Chapter 2
Personal Income Taxation in Canada

PERSONAL INCOME TAX is the largest single source of government revenue. It follows, therefore, that the largest single tax paid by the average Canadian family is the income tax. This tax came into existence in 1917 as a "temporary" emergency measure to help finance the increasing debt incurred during World War I. Nothing, it seems, endures like the temporary.

The current income tax structure

Several significant changes to personal income taxation were announced or confirmed in 1999 and 2000. These changes include the re-indexation of exemptions and brackets and the move by the provinces from "tax-on-tax" assessment of personal income to "tax-on-income" assessment.

Bracket creep

Many Canadian taxpayers have been pushed into higher tax brackets and have seen the value of their basic exemption eroded in recent years because governments have not always adjusted brackets and exemptions to mitigate the effects of inflation. The best way to illustrate this problem, which is often called "bracket creep," is with an example. If a worker earning \$29,000 received a 5% raise to compensate for a 5% increase in prices, her income would increase to \$30,450. This 5% raise would almost allow her to maintain her standard of living but falls short because she would now pay more income tax relative to her income than when she earned $29,000. Whereas all of the $29,000 was taxed at the 17% federal rate, the part of $30,450 in excess of $29,000 is taxed at the 25% federal rate. In the 2000 budget, the federal government announced that it would index all brackets and exemptions to the inflation rate for the 2001 and subsequent taxation years, thus ending bracket creep in the federal personal income-tax system.

Tax-on-tax assessment and tax-on-income assessment

The federal and provincial governments share personal income taxation. Prior to 2000, most provinces based their personal income tax on the "basic federal tax." Residents of provinces other than Quebec determined their basic tax owing by multiplying the basic federal tax by the provincial tax rate; hence the term "tax-on-tax" applied to most of the provincial personal income-tax systems. Quebec has operated its own personal income-tax system since 1954 on the "tax-on-income" basis. Tax-on-income assessment parallels the federal personal income-tax calculation, with taxable income as the starting point for the tax calculation. British Columbia, Manitoba, New Brunswick, Nova Scotia, and Ontario introduced tax-on-income systems in 2000. Alberta, Saskatchewan, Prince Edward Island, and Newfoundland and Labrador introduced tax-on-income systems for 2001. The territories will continue to use the tax-on-tax system. Tax-on-income assessment gives the provincial governments more flexibility in changing their personal income-tax systems to suit the needs and priorities of their constituents. The switch to tax-on-income also protects provincial revenues from decreases in federal personal income tax that, in a tax-on-tax system, automatically translate into decreases in provincial personal income tax because they decrease the basic federal tax and, therefore, the base for the provincial tax calculation. For a good overview of the recent changes to the provincial personal income tax systems, see Ort and Perry (2000) and Treff and Perry (1999).

Combined income-tax rates

Table 2.1 presents the actual income-tax rates (combined federal and provincial) encountered by the average single individual at various levels of taxable income in 1992 through 2000. As the figures show, the minimum rate of tax in 2000 is 25.84%, payable on the range of taxable income from $1.00 to $30,004. The second rate is 38.00%, payable on the range of taxable income from $30,005 to $60,009. The third rate is 44.08%, payable on the range of taxable income from $60,010 to $72,516. The maximum rate of 45.53% is payable on taxable income in excess of $72,517. These rates are the marginal rates of tax encountered as one moves from one level of taxable income to the next.

Table 2.1: Marginal rates (rate of tax in percent on the next dollar of income), 1992 through 2000, for combined federal and provincial personal income tax

1992		1993–1998		1999		2000	
Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate	Taxable Income	Rate
$1–$29,590	26.61%	$1–$29,590	26.35%	$1–$29,590	26.10%	$1–$30,004	25.84%
$29,591–$59,180	40.69%	$29,591–$59,180	40.30%	$29,591–$59,180	39.91%	$30,005–$60,009	38.00%
$59,181–$62,192	45.39%	$59,181–$62,192	44.95%	$59,181–$62,391	44.52%	$60,010–$72,516	44.08%
$62193 & above	46.84%	$62,193 & above	46.40%	$62,392 & above	45.97%	$72,517 & above	45.53%

Sources: Canadian Tax Foundation, The National Finances 1993 and 1994; Finances of The Nation 1995 through 2000; federal and provincial budgets; calculations by the authors.

Table 2.2 shows the combined federal and provincial marginal tax rates for a single individual in each province at three levels of income. An equally interesting series of calculations shows the amount of tax an individual pays on a given amount of total, rather than taxable, income (see table 2.3).

The situation can be slightly different for families because there are credits permitted for the dependent spouse. Support of children also eases somewhat the tax burden on the taxpayer. In perusing tax rates for the average family of four presented in table 2.4, the reader should bear in mind that this schedule of rates is not applicable to all families. In many cases, both adult members of the family declare taxable income and, since each files a separate return, tax rates for individuals apply. Of course, this is to the advantage of the taxpayers. If, for example, a childless couple who are both working have the same income—say $25,000 per year—they pay total tax of about $8,941 when they file as individuals. If the family's total income of $50,000 were earned by only one of them, the total tax payable would be about $11,584—a difference of $2,643. In other words, if the family's income is earned by one family member, the family pays a gross tax rate of 23.2% but, if this income is composed of two salaries, the tax rate is

Table 2.2: Personal income tax for a single taxpayer, combined federal and provincial marginal rates (%), 2000

	Income		
	$20,000	$50,000	$100,000
Newfoundland	26.4	41.1	51.3
Prince Edward Island	25.1	39.4	48.8
Nova Scotia	30.1	39.4	48.8
New Brunswick	25.2	40.2	47.4
Quebec	31.3	43.8	50.7
Ontario	21.9	34.6	47.9
Manitoba	27.4	41.2	48.1
Saskatchewan	25.1	41.9	49.7
Alberta	23.4	36.5	43.7
British Columbia	23.8	37.4	49.1

Source: Finances of The Nation, 2000, Canadian Tax Foundation, 2000.

Table 2.3: Combined federal and provincial personal income tax and tax rate (single taxpayer with no dependants), 2000

Total income ($)	Total tax payable ($)	Rate (%)
7,500	68	0.9
10,000	697	7.0
12,500	1,326	10.6
15,000	1,955	13.0
17,500	2,584	14.8
20,000	3,213	16.1
25,000	4,146	16.6
30,000	5,729	19.1
50,000	13,129	26.3
100,000	34,369	34.4
200,000	78,739	39.4

Sources: Provincial budgets and tax forms; calculations by the authors.

only 17.9%. The difference between the two tax rates rises as family income increases until very high income levels are reached (see table 2.5). This difference between the tax rates of families with a single income and those with double incomes affects many of the other calculations in the remainder of this book. In particular, income-tax payments shown in the various composite tax tables in chapter 3 reflect the fact that, on average, tax payments are made by a mixture of single-taxpayer and double-taxpayer families.

Table 2.4: Combined federal & provincial personal income tax, Canada Child Tax Benefit, and tax rate (married taxpayer with two dependant children under 16 years of age), 2000

Total income ($)	Total tax payable ($)	Canada Child Tax Benefit ($)	Net tax ($)	Rate (%)
15,000	410	3,683	(3,273)	(21.8)
17,500	1,039	3,683	(2,644)	(15.1)
20,000	1,668	3,683	(2,015)	(10.1)
25,000	2,926	3,482	(556)	(2.2)
30,000	4,184	2,733	1,451	4.8
50,000	11,584	1,601	9,983	20.0
100,000	32,772	0	32,772	32.8
200,000	77,142	0	77,142	38.6

Sources: Provincial budgets and tax forms; calculations by the authors.

Table 2.5: Tax rates for a married couple, 2000

Total family income ($)	One income earner		Two income earners	
	Tax ($)	Tax rate (%)	Tax ($)	Tax rate (%)
15,000	410	2.7	135	0.9
20,000	1,668	8.3	1,393	7.0
25,000	2,926	11.7	2,651	10.6
30,000	4,184	13.9	3,909	13.0
50,000	11,584	23.2	8,941	17.9
100,000	32,772	32.8	26,257	26.3
200,000	77,142	38.6	68,739	34.4

Sources: Provincial budgets and tax forms; calculations by the authors.

Who pays the income tax bill?

According to data for 1997 from the Canada Customs and Revenue Agency (formerly Revenue Canada), a total of $104.8 billion in income taxes was paid by individuals and, as table 2.6 shows, 41% was paid by individuals with incomes below $50,000. Individuals with incomes below $60,000 paid 52% of the total income tax bill. In fact, 36% of all income taxes were paid by individuals with yearly incomes in the relatively narrow range of $20,000 to $50,000.

As column 4 of table 2.6 shows, over one-half of all returns were filed by individuals with incomes less than $20,000. This proportion reflects the large number of part-time workers, students employed during the summer, and other intermittent workers earning low incomes.

These taxpayers generated only 4.6% of total tax revenue, while the top 26.1% of taxpayers—those declaring income of $35,000 or more—contributed 79.3% of the total income tax bill.

An interesting aspect of the information in table 2.6 is the relation between taxes paid and income declared. For example, while 20.7% of the total income-tax bill was paid by individuals with incomes below $35,000, column 6 reveals that this group earned 39.4% of all the income declared. So, those earning incomes below $35,000 paid a smaller proportion of the total tax bill than their share of total earned income might suggest. On the other hand, the top 26.1% of taxpayers, those who had incomes in excess of $35,000, paid about 79.3% of the total tax bill, while receiving only 60.6% of total income earned.

The reason for this, of course, is that the income-tax structure is "progressive." That is, it takes a larger fraction from high incomes than it does from low incomes, as is clear from the tax rates presented in table 2.4. Sales taxes also contribute to progressivity, even though everyone pays the same rate irrespective of income, because sales-tax rebates vary inversely with income. Furthermore, many income transfers from the state are indexed to the price of goods so that, as the price rises due to a sales tax, so do the transfers. This eases the burden of sales taxes to the poor.

Table 2.6: Income, taxes, and tax returns by income group, 1997

Total income assessed ($000s)	Total tax paid by this income group (%)	Total tax paid by all groups at or below this income group (%)	Total returns filed by this income group (%)	Total returns filed by all groups at or below this income group (%)	Total income declared by this income group (%)	Total income declared by all groups at or below this income group (%)
loss or nil	0.00	0.00	4.24	4.24	(0.13)	(0.13)
.001–10	0.22	0.22	22.63	26.88	4.48	4.35
10–15	1.38	1.60	14.81	41.68	6.70	11.05
15–20	2.98	4.58	9.98	51.66	6.35	17.40
20–25	4.24	8.82	8.16	59.82	6.71	24.11
25–30	5.58	14.40	7.58	67.40	7.61	31.72
30–35	6.33	20.73	6.51	73.90	7.72	39.44
35–40	6.73	27.46	5.34	79.24	7.31	46.75
40–45	6.80	34.25	4.34	83.58	6.74	53.49
45–50	6.31	40.56	3.37	86.96	5.85	59.34
50–60	11.85	52.41	5.11	92.07	10.23	69.57
60–70	8.87	61.29	3.01	95.08	7.09	76.65
70–80	5.87	67.16	1.61	96.68	4.39	81.04
80–90	4.07	71.22	0.94	97.62	2.91	83.95
90–100	2.78	74.00	0.55	98.17	1.89	85.84
100–150	7.20	81.21	1.05	99.22	4.55	90.39
150–250	5.78	86.99	0.48	99.69	3.27	93.65
250+	13.01	100.00	0.31	100.00	6.35	100.00

Sources: Revenue Canada, Income Statistics, 1999 Edition, (1997 Tax Year), 1999; calculations by the authors.