The Royal Bank of Canada

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SPRING is not only a time of young men's fancies, of budding trees, and burgeoning flowers: it is also the open season for income tax returns and payments.

It has been said, particularly in war years, that Canadians do not dislike the payment so much as the act of paying and the chore of filling blank spaces in forms. Hostility to tax reports seems to be a natural reaction. The grumbling taxpayer resents the intrusion of the government in his private affairs. And, of course, he does not like the changes in his desired standard of living made necessary by payment of taxes.

Canada's Income War Tax Act has grown from a few paragraphs to 84 pages, containing 48,000 words, and there are pamphlets and booklets galore explaining what the Act means. One "guide" to income tax has 131,000 words, while another, designed for more popular use, has 80,000 words. The mass of explanatory material available on income taxes recalls the announcement of the Scottish inventor of a system of logarithms. In 1614, John Napier wrote: "Seeing there is nothing (right well beloved Students of Mathematics) that is so troublesome to mathematical practice, nor doth more molest and hinder calculators, than the multiplications, divisions, square and cubical extractions of great numbers, which besides the tedious expense of time are for the most part subject to many slippery errors, I began therefore to consider in my mind by what certain and ready art I might remove those hindrances." Men and women today would be very thankful if Mr. Napier had turned his attention to the simplifying of income tax forms, and the removal of multiple chances for "slippery errors." At the same time, income tax prose should be abolished and there should be an Act compelling the authors of tax instruction sheets to use short words, short sentences and no brackets.

It is generally conceded that the income tax is a reasonable kind of taxation. It can be delicately adjusted to individual circumstances, and thus made fairer in its incidence than other taxes. It adapts itself automatically, particularly since Canada went on the "pay-as-you-go" basis, to economic fluctuations.

Before the war, there were about 300,000 persons making income tax returns in the Dominion; today, there are 2½ million. In addition to the increase in numbers of persons preparing returns, there has been a yearly complication of the statements needed, so that both taxpayers and officials have been laden with work. It has been suggested that the government might eliminate all reports on incomes of less than $3,000 a year, leaving the employer to deduct the tax and make consolidated returns, while the taxation department concentrated upon the taxpaying class which contributes the bulk of revenue with the objective of making assessments more speedily. Against this it is argued that when every person within the taxable class must present a declaration of his income, and calculate his own tax, he becomes better aware of the responsibility he bears in the national economy. Probably Aesop, in his fable about taxation of the animal kingdom, hit the nail on the head. When the tiger proposed that taxation should be judged by vices, each beast settling the quantity for its neighbour, the elephant countered with a suggestion that taxation should be levied on virtues, and "leave it to everyone to give a catalogue of his own, and then there is very little doubt but it would prove the means of raising a most ample and rich exchequer." When a campaign for publicity of income tax returns was going through one of its periodical resurgences in the United States, an argument was brought forth in favour of publicity to the effect that "our pride and the vanity of our wives and families would impel us to pay the biggest income tax we could charge ourselves with." The income tax forms proffer this opportunity to every citizen. Those who do *not* satisfy the Inspector of Income Tax at the first try will find the officials eager to help them in their plight.

Imposed, like the British income tax, in a wartime emergency, the income tax is now an abiding part of the taxation structure. After many ups and downs since its imposition in 1917, it entered its era of greatest changes in 1941, a year of enhanced war dangers. The Minister of Finance told the House of Commons: "We have reached the conclusion that the rates of personal and corporation income taxes should be raised by the dominion to the maximum levels which would be reasonable at this time if the provinces were not in those fields . . . I shall outline proposals to increase the minimum rates of corporation income tax to 40 per cent; to increase the rates of personal income taxes very considerably, and to increase the national defence tax. But these increases, if taken together with the existing provincial rates, would result in too heavy a burden, and it is proposed, therefore, as a temporary expedient for the duration of the war only, to ask the provinces to vacate these two tax fields. The plan . . . will permit the dominion government to levy the necessary taxes without injustice to residents of different sections of the country, or to different income groups." The provinces agreed to vacate the income tax field for the duration and for one year after termination of hostilities.

To summarize the income tax changes during the war, a booklet entitled "Personal Income Tax" was prepared for the Dominion-Provincial Conference on Reconstruction which opened at Ottawa last August. It reported: "Individuals paid at the highest level in 1943. Although the rates of taxation reached their peak in 1942, the effective rate of tax was not at its greatest in that year owing to the forgiveness of one half the tax. Since 1943, all amendments of a major nature have been made generally to decrease the amount of tax payable by widening the scope of allowances and deductions and by removing the 'savings' or 'refundable' portion; the scale of rates has not changed since 1942 (other than by the removal of the 'refundable portion') and individuals have paid the same rate of actual tax (not including 'savings') since that time." In December, 1945, the Government reduced the income tax by 16 per cent, allowing a deduction of 4 per cent from aggregate taxes due on incomes earned in that year.

Taxation is the chief means by which a government obtains funds, and the tax represents a compulsory transfer of wealth from the individual to society. Wrapped up in this transfer is the danger that imposition of a tax may discourage production in private industry, because there will be less left for industry to spend on expansion of its facilities and less for individuals to invest in productive enterprise. This has to be taken into consideration as governments decide how much they should spend, how much they should borrow, and how much they should collect in taxes. Taxes are determined in the main by government expenditures. Some are forced, as in the case of war for the country's preservation. Others are incurred by choice, such as social security expenditures and the amounts spent on public works. The inclination in late years is for people to seek satisfaction of more and more of their wants out of the public exchequer, and the state strives to meet these demands out of increased taxes.

The pressure upon governments to spend money was summed up by the Minister of Finance in December when he admitted the difficulties he met in trying to economize: "We talk about putting a watch on expenditures, but how much assistance do we get in this House in watching expenditures? Nine-tenths of the speeches in this House are asking for bigger and better expenditures . . . If the Government is making large expenditures, it is not because the ministers are trying to make those expenditures; it is because of public and parliamentary demands for these expenditures. That is why the expenditures are being made. At times I feel as though I am against the whole world when I try to keep a lot of these expenditures down."

Accordingly, the income tax is here, apparently to stay so long as the people and their representatives in Parliament demand the expenditures. Income taxes, both individual and corporation, are among the government's most flexible sources of revenue. By careful adjustment from year to year, say those who approve, income taxes can be made to yield revenues suited to the needs of the government. On the other hand, those opposed declare that it is false economy to increase corporation and individual taxation in lean years when the government needs money, such as in the case of a depression. Taking the increased levies means that capital is being removed, capital which might have been used to expand and improve the employment capacity of the country, and the results of taxation may be very far-reaching. The old English tax on windows led to such economy in the use of windows that the population was deprived of the light and air needed for health; the English corn laws brought some prosperity to the farmers, but reduced the diet of industrial workers.

There is, to everyday people, an Alice in Wonderland aura around government finance. Most public bodies seem to subscribe to the purpose attributed to Mark Twain, that he "was resolved to live within his income even if he had to borrow to do it."

As to the government's method of collecting taxes, it resolves itself, in the broad sense, into a choice between direct and indirect taxation. A direct tax is one demanded from the persons who should pay it; indirect taxes are levied upon one person in the expectation that he will pass them on. It may be said by some that payment of indirect taxes is optional with the consumer, because he does not have to buy the goods in the price of which the taxes are included. He may give up smoking, if he resents strongly enough the increase in cost from about 50 cents a half-pound of tobacco to 93 cents, and from free to 14 cents for a packet of cigarette papers. This is one reason why reliance upon consumption taxes is not always satisfactory. War experience showed that countries which relied heavily on indirect taxes found them a disappointment. They served to limit consumption, which was one desirable feature in wartime, but they did not thereby augment public revenue. Another argument against indirect taxes, and therefore in favour of such direct taxes as those on income, is that all indirect taxes press most heavily upon persons in the lower income brackets. Yet another reason against indirect taxes is their hidden nature, so that most people pay no attention to the toll they are paying, and therefore feel no responsibility for the expenditures of their governments. There is more talk about income tax, which in 1944 yielded $1,037 million, than about all other taxes, which yielded $1,400 million, and this may undoubtedly be attributed to the fact that every dollar and cent of the income tax was seen and felt. To encourage wholesome vigilance by citizens, say those who oppose indirect taxation, people must be able to discover without difficulty what they have to pay and why.

Incidence is one of the most complicated and important subjects in economic science. Unless there is proper analysis of the incidence of a tax, there can be no just opinion formed of its actual effect. There will undoubtedly be cases of inequity under all taxes, but if the overall system is well designed it should not as a whole bear inequitably on anyone or on any class. The first problem is to decide what justice and equality are. Some think taxation should be according to benefit, but the benefit accruing to an individual from the state cannot be measured. Others would make ability to pay the criterion, but this, like standards of living, is a flexible and changing thing, a loose term conditioned by all kinds of unexpected factors.

People object to the intricate nature of the income tax report, but no plan of taxation can be both simple and fair. If due regard is to be paid to the impact of a tax upon every individual, considering the individual's particular circumstances and needs, then a very complicated system of inquiry and assessment is needed. If everyone had to pay an equal tax of $50, regardless of circumstances, no inquiry or forms would be required, but such a tax would be obviously unfair. The political measure of equality means equality of proportional sacrifice, so that, by apportioning the contribution of each citizen toward the expenses of government, none shall feel more or less inconvenience from his share of the payment than anyone else. It has been admitted by ministers of finance repeatedly that this perfection cannot be completely realized, but it is always in the forefront of the minds of sincere governments, and the difficulty of doing perfect justice is no reason against doing as much as possible.

Because a certain minimum of income is necessary to existence, tax laws provide that up to a fixed amount no taxation shall be levied. It is probably impossible to determine a precise amount, and the approximations vary with nations and times. Another reason for exemption of small incomes, a reason which has nothing to do with the principle, is the cost of collection. It costs no more to collect the 94 per cent which is charged on single status incomes over $100,660 than to collect the 2 per cent which might be levied on incomes under $660. In other words, $235,000 can be collected on an income of $250,000 with as little effort and cost as can $13.20 on an income of $660.

Many regard the excess profits tax, corporation tax and succession duties as all falling under the general heading "income tax." The Succession Duty Act came into force in 1941. It exempted estates of less than $5,000, and extended exemption to sums over that amount, varying, as did rates, according to the relationship of the beneficiary. Since the incidence of duties on transference of a person's property at death is similar to that of general ad valorem property taxes, it has been argued that they should be used only for capital expenditures, and not to meet ordinary running expenses. Others, of course, regard taxes on estates as an instrument to break up fortunes on the death of the original creator. These argue, in favour of their contention, that no person actually feels the weight of such taxation, because the deceased enjoyed his income up until his death, and his heirs never had the income. Still others contend that milking of estates by taxation will result in less effort being made to accumulate wealth, with consequent bad effects upon the economic life of the country.

That business can be hurt by too heavy taxation seems evident, but there has been a marked tendency in recent years in the direction of taxing the right to carry on business, especially in the corporate form. The present complexity of corporation taxation, said the Royal Commission in 1940, "is beyond belief." It pointed out that there were, in the way of taxes: the corporation income tax, levied by the Dominion and most provinces; taxes levied by one or more governments on capital stock, number of business places, gross revenue, physical volume of output, period of operation, mileage of track or wire, mileage operated, note circulation, insurance premiums, investments, volume of deposits, and so on, according to the business of the taxpayer. "They have grown up in a completely unplanned and unco-ordinated way," says the Commission report, "and violate every canon of sound taxation." Corporation taxes may be based upon either income or capital structure. So long as the same system of taxation is applied to corporations in the same business, there may be approximate equality, but when one company happens to be in a different province from another, subject to different taxation, the result is to penalize one of the two by upsetting the basis of competition.

The Excess Profits Tax Act of 1940 has as its objective the taxing of excess business profits occurring in an expended wartime economy. Standards were set on the three best years of the four-year period extending from 1936 to 1939. This tax is really in the nature of a special income tax, very remunerative to the government.

Many persons wonder how much Canadians pay in income tax compared with people in other countries. The accompanying graph, based upon data in "Personal Income Taxes, a Reference Book for Dominion-Provincial Conference on Reconstruction," supplies a partial answer. It would require many pages of figures to give a complete comparison embracing variable state and municipal taxes, exemptions and surtaxes, and taking account of the variation in cost of living by which the amount left after taxes is modified. However, this chart shows roughly the relativity between payments made by persons in various income brackets in four countries. A tax of 6.7 per cent on the first $1,500 of income in Canada compares with 19.1 in Australia, 10.7 in the United Kingdom, and 6.3 per cent in the United States, while at $50,000 income the rates are 67.5, 85.6, 70.0 and 60.6 per cent respectively.

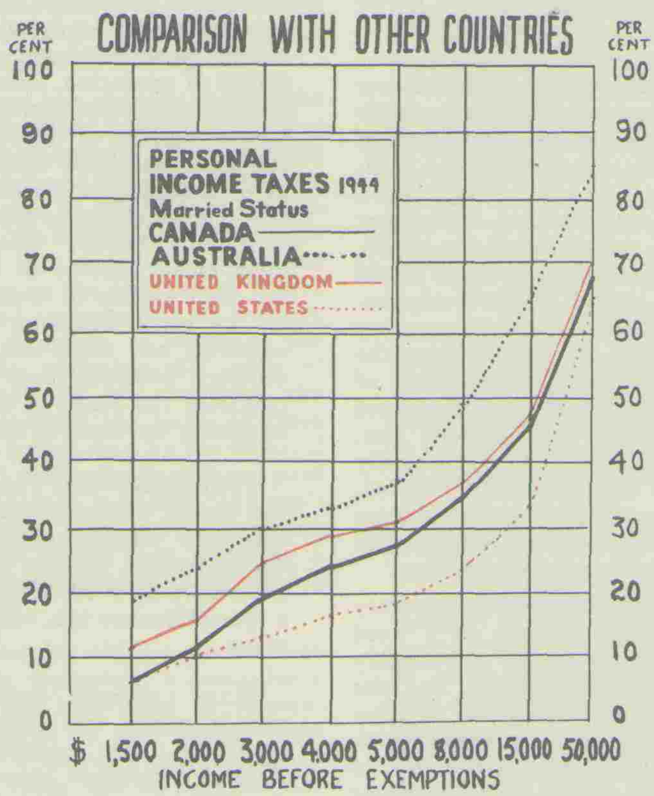
Since excessive taxation damps down enterprise, initiative and effort, it is advisable to make sure the income tax is carefully integrated with the whole life of the country. This is just as necessary if a view is taken from the government's strong box as from the office of a business executive, because as a tax or tariff becomes completely absorbing, by its very nature it ceases to produce revenue. Industry is a living, progressing thing, and cannot be limited permanently to profits earned in a base period if it is to provide for the material wants of the people and the pecuniary wants of the government. It needs a continual supply of new capital, and over-taxation of individuals or corporations will kill the goose that lays the golden eggs. This seems obvious, but legislators and factions are often short-sighted as to the ultimate consequences of legislation. All idealistic visions to the contrary notwithstanding, the foundation of productive enterprise is laid through energy, skill, thrift, and expansion, and care must be taken not to paralyze these virtues through indiscreet taxation.

When principles to be followed in taxing incomes, assessing various kinds of workers and striving for an equal distribution of tax responsibility have been established, the work of the administrative department is just beginning. The rules laid down by the legislators require a great deal of interpretation to fit all the cases which come before the collectors. Recent criticism has been directed toward the delays encountered in assessments and decisions, and the wide latitude allowed taxing officers. As to the first, all tax returns are supposed to be verified and assessed by departmental officers within a year of filing, but everyone knows that the wartime increase in returns has thrown the department back years. The last "pink slip" (final judgment on an income tax return) received by some T-1 taxpayers was for 1941. This quaint state of things, it is being argued, is a handicap to business, and there is agitation in some circles for a re-organization of the Income Tax Division with a view to bringing it, as well as the whole taxation system, up to date.

With regard to administration discretion, both taxpayers and tax division men walk some fine chalk lines, though there is not so much room left as formerly for caprice in the handling of tax assessments. In a recent Supreme Court ruling the Department of National Revenue was sharply criticized for its wide discretionary powers, but the fault does not lie so much with individuals administering the Act as with the Act itself. It is a complicated accretion of regulations, amendments, and rulings, requiring a complete overhaul and codification.

Much of the future depends upon sane taxation policies. The government, realizing this, has been ready to pledge that as soon as the Dominion's proposals were accepted by the provinces, further reductions in income tax would be made, and that the element of double taxation in corporation income tax would be cut down. Taxes may be the sinews of the state, as Cicero said, but there are bounds, all governments have found, to the supply of medicine that builds the brawn of the state. Kings ought to shear, not skin, their sheep, and taxation should be based not only on the resources of the citizen, but on his ability to recuperate.

To make the income tax consistent with justice and good sense, it should neither add to the hardships of those in the lower brackets, nor detract from the achievements of those in the upper range. Governments should be prepared to answer criticism of taxes of all kinds by pointing to necessary things done for the good of all society. Otherwise, they may find a lesson in an episode from Greek history: When Themistocles went to Andros seeking money, he warned that he had brought with him two goddesses, Persuasion and Force. He was answered that they, also, had two great goddesses, who prohibited them from giving any money. They were Poverty and Impossibility.



The Canadian and the United Kingdom percentages exclude the "refundable" portions. The U.S.A. percentage includes the New York State income tax before the recently-announced reduction. The $50,000 percentage includes 50 per cent "investment income"

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