tax reform has to do with evaluating the technical tax rules that result in the notional tax cheque that the recipient of a tax expenditure sends to the government; an analysis of tax expenditures has to do with the rules that determine the amount of the notional spending cheque that the recipient can offset against his or her tax liability. The first set of rules is evaluated using tax criteria; the second set of rules is evaluated using budgetary criteria. Although the technical tax rules are in need of reform to render them more equitable,

neutral, and simple, the much more pressing need is to rationalize the spending done through the tax system…..

[Political parties in Canada, particularly the Conservatives over the past decade, have been attracted to tax expenditures. Tax expenditures have been prescribed for seemingly every social and economic ill the country faces. Although this essay has dealt with only a few specific tax expenditures, the ones referred to generally are found not to be serving compelling government objectives, are ineffective in achieving their objectives, are inequitable, incur costs that likely outweigh whatever benefits they might achieve, and could be replaced with more appropriate governing policy instruments. There is an urgent need to ensure that tax expenditures are

properly conceptualized in the tax reform process so that the powerful political incentives leading to their proliferation are neutralized. Subjecting them to the analysis suggested in this essay will increase the integrity of the Canadian tax system, the efficiency and equity of government spending programs, and the transparency and vibrancy of Canadian democracy, and will spell the end of the unprincipled use of boutique tax credits.