DEVELOPMENT OF THE CANADIAN INCOME TAX

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by

William McCulloch

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Chapter I - INTRODUCTION:

However limited or extended the responsibilities of a state may be, it has some functions or other to perform. In carrying out this activity there is of necessity some expense involved which must be balanced by an equivalent revenue. This is a fundamental principle of public finance and any state which ignores it cannot long endure. Though the organizations and functions of the state have been as diverse as their numbers, there has been one outstanding continuity from the earliest ancient state to the present day ---- the growth of government activity and hence expenditures.

This growth of public expenditure has had to be met by increased revenues, or where these have not been immediately forthcoming by the gradual rise of the national debt, often to extreme heights.[1] The old adage that 'necessity is the mother of invention' has been born out by the ingenuity of governments in refining old sources and adopting new ones from which to obtain increased revenues.

For the ancient state the ~~principle~~ source of revenue was the booty obtained from conquered tribes and the tribute payed by subject peoples. This revenue would generally be supplemented by the military services of the citizens and by

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[1]The United States is presently increasing its national debt at the rate of $10,000 a minute. As quoted in Time Magazine Vol. IV, No. 9.

the uncompensated labour of the slaves. On the same level, the chief objects of expenditure were the support of the rulers, the construction of elaborate public works, and a lavish display of the fruits of military victory by the erection of triumphal arches. This system was hardly self-sustaining over a long period of time---the tribes to plunder were soon subjugated and swallowed up, thereby killing the proverbial golden goose.

During the Athenian and Roman periods more refined and enduring sources of revenue were developed, rentals obtained from the leasing of state lands, tolls, fines, and court fees. The Anthenians reverted to direct taxes, (on property), only as a last resort. The Romans, with their genius for legal devices, developed an elaborate system of tax administration. Unfortunately, it was planned for an effective collection of revenue with no thought of the just and equitable distribution of tax burdens, and this gradually unbalanced their social system and became one of the causes leading to internal decay.

During the medieval period, the head of the state depended for support mainly upon his own property and on the dues and obligations which were paid to him by the lesser nobles. The king was the state and there was little thought for much public expenditure other than for himself. Wars were financed by the soldiers and their lords who usually provided their own equipment and received no pay; and wars constituted the main activity of the state in this period. Out of the early medieval state there gradually developed the principles which we call mercantilism with the idea of supplying the state with a revenue sufficient for the public service. Wars, with the advent of powder and paid mercenaries, were no longer cheap, and a well filled treasury was a prime necessity to maintain the state's position. The functions of the state were still fundamentally simple---national defense, protection within the state, and such limited works as canals, roads, and government buildings.

In the past hundred years there has been an accelerated growth of public expenditures with the extension of government into all phases of the social and economic life of the country. The supervision and control involved in the protection of the labouring class; the policy of universal elementary education at public expense; social insurance; the care of defectives, dependents, and delinquents; subsidization of large parts of the economy; and above all the cost of wars and the maintenance of large military forces even in time of peace; account in large part for the government's increased expenses. For Canada, this has meant an increase in per capita expenditures from $4 in 1868 to $419 in 1946. The per capita net debt has increased from $21.87 in 1867 to $1,090.55 in 1946.[1]

From the Middle Ages, when practically the entire revenue came from the public domain, that is, the renting and selling of

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[1]Excerpts from tables appearing in <u>Canada Year Books</u>, p. 141 of 1936; p. 771 of 1941; pp. 139 and 986 of 1949.

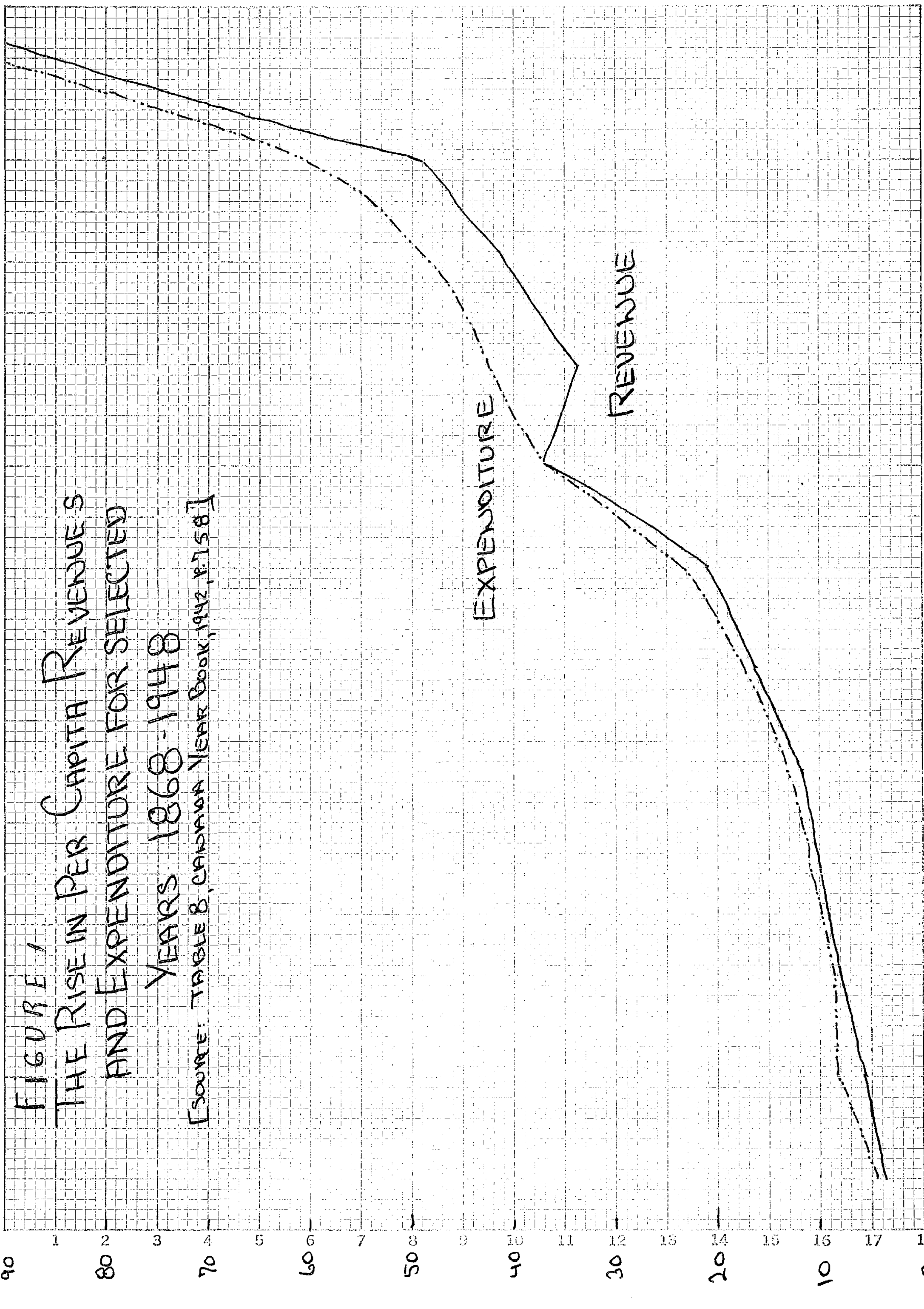
FIGURE I
THE RISE IN PER CAPITA REVENUES
AND EXPENDITURE FOR SELECTED
YEARS 1868-1948
[SOURCE: TABLE 8, CANADA YEAR BOOK, 1942, P. 758]
EXPENDITURE
REVENUE
SELECTED YEARS
'68
'80
'91
'01
'05
'11
'15
'25
'31
'37
'40
'48
0
10
20
30
40
50
60
70
80
90
1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18

state lands, until today when there are over fifteen major sources of federal revenue,[1] the expansion, development, and refinement of government revenue systems has been going on continuously. The property and the poll tax have had a relatively long history but neither were productive of much revenue and were soon by-passed for more lucrative sources. The property tax is essentially a municipal revenue where its assessment and collection is most easily supervised. The poll tax is limited in its productivity and is extremely unfair in respect to distribution of its burden. For instance, if the revenue received from income tax returns were re-allocated evenly in the form of a poll tax, every man and child, millionaire and pauper, would have paid $69 in 1943.[2]

Taxation was best developed in the field of customs and excise, where it performed nobly throughout the 18th and 19th centuries. Customs served the two-fold purpose of protection to the home industries and as an important source of revenue to the government. It had the further advantage of being hidden from the people who ultimately paid the tax in the purchase price of the goods. In Canada, customs and excise taxes formed the largest source of government revenue from 1867 until 1933,[3] when the sales tax became the most important, only to be surpassed by the income tax in 1940.[4]

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[1]Including in order of importance in the year 1944; income, excess profits, sales, customes, excise, post office, investment, gasoline, and succession duties.

[2]Total income tax receipts for 1943 $825,781,811; population is estimated at 12,000,000. Tax figures extracted from Table F, p. 22. Taxation Statistics, 1949

[3]With the exception of three years, 1922, 1923, 1924.

[4]Based on tables contained in the Canada Year Book, 1945 pp. 925-937; and Taxation Statistics. 1949

Canada did not enter the field of direct taxation until 1915, prior to this direct taxes accounted for an insignificant part of the total revenue and were primarily for other purposes.[1] Living in this present day of relatively heavy direct taxation, it is difficult to understand the government's apathy in entering this field. There were two primary reasons for this which apply to other countries as well as to Canada. Firstly, there was an almost unanimous hatred of taxes. People would pay for the direct use of government service such as rent for lands or a license to trade; and they would pay hidden taxes in the form of customs because they were unaware of them. But they refused to pay taxes for which they received no tangible returns. Secondly, the government of the 19th century had not developed an administrative system capable of dealing with the regulation of direct taxes, particulary those on incomes. Thus the early attempts by the United States and Britain to introduce the income tax were extremely onerous, and there was much evasion and shifting of the taxes. It is only with the education of both the populace in accepting direct taxation and the government in developing a just and systematic means of collection, that it could become successful and hence productive.

It is interesting in regards to the introduction of the income tax in Canada, the United States, and Great Britain that it was originally enacted as an emergency measure during a war

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[1] In 1914, the total revenue from diredt taxation amounted to only 1.5 per cent of the Dominion's income. As compared to this revenue for direct taxation in 1944 amounted to over 60 per cent of the governments revenue.

crisis when the people were willing to make sacrifices which they normally would not. Britain introduced it during the Napoleonic Wars, United States during the Civil War, and Canada during the First World War. In the case of United States and Great Britain it was never the intention of the government or the people that it should remain after the emergency was over, and popular agitation together with the government's realization of its ineffectiveness was enough to cause its removal. But these original enactments were the 'thin edge of the wedge', and England adopted a permanent income tax in 1874, United States in 1913. In Canada, it was introduced as the Income 'War' Tax, but coming as it did in 1917, there was little agitation for its repeal and since 1940 it has become the backbone of the government's revenue system.

Thus direct taxation, and particularly the income tax, is essentially a product of the 20th century.

Chapter II - CONSTITUTIONAL RIGHTS AND DOUBLE TAXATION

There never seems to have been an question of whether a government has the constitutional rights to tax its citizens. The only problem that has arisen is 'which' government has the right to tax people on their incomes. This is particularly true where there is a federal government as well as state or provincial governments as in Canada and the United States. In both these countries there is of necessity a written form of constitution whereby all powers and authority are distributed between the central and local powers, usually on the basis of what rights are given to the one authority are not given to the other. In both constitutions there is what is known as a 'residual powers' clause, held by the State governments in the United States and by the Federal government in Canada. Generally speaking, the government with the residual power is constitutionally and thereby legally able to enact any legislation other than what has been given categorically to the other government.

In Canada, the Parliament of the Dominion and the Legislatures of the various Provinces derive their powers from the British North America Act, 1867.[1] There are four provisions in this Act that deal directly with taxing power. Under Article 91, which in part states, 'It shall be lawful for the Queen,

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[1] <u>The British North America Act</u>, 1867, 30 and 31 Victoria, c.3

by and with the advise and consent of the Senate and House of Commons, to make laws for the peace, order, and good government of Canada, in relation to all matters not coming within the classes of subjects by this Act assigned exclusively to the Legislatures of the provinces,' there are twenty-nine subsections of matters that belong exclusively to Parliament. Two of these subsections refer to the raising of revenue:

"2. The regulation of Trade and Commerce.

3. The raising of money by any mode or system of Taxation."

Under Article 92, 'In each Province the Legislature may exclusively make laws in relation to matters coming within the subsections which deal with the raising of revenue are:

"2. Direct taxation within the Province in order to the raising of revenue for Provincial purposes.

3. Shop, saloon, tavern, auctioneer, and other licenses, in order to the raising of a revenue for Provincial, local, or municipal purposes."

The policy in regards to taxation follows through with the general theme of the Canadian Constitution, the distribution of authority in such a manner that the residual powers of government are expressly retained for the central authority, while the legislatures have a definite and thereby restricted area of authority.

While there appears to be a conflict between hhe 'raising of money by any mode of taxation' granted to the Dominion, and

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'direct taxation' granted to the Provinces, it is actually an overlapping. The two governments are independent powers springing from the same source which do not interfere with each other. Both have been granted powers under the B.N.A. Act which neither can take away from the other. The Dominion can tax by any means including direct, throughout the Dominion and the Provinces can also tax directly, but within their respected bounds. This point was brought out by the Finance Minister during the budget speech of 1915, when he said in part, "Under the British North America Act, while the Dominion may impose direct or indirect taxation, the provinces are restricted to the former."

At the time the Constitution was drawn up there was little thought of this overlapping becoming an actuality. The provincial power was limited to what was than a very narrow field of taxation, while the Dominion had the whole of indirect taxes to draw from, primarily customs and excise, which the provinces turned over to it at Confederation. It was thought very unlikely that the Dominion would enter the field of direct taxation which consisted at that time of the assessment of business and real estate, and licenses.[1]

When the Dominion entered the field of direct taxation in 1915, and introduced the income tax in 1917, the overlapping

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[1]The Royal Commission on Dominion-Provincial Relations Report, Book I, pp. 44-45.

possibilities became a reality. Unlike the United States where the Federal Income Tax Act of 1894 was declared illegal by the Supreme Court as infringing on state rights, there was no question of constitutionality about the Dominion Income Tax Act. The Dominion's as well as the provinces' rights were clearly defined by the B.N.A. Act. It was only in regard to the double taxation which arose in some of the provinces which had income tax schemes of their own that there was any anxiety shown.

We might well stop here and consider the problem of double taxation. Unfortunately, this term has come to have an onerous meaning which in many cases is quite unfounded. In order to be an evil double taxation must be discriminatory and the weight of the two taxes must be unjustly heavy. The Canadian income tax has never been discriminating, as the Dominion tax has always applied uniformly throughout the entire country. The differences in the provincial income taxes does not constitute discrimination because none try to influence the others, and each is within its rights in determining the income tax structures and rates under its own jurisdiction.

The weight of the combined taxes is a relative matter. For instance, the Dominion income tax on a married man with two children, in 1937, was $462, the Ontario tax was $198.21, making a total tax of $660.21. At that time this may have seemed burdensome yet, only three years later, in 1940, the Dominion tax alone was $1,688.[1] Actually, the combined taxes were never very high, the

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[1]For a man earning $10,000 a year gross income.

Ontario tax being usually fixed at one-half the amount of the Dominion return.

The problem of double taxation was settled, at least temporarily by the Dominion-Provincial Taxation Agreement Act, 1942,[1] whereby the provinces agreed to vacate the income tax field in favour of the Dominion for the duration of the war and a limited period thereafter, and the Dominion agreed to compensate the provinces for their loss in revenue. Under the agreement the provinces undertook not to tax personal or corporation incomes earned after 1940. The understanding was that after hostilities ceased the Dominion would reduce its tax rates and permit the provinces to re-enter the income tax fields. In 1947, the Finance Minister, following the failure to achieve complete agreement among all the provinces at the Conference held at Ottaw in April 1946, as to the terms for renewal of the Wartime Tax Agreements, made the following proposals, which any province could accept or reject if it wished:

1. The new agreements would be for a period of five years.
2. The Dominion would undertake to make to each agreeing province the payments offered under the Dominion proposal submitted at the April Conference.[2]

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[1]This agreement was a result of the recommendations of the Royal Commission on Dominion-Provincial Relations, 1939.

[2]Such payments were based on a minimum equal to a per capita grant of $15 on the greater of the 1941 or 1942 provincial population, with payments in any one year adjusted for increases in population and in gross national production.

3. In return for such payments an agreeing province would undertake not to impose any personal income taxes.
4. In respect to the non-agreeing provinces the Dominion offered to allow a credit against Dominion personal income tax paid to a province up to five per cent of the Dominion tax.

Unlike the United States there has never been a question of constitutional rights in regard to the income tax. The only unfortunate outcome is the possibility of the double income tax which is perhaps more irksome than burdensome to the payers. The Dominion has attempted to correct this situation in much the same way as it did when it took over the provincial custom and excise revenue at Confederation. This is by means of subsidies which for most provinces is an advantage compared to collecting revenue from their provincial income tax.[1]

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[1] This Dominion grant in lieu of tax receipts amounted to $84,427,644, in 1941. The total tax receipts of the provinces in 1940 amounted to $66,762,000.

Chapter III - GOVERNMENT FINANCE 1913-1917

Throughout the period from 1867 to 1912 there are two outstanding characteristics of the government's financial operations. The Dominion's revenues were based almost entirely on customs and excise duties. These receipts, in turn, depended almost entirely on the financial conditions of foreign markets over which Canada had no control. The Dominion's expenditures consisted almost entirely of outlays for the development of the country's economy, primarily in the field of transportation.[1] These expenditures did not constitute any definite obligations and could be attuned to changes in the governments income, over a period of a few years. Thus the country was always able to live, relatively, within its income.

With the advent of the Great War with its increased demands for government expenditures at the same time as her revenues were decreasing, put Canada's finances in a new light. It was no longer a question of developing new resources or not, the war had to be paid for and if the old sources of revenue could not be counted on then new ones had to be developed. It took the government nearly three years and a nine million dollar deficit to realize this.

With Canada's economy based as it was on international trade and her prime source of income depending on imports, it was

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[1]Customs and excise accounted for over 80 per cent of the revenue for this period, and development and debt changes accounted for over 60 per cent of the expenditures. Dominion Provincial Relations, Vol. I, 1939.

impossible that she could escape the effects of the world-wide stringency with the restrictions of commercial credit brought about by the fears of war.

The result was a sharp decrease in trade in 1913-14, with a corresponding decrease in revenue---six million less than hhe year before. There was a decrease in the surplus of $20 million, and an increase in the net debt of $19 million.[1] In 1914-15, the revenue continued to decrease---33 million less than the previous year, at the same time expenditures increased tremendously, raising the national debt to $110,000,000. After all immediate sources of raising the required funds had been used it was estimated that over $180,000,000. still had to be covered by additional taxation and borrowing.[2]

In the Budget Speech of 1915, Fincance Minister, The Honourable W.T. White, said: "It is not a question of raising a few millions by stamp taxes, by income taxes or other minor means of supplementing revenue."[3] Hardly a fitting tribute to a source of revenue that has become the mainstay of government income. It nevertheless shows the opinion of government in regard to this field of taxation. The Finance Minister stood by the tried and true friend of the past hundred years, the tariff, and defended it with much the same arguments that are given for any type of government taxation at the time in favour. "Taxation imposed by increased customs

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[1]From the Budget Speech of April 1914, pp. 1-11.
[2]From the Budget Speech of February 1915, pp. 1-12.
[3]*Ibid.*, p. 13.

duties bears upon all classes because all are consumers and in paying additional taxation eachmember of the community will feel that he is to that extent contributing to the cost of the war..."[1] The governments entrance into the direct taxation field was made in this year of 1915 when a special tax on banks, trust and loan companies, railway tickets, stamps, etcetera, was levied which was expected to yield an additional revenue of $8 to $10 million.

There had been some agitation both in the press and in the parliament for the introduction of an income tax system in Canada, but the Finance Minister denied its value, in part on logical gounds, but in part obviously for political reasons, as the idea was still not popular with a great many people. "It will be observed that I have in the special taxes omitted income tax upon individuals about which there has been some discussion since the outbreak of the war. The matter has had the consideration of the government and it appears clear to us that such a tax is not expedient, at all events for the present...In order to bring into force an income tax the Government would be obliged to create machinery for assessment, revision and collection. This would involve expense as compared with the amount which would be realized. Taking the income tax of the United States as a basis it would appear that Canada could hardly expect to derive from a similar tax a sum in excess of two million dollars from which would have to be deducted the heavy expense connected with its administration. My

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[1] Ibid., p. 14.

chief objection, however, to an income tax is the fact that the several Provinces are also likely to be obliged to resort to measures for raising additional revenue and I am of the view that the Dominion should not enter upon the domain to which they are confined, to a greater degree than is necessary in the national interest. There is another feature of the income tax which makes it unsatisfactory for the purpose of Dominion finance. I refer to the length of period which must elapse before it become productive.[1]

The Finance Minister was partially right, it would be complicated to some extent by the existence of municipal and provincial income taxes, there would be a need for assessment machinery, and there would obviously be a delay in the receiving of its full benefits. But Canada was living on borrowed money which would have to be repaid, and it was obvious even at this early stage that customs and excise receipts would never meet the needs of government, whereas the revenue from income taxes would not be needed immediately. If a start could be made now, they would be productive by the time the loans had to be paid off. As far as creating machinery for its sufficient operation, Canada would have the benefit of using the experience gained in the operation of the British and American income tax systems. However, the government refused to consider the income tax in its plans for increasing the revenue.

While receipts from increased tariff rates and special taxes exceeded the expectations of government by $20 million, the war

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[1] *Ibid.*, p. 16.

expenditures exceeded total revenue by some $131,000,000, raising the net national debt to $580,000,000.[1] In the Budget Speech of February 1916, the Government still refused to consider the use of the income tax although they had imposed direct taxes on practically everything else. The Finance Minister reaffirmed his arguments against it, and offered instead a Business Profits Tax, which basically was to be one-fourth of the net profits in excess of 7 per cent of the paid-up capital on all persons, firms, or companies whose capital exceeded 50,000 dollars. It was hoped that between $25 and $30 millions would be raised from this source.[2]

In the Budget Speech of April 1917, it was stated that the total income for the previous year was some $232,000,000 almost double that of 1914. Unfortunately, all this increased revenue did little more than meet current and capital expenditures, and the national debt rose to over $900,000,000. It was fully anticipated that it would rise to $1.2 billions by the end of the year. With expenditures moving ahead of revenue at approximately $300,000,000 ayear, the Finance Minister rather astutely observed: "From the beginning it has been clear that it would not be possible for the people of Canada to pay during the war, more than a part of the principal of our war expenditure." He went on to point out that increased revenues from customs would be difficult because of the 'fixed rate' treaties with most of

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[1] Budget Speech of February 1916, pp. 1-9.

[2] *Ibid.*, p. 15.

the countries with whom Canada traded. The Finance Minister then reviewed, once more, the reasons why Canada could not have an income tax.[1] While they are in part reasonable they lose much of their validity since he introduced an income tax only four months later. he said, "...it has been frequently suggested that following the example of Great Britain and the United States, we should adopt an income tax upon all incomes beyond, say, $1,000 or $2,000. The comparison in this regards, however, of Canada with either of these countries is fallacious. We are not a country of large accumulated wealth and of income derived from investments. Canadian incomes are derived mostly from personal earnings, and while there are many exceptions, the rule prevails generally throughout the Dominion... It is further to be pointed out that the maximum amount which would be obtained from such a tax in Canada would, in terms of Dominion finance, be comparatively small and that its administration would require almost a second civil service sufficient in number to cover every municipality, rural and urban, throughout the Dominion... On the whole it would appear to me that the income tax should not be resorted to by the Dominion Government until its necessity becomes clearly unmistakable."[2] The necessity apparently became clearly unmistakable in the following July. The government's methods of providing funds was in part to be met by an increase in the Business Profits War Tax Act, 1916, whereby 50 per cent of all profits

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[1]Budget Speech of April 1917, pp. 1-7.

[2]*Ibid.*, pp.7-8.

in excess of 15 per cent and not exceeding 20 per cent, and 75 per cent of all profits in excess of 20 per cent upon capital would be levied.[1]

In the Session of July 1917, the Finance Minister introduced the first Income War Tax resolutions. After his explanations of why it would not be practical, during his Budget Speech his reasons for its introduction seem weak. "The enactment of the Military Service Bill which has just passed through the House will result in material increase in and acceleration of the war expenditures of the Dominion. In view of the expenditure involved, and in order to maintain the credit of the Dominion it is necessary that we should adopt further taxation measures...In view of these considerations, I desire to lay before this Committee proposals for a national measure of income taxation..."[2] His views were criticized in Parliament. He (the Finance Minister), stated that he was urged to do this by reason of the fresh burdens which this country was to assume owing to the passage of the Military Service Bill. That is hardly good ground upon which to justify the resolution...The Minister of Finance in discussing his Budget of the 24th of April last, took very strong ground agains the imposition of an income tax, and argued very seriously and carefully the undesirability of imposing such form of taxation. The truth is that almost since the beginning of the war we should have had some form

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[1] Ibid., pp.9-10

[2] Debates of the House of Commons, 1917, July 25, pp. 3760.

of income taxation."[1]

There was no criticism of the Income Tax Act on the grounds of principal, both sides of the House being strongly in favour of it. In fact, the debates centered about such details as the exemption of judges' incomes, the progressiveness of the graduated tax, and the severity of the tax rates at the higher levels. The Minister(Minister's defense of the leniency of the bill compared to the much heavier tax rates on income in the United States and Great Britain, rested on the fact that a high income tax would discourage immigration which was one of the prime policies of the government. In general the Income Tax resolutions passed the House and Senate essentially as introduced and came into effect for the year 1917. Its main feature will be considered in the next Chapter.

At the time of its introduction, it was never anticipated that it should become the main source of revenue for the government, it was primarily a wartime measure. In regards to its expected earnings, it was hoped that it would produce between 15 and 20 million dollars.[2]

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[1] Ibid., p. 3767. Mr. A. K. MacKeah's reply to the Income War Tax resolutions. (the Finance Minister's defence is given on p. 3768).

[2] Compare this with what the Finance Minister said in the 1915 Budget Speech where he stated that the anticipated income from a Canadian income tax would be only $2 million, $13 million less than he expected in 1917 although the excemptions were $1,000 higher. Actually, the income tax for 1917 produced $11½ million from persons and $4½ million from corporations.

Chapter IV - INCOME TAX ACT AND AMENDMENTS 1917-1950

In considering the development of the income tax it will not be necessary to become enmeshed in the vast labyrinths of The Act and its various amendments. The complicated layout of the Act with its some twenty pages of 'whereases' and 'whyfors' have always been a source of complaint to the various Tax Associations, of confusion the the general taxpayer, and of income to lawyers and accountants. It is possible to strip down the Act and consider only its basic points as it affects the taxpayers without omitting any of the significant sections.

The original Income War Tax Act of 1917, was extremely moderate as compared to later revisions particularly in the last ten years. There was a basic exemption of $1,500 for single and $3,000 for all other persons. There was a normal tax of 4 per cent on all incomes above the basic exemptions. In addition there was a supertax of 2 per cent on incomes of over $6,000 increasing to 25 per cent on incomes of over $100,000.[1]

At the time of the original Act there was much debate on the rather high exemptions, and mild graduation of the larger incomes. In 1918, the basic exemptions were reduced to $1,000 for single and $2,000 for all other persons. The normal tax was 2 per cent, which increased to 4 per cent on incomes over $1,500 and $3,000 as in 1917. The supertax was increased on all incomes over $50,000. extending the graduated tax from 25 per cent on incomes of over

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[1] Statutes of Canada, Income War Tax Act, c. 28, 1917.

$100,000 to 50 per cent on incomes over 1 million dollars. In addition, there was a war surtax ranging from 5 per cent to 35 per cent of the normal supertax, on incomes of over $6,000. There was an exemption allowance of $200 for each child under 16 years. The effect of this increased rate structure was to increase the revenue from $11½ million in 1917 to $18½ million in 1918.[1]

The tax revisions of 1919 put a normal tax of 4 per cent on all incomes over the basic exemption up to $6,000, and an 8 per cent normal tax on incomes in excess of that. The surtax, a wartime measure, was dropped, but the supertax progression was again increased. It ranged from 1 per cent on incomes ofver $5,000. to 65 per cent on incomes over $ 1 million. The $200. excemption for children was extended to cover all those under 19 years.[2] The effect of this revised tax rate was to increase revenue to $33 million.

The surtax was replaced in 1920 and was fixed at a flat 5 per cent on all incomes of over $5,000.[3] The increase in tax revenue of $6 million is to be explained by the increase of national income and the effects of inflation.

There were minor changes in the Act from 1921 to 1925. In 1922, the allowance for children was increased to $300.[4] and in 1924, it was increased to $500.[5] Since the basic tax structure

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[1] Ibid., 1918, c.25.

[2] Ibid., 1919, c.49.

[3] Ibid., 1920, c.49

[4] Ibid., 1922, c.25.

[5] Ibid., 1924, c.46.

was not altered in these years, the explanation for the decrease in revenues from $39 million in 1920 to $19½ million in 1925 was due to the depression of the postwar years.

In 1926, the exemptions were raised from $1,000 to $1,500 for single persons and from $2,00 to $3,00 for all others. The normal tax was reduced from 4 per cent to 2 per cent on incomes below $5,000. The graduated supertax was reduced considerably from what it had been since 1919. The normal tax was no longer computed separately but was included in the graduated tax.[1]

In 1927, there was a reduction of 10 per cent in all taxes paid using the 1926 rate structure. The effect was that a man who paid $100,000 now paid only $90,000 and a man who paid $10,00 now paid only $9,000. The exemption allowance for children was extended to include those under the age of 21 years who were dependent on the taxpayer.[2] In 1928, the tax was reduced another 10 per cent, making a total tax reduction of 20 per cent on the 1926 tax rate.[3]

In 1930, government or like annuities up to $5,000 and donations to churches, schools, hospitals, to a maximum of 10 per cent of the net income of the taxpayer were exempted from the tax. The $500. exemption for children was extended to cover dependent relatives suffering from mental or physical infirmities.[4]

Because of the falling government revenue, in 1932 the deduction

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[1] _Ibid._, 1926, c. 10.

[2] _Ibid._, 1927, c. 31.

[3] _Ibid._, 1928, c. 12, 30.

[4] _Ibid._, 1930, c. 24.

of 20 per cent allowed in 1928 was repealed. A surcharge of 5 per cent was made on net incomes of over $5,000. The basic exemptions were reduced from $1,500 to $1,200 for single persons, and from $3,000 to $2,400 for all others. The changes were to apply to 1931 incomes.[1] These revisions had no appreciable effect on revenue, the increase being only $90,000.

The tax was further increased in 1933 when personal exemptions were reduced from $1,200 to $1,000 for single persons and from $2,400 to $2,000 for all others. The exemption for children and dependents was also reduced from $500 to $400. The rates of taxation was increased when a new graduated schedule was introduced, the tax being 3 per cent on the first $1,000 and increasing at each level over the 1926 rate structure by 2 per cent.[2] Revenue actually decreased although in many cases the tax was tripled. There were minor changes in 1934 but they applied only to special individuals.

Cognizance was taken of investment income as being different from 'earned' income, and a surtax ranging from 2 per cent to 10 per cent was levied on all investment income over $5,000 and on all income over $14,000, in 1935. A tax on gifts was added to the income tax with rates changing from 2 per cent on amounts up to $25,000 to 10 per cent on gifts exceeding $1 million. An annual exemption of $4,000 with specific exemptions of gifts

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[1]*Ibid.*, 1931, c. 35.

[2]*Ibid.*, 1933, c. 41.

to charitable or educational organizations or to governments.[1]

There were no major changes in the Act for 1936, 1937, 1938, and 1939. The steady rise in revenue from $26 million in 1933 to $54 million in 1939 was due primarily to the recovery of the nation from the depression. With the outbreak of the Second World War, a war surtax equal to 20 per cent of the tax payable by individuals under existing income tax rates was levied, a stop-gap measure introduced until a revised Income Tax could be developed. An allowance of contributions to patriotic organizations up to 50 per cent of the net taxable income was provided.[2]

In 1940 a completely new income tax structure was introduced. The income tax at all levels was increased substantially, in the case of the lower income groups as much as ten to twelve times. Personal exemptions were reduced from $2,000 and $1,000 to $1,500 and $750. for married and single persons respectively. The revised rates of tax ranged from 6 per cent on the first $250 to 78 per cent upon the amount by which the income exceeded $500,000. The increase was particularly heavy in the lower and middle incomes. Supplementing the regular graduated income tax there was a National Defense Tax. In the case of single persons, 2 per cent of the total net income between $600 and $1,200; or 3 per cent if the income exceeded $1,200. There was a tax credit of $8 allowed for each dependent on this tax.[3] The results of this new tax were tremendous,

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[1] *Ibid.*, 1935, c. 40.

[2] *Ibid.*, 1939, (Second Session) c. 6.

[3] *Ibid.*, 1940, c. 34.

increasing the revenue from $55 million in 1939 to $152 million in 1940.

In 1941 the tax rate was raised further, being 15 per cent on the first $1,000 and increasing to over 85 per cent on incomes over $500,000.[1] In 1942 the graduated tax rates were increased still further ranging from 33 per cent on the first $1,000 to 85 per cent on amounts over $100,000.[2] The main changes in the personal income tax for 1943 were that the National Defense Tax lost its identity and was incorporated into the general income tax as a flat rate normal tax, although at a much higher rate being increased from 2 per cent to 7 per cent; the credit for dependents was changed from a deduction from income to a deduction from the tax itself. A compulsory savings programme was combined with the income tax and amounted to approximately half the income tax. The tax was deducted at the source from all salaries and wages, and in the case of other forms of income it was to be paid on the basis of quarterly instalments of estimated yearly income. Allowance of a deduction from incomes in respect of medical expenditures in excess of 5 per cent of the income of the taxpayer was incorporated into the act.[3]

Under this 'pay-as-you-go' plan the taxpayer was, at all times, considerably in arrears to the government for income tax. In 1944 there was a cancellation of 50 per cent of the 1942 tax

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[1] Ibid., 1940-1941, c. 18.

[2] Ibid., 1942-1943, c. 28.

[3] Ibid., 1943-1944, c. 14, 24.

liability on earned income and on investment income up to $3,000. Tax changes for 1944 were more in the nature of adjustment within the existing tax structure than a general revision or relaxation. The most important change was the reduction of the savings requirements by one-half. The definition of 'dependent' was broadened to include in-laws and illegitimate children, previously excluded. The allowance for medical expenditures were made more generous, including all expenses over 4 per cent instead of 5 per cent.[1]

In the government Budget of October 12, 1945, a 16 per cent abatement of tax was announced, effective as of October 1st, 1945. This was equivalent to a 4 per cent reduction for the year 1945 as a whole.[2] The basic income tax rate structure which was introduced in 1942 continued in force until 1946. However, for the year 1946 there were three modifications. First, the savings portion of the tax which had been dropped since 1944 remained uncollectable. Secondly, there was a flat 16 per cent reduction of tax in effect for this year. Thirdly, the recovery of Family Allowance payments was a separate factor in the 1946 tax structure having been imposed for the purpose of off-setting in part the duplicate benefit for children contained in the existing tax structure.[3]

In 1947, there was a complete revision of the personal

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[1] _Ibid._, 1944-1945, c. 43.

[2] _Budget Speech_, October 12, 1945.

[3] _Statutes of the Dominion of Canada_, 1946, c. 55.

income tax structure. The basic exemptions were increased from $660 to $750 for single persons and from $1,200 to $1,500 for all others. The allowance for children under 16 who were receiving family allowance was $100 and for all other children or dependents there was allowed a deduction of $300.[1] In 1948, the graduated tax structure was revised downward still further being only 10 per cent on the first $100 as compared to 16 per cent in the previous year; and this reduction was carried through at each income level.[2]

In 1949 the basic exemptions were increased to $1,000 for single persons and $2,000 for all others. There was an allowance of $400 for each dependent. The rate structure was further reduced, the rates ranging from 15 per cent on the first $1,000 to 80 per cent on amounts over $400,000. The effects of this new tax structure was to reduce personal income tax to the lowest it had been since 1939.[3] There are no changes in the 1950 income tax structure.[4]

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[1] Ibid., 1947, c. 63.

[2] Income Tax Return, 1948.

[3] Income Tax Return, 1949.

[4] Budget Speech, March 1950.

Chapter V - REVENUE

All taxes are subject to fluctuations in yield not intended by the government. Some are more sensitive to outside conditions than others and this is true of the income tax. These unintentional effects include changes in the size and distribution of the national income, changes in population, employment, and the general price level. We shall consider first the revenue produced and then the causes for this change.

Income tax revenue statistics is computed on the basis of collections for the fiscal year and the taxation year. The fiscal year revenues is the amount received in any one year regardless of what year it is being paid for by the taxpayer. It is this figure which is used in the calculation of the yearly government accounts. The amount by taxation years shows the revenue after it has been re-allocated to the year in which the income was earned. In general there is a time lapse of a year or more between the amount received by the government and the amount actually owing by the taxpayers so that any situation intended or otherwise, affecting the income tax will not be reflected in the government receipts of that year. Thus, although the income tax was effective on incomes earned in 1917, the government did not receive full payment until 1920. This situation was corrected in 1941 with the introduction of payments at the source but its effects were not felt until 1944 when government revenue from this source was $809,570,762 and the amount actually due was $809,113,007.

This 'pay-as-you-go' policy was an important step if the income tax was to be the mainstay of government revenue, because the government must be able to alter its revenue at least within the period of one year. In considering the actual revenue produced from the inceom tax as compared to total revenue, it is necessary to use the figure for receipts by fiscal years. The table indicates the total revenue from all sources, the revenue from the income tax, and this latter as a percentage of total revenue. These figures do not include the corporation tax yields which are about half that of the individual yields.

THE PRODUCTIVITY OF THE INDIVIDUAL INCOME TAX
BY FISCAL YEARS 1919-1948

Year	Total Revenue	Income Tax Revenue	Percentage of Total Revenue
1919	312,947	7,973	2.5
1920	349,746	13,195	4.
1921	436,292	32,533	7.5
1922	382,272	39,821	10.
1923	403,094	31,689	8.
1924	406,581	25,657	6.
1925	351,515	25,157	7.
1926	382,893	23,849	6.
1927	400,452	18,043	4.5
1928	429,643	23,223	5.
1929	460,151	24,793	5.
1930	453,007	27,238	6.
1931	357,720	26,624	8.
1932	334,508	24,773	7.
1933	311,735	25,959	8.
1934	324,661	29,183	9.
1935	361,974	25,201	8.
1936	372,596	32,789	7.
1937	454,154	35,358	8.
1938	516,693	40,071	8.
1939	502,171	46,591	9.
1940	562,093	45,009	8.
1941	872,770	103,308	12.
1942	1,448,536	295,874	20.
1943	2,249,496	533,915	24.
1944	2,765,018	809,570	29.
1945	2,330,097	763,896	33.
1946	2,363,167	689,506	29.
1947	2,588,531	691,989	27.
1948	2,629,845	656,873	25.

Source: Taxation Statistics, Table C: Canada Year Book, 1944 p.929.

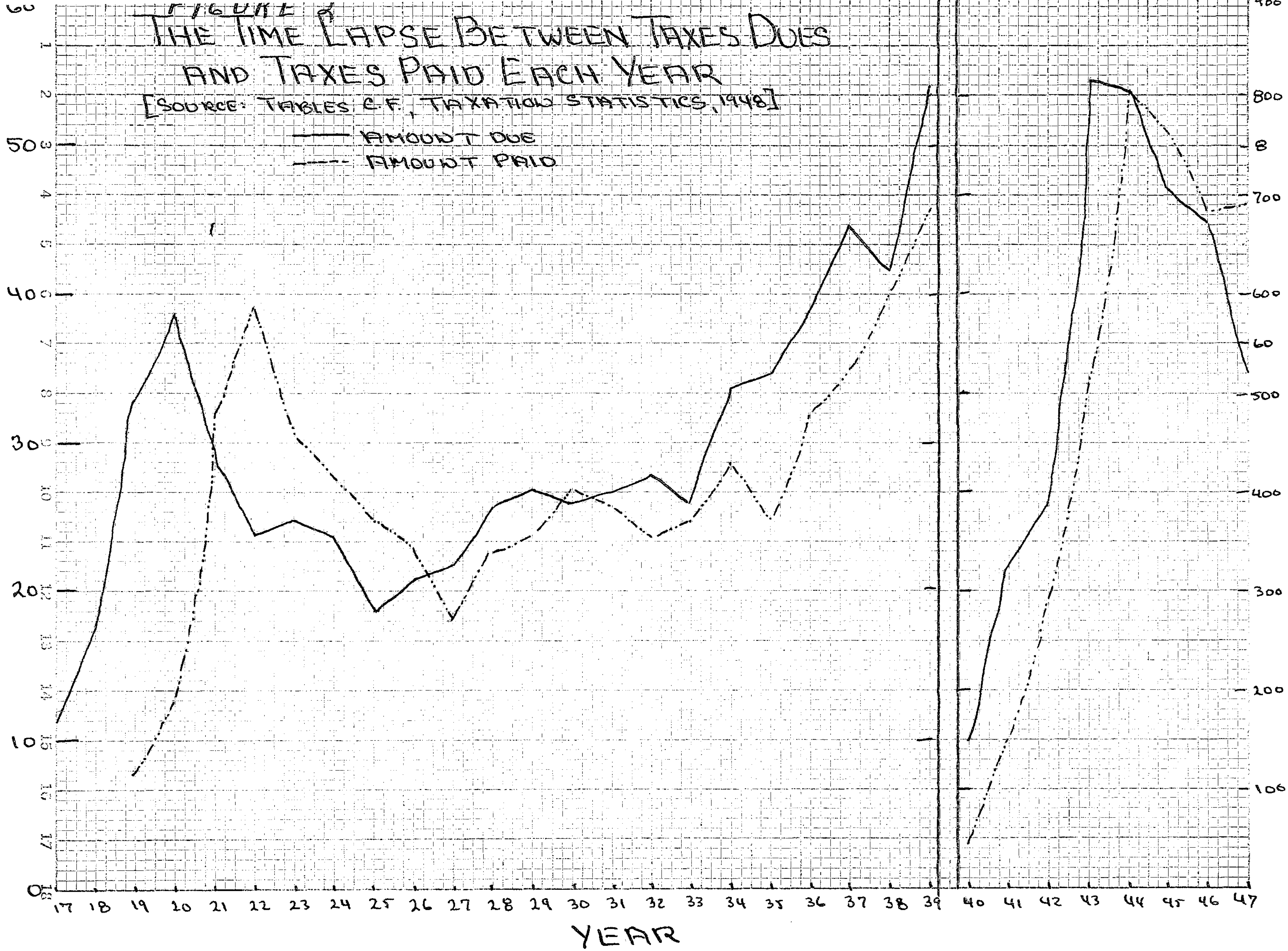
FIGURE
THE TIME LAPSE BETWEEN TAXES DUES
AND TAXES PAID EACH YEAR
[SOURCE: TABLES E.F., TAXATION STATISTICS, 1948]
AMOUNT DUE
AMOUNT PAID
YEAR
17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47
10
20
30
40
50
100
200
300
400
500
600
700
800

In order to examine the true revenue producing ability, the figures of income tax receipts by taxation year are best suited as this is the amount that was actually due. With the high exemptions and low progressive rates the revenue for 1917 was only $11 million, with the increased tax rates of 1918 and 1919 the revenue was tripled. In 1920 with no change in the tax, revenue increased $6 million, in 1921 it decreased $10 million and had decreased a further $10 million by 1925 though there were no important changes in the rate structure. In 1926 the tax rates were revised downward and were further reduced in 1927 and 1928, yet the revenue increased $7½ million. Therefore the income tax is subject to greater forces than changes in the income tax rate. Changes in the population have been minor, the main cause affecting income tax revenue has been size and distribution of the national income. A slight change has a more than proportional effect on the revenue for two reasons, first, because of the extremely large number of wage earners at the bottom of the rate structure and secondly the progressive rates of tax as incomes increase in size.

During the depression years of the early twenties and early thirties the lower income groups were either unemployed or had their wages reduced below the basic exemptions and this removed a proportionally large number of taxpayers. In the middle and upper income groups wages were also reduced. The amount of tax paid was reduced by a relatively greater amount than the national income for this reason, if we assume that the that the national income is reduced by 10 per cent and for simplicity all incomes are reduced 10 per cent, than the large incomes would be so reduced in absolute amount that the progressive tax would decrease by more than 10 per cent. The opposite is true when the national income is increased. This happened in 1927, 1928 and 1929.

When the revenue system was dependent upon customs and excise duties the government's income was subject to all the ups - and downs of international trade. The revenue from income tax is dependent primarily on the Canadian economy. In the world financial crisis from 1913 to 1917 customs and excise revenues were reduced at the very time when the government needed a larger income. During the Second World War national income rose substantially while international trade declined relatively to this. The income tax based as it is on national income, increased the government revenue from this source by fifteen times the amount produced in 1939.

Until 1941 revenue from income tax produced about as much as excise duties and post office revenues. Since then it has become the leading source of revenue and therefore its advantages and disadvantages are important considerations. It has the advantage of being dependent on the Canadian economy unlike customs and excise which are dependent on both the Canadian and foreign situation. Also the government can alter its productivity to a much greater extent than it can other sources. If it raises its tariff rates people can stop purchasing foreign goods, if it raises the income tax rates people are not very likely to stop earning incomes. One of its main disadvantages, the two year time lag in its response to changes has been corrected. It still suffers from instability because of the more than proportional effect a change in the national income will have on income tax. If government revenue from this source is to remain stable it will necessitate continual revision of hhe tax structure.

The cost of collection is an important consideration for any type of government revenue. There are no figures available for individual income tax cost alone, the corporation income tax costs are included also. There are a certain number of fixed costs, primarily the payment of personel. Therefore the larger the tax receipts the less will be the percentage cost of collection. The actual cost has risen from $58,000 in 1917 to a high of $19½ million in 1948. The percentage cost of collection reached its low in 1943 when it was only .39 per cent of income tax revenue and reached its high in 1927 when it rose to 3.58 per cent. The average total cost expressed as a percentage is only 1.03 per cent which is an extremely small cost.[1]

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[1]Table B, Cost of Collections, Taxation Statistics, 1948.

Chapter VI- DISTRIBUTION AND JUSTICE

In a consideration of any type of revenue system there are two fundamental principles involved---adequate productivity, and an equitable distribution of the costs of government amongst its people. The productivity of the income tax has been examined; we shall now consider the 'justice' of it according to the various theories on the subject of equitable distribution.

There are different fundamental ideas on the distribution of the costs of government all of which are in use in Canada to various degrees. There is the idea of distribution on a basis of equal payments, the costs of government services enjoyed, the value of benefits received from government services, the ability of taxpayers to contribute to the costs of government, expediency and the effects of taxes. Equal payments is the simplest but least used today, for it is clearly impractical in a society like ours composed of people with such varying degrees of income. The municipal poll tax is the classic example.

The cost of service principle is used to pay the cost of such government services as electricity, water, and post office. This method is strictly limited to such fields where the benefits to each individual can be accurately assessed. The Dominion government could not work out the costs of railway or defense on an individual basis. The benefit principle is similar to the cost of services, it also is difficult to assess on an equitable basis to everyone. In fact, on the basis of benefits actually received, the poor should pay a much higher tax than the rich for they depend more on government services.

One of the highest ideals of equitable taxation yet devised is ability to pay, and it is on this principle that all modern income taxes are based. Here again ability is by no means a mathematically exact concept, and in fact, it has been vaguely and variously applied over a rather wide range. There is a subjective principle on the basis of equal sacrifice which alone is not practical, and the objective principle which uses net income as a test of ability. These two principles are employed as the basis for our income tax system by relating net income to marginal utility. Even when we have reached this point there are still many possibilities for inequality. The economic status of the individual must be considered in allowing for dependents, the source of income, other taxes, gifts and donations. The idea of proportional or progressive rates and the degrees of progression are an important consideration also.

When the Dominion introduced the income tax it was fortunate in having the advantages of using the experience gained by Great Britain and the United States in this field. In fact, Canada's first tax was based primarily on the United States Federal income tax of 1913 and revisions of 1917.

The marginal utility concept, the theory behind the income tax, is basically that money like commodities and production units have different relative values and their utility value does not increase or decrease in an arithmetic ratio as the amounts are increased or decreased. That is to say, that an income of $5,000 does not have the same value to all people earning that amount; further an income of $30,000 does not have ten times the utility of a $3,000 income. On the basis of this argument a tax on gross incomes would be more of a burden on some than others though they may have the same income. Similarly a proportional tax would be harder on the smaller income groups than the larger because the marginal utility decreases as incomes rise. A $1,000 loss in income is obviously much harder on a man earning $3,000 a year than $30,000.

To provide for these differences in the relative value of income there is first a number of deductions and exemptions to make the burden on people earning the same gross income more equitable. Secondly there is the idea of progressive tax rates as the incomes increase. The exemptions apply to all incomes regardless of size and it is on this remaining so called 'net taxable income' that the progressive tax rates apply. We shall consider first the deductions and exemptions allowed under the Canadian income tax.

There is first what is known as the basic exemption which every person is entitled to deduct from the gross income. With this there has always been an equal allowance for a wife which is also deducted from gross income. The fundamental idea behind this exemption is to prevent anyone's income from falling below a certain standard, though just what this standard is based on is not too obvious. It is not the idea of keeping the income above the minimum standard of living because, with the exception of the war years these exemptions have always been at least $2,000 which is far above any idea of minimum or decent standard of living since according to the census of 1931 and 1941 over 87 per cent of the wage earners earned less than this amount. Another, but less flattering, explanation of such a high basic exemption is the large number of citizens and hence voters it kept away from paying any income tax. The basic exemption of $2,000 for man and wife without any consideration of any other deductions eliminates some 2,270,000 income earners out of a total of 2,450,000.[1] It would seem that while basic exemptions should be included in a computation of taxable income such allowances as have been made in all but the six war years is far too high. If we assume that the government must raise a certain revenue it would be far less harmful to the economic structure if the basic exemptions were reduced to say $500 each with an extremely small tax rate on these incomes rather than a much heavier tax on the large incomes. Because of the pyramidal structure of incomes with such a large base the revenue with only a 1 per cent tax on the first $1,000 would be much larger than and increase of say 5 per cent on incomes over $20,000.

There have always been allowances for children with the exception of 1917. This allowance has ranged from $200 to $500

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[1]Based on figures contained in the table on income classes, <u>Canada Year Book</u>, 1945, p. 975.

for each child, and the age limits have ranged from 16 to 21. This allowance is consistent with the idea of the different marginal utilities of the same gross income. Clearly the income of a man with five children has a much greater value than a man with none or only one child. There is a necessary expense in providing for children, and this obligation should be met in part by the country for children are an asset to a country. The extension of the age limit to 21 has encouraged to some extent the keeping of children at school and this too, is of benefit to the country as a whole. In the same vein the allowances for dependent relatives which was introduced in 1930 and extended in 1944 to include all dependents recognizes the relative values of the same incomes.

Donations, which can be deducted up to the amount of 10 per cent of the net income is in a slightly different category. The government, to the extent that it reduces the individuals' income tax is actually making the donation. Unlike the other deductions, the allowance depends on the size of income. For instance a man earning $20,000 can deduct up to $2,000 from his income; a man earning $3,000 can deduct up to $300 (providing they donate at least 10 per cent of their incomes.) The argument in favour of this allowance is that it recognizes the generosity of one man as against another who uses the money for his own purposes. The actual saving in taxes is not very large. A man with $20,000 reduces his taxes by a $150 from $5,660 to $5,510 though he has reduced his income by $2,000. A man with an income of $3,000 reduces his tax by $60 from $510 to $450, though his income is reduced $300.

Medical expenses allowable since 1941, are deductable by the amount which they exceed 4 per cent of the net income up to a maximum of $1,000. This is an advantage to the smaller income groups. On incomes of over $25,000 a year the expenses exceed $1,000 before a deduction can be made whereas for a man earning $2,000 any expenses over $80 is deductable.

There are as well deductions for old age, blindness, and certain pension incomes all of which incorporate the principle of equitable distribution based on the idea of the marginal utility of income.

We shall consider the effects of these allowances on people within the same income group, and then with people in different income groups. We shall assume there are two men earning equal income of $5,000 a year. Further we shall assume that A is married, has two children ages 12 and 19 and a dependent mother-in-law. Further he donates $500 to various charitable organizations, and spends $600 for medical care. The second man, B, we shall assume is a bachelor who spends nothing. The effects of the various allowances is shown in the following table:

Year	Gross Income	Exemptions Self	Wife	Dependents Child	Mother	Donations	Medical	Taxable A	Incom B
1917	5,000	1,500	1,500	...	...	...	...	2,000	3,500
1919	5,000	1,000	1,000	200	...	...	...	2,800	4,000
1926	5,000	1,500	1,500	500	...	...	...	1,500	3,500
1933	5,000	1,000	1,000	800	...	500	...	1,700	4,000
1947	5,000	750	750	600	300	500	400	1,700	4,250
1949	5,000	1,000	1,000	800	400	500	400	900	4,000

If we apply the 1949 tax rates to these net taxable incomes the tax for A has changed from $320 in 1917 to $95 in 1949; the tax for B has changed from $415 in 1917 to $700 in 1949. Clearly then, the burden has been taken off those with incomes of greater marginal utility. If we consider the effects of these deductions on incomes of different size it appears that the lower incomes gain relatively more than the large incomes. Let us assume two incomes of $5,000 and $50,000. Using the 1949 tax rates applied to the gross income the tax would be $920 on $5,000 and $21,660 on the $50,000. If we apply the same deductions as used in the example above the tax would be reduced to $135 and $19,625 respectively. This amounts to reduction in tax of 86 per cent on an income of $5,000 but only 9 per cent on the $50,000 income.

With the exception of the 10 per cent allowance for donations these various allowances and exemptions are far more important to the lower income groups than the larger. They remain constant and therefore as the income decreases they become relatively less important.

The other main part of the income tax is the rate structure. There are three ways in which a tax may be applied, a flat or poll tax, a proportional tax and a progressive tax. The tax on incomes has always applied a progressive tax though in varying degress. According to the marginal utility theory as incomes increase in size the value of each succeeding dollar declines in value. Supposedly then the rate of tax can be higher on incomes between $10,000 and $15,000 than on incomes between $1,000 and $5,000 without causing a relatively greater sacrifice of value. Since 1917 the rate structure has been

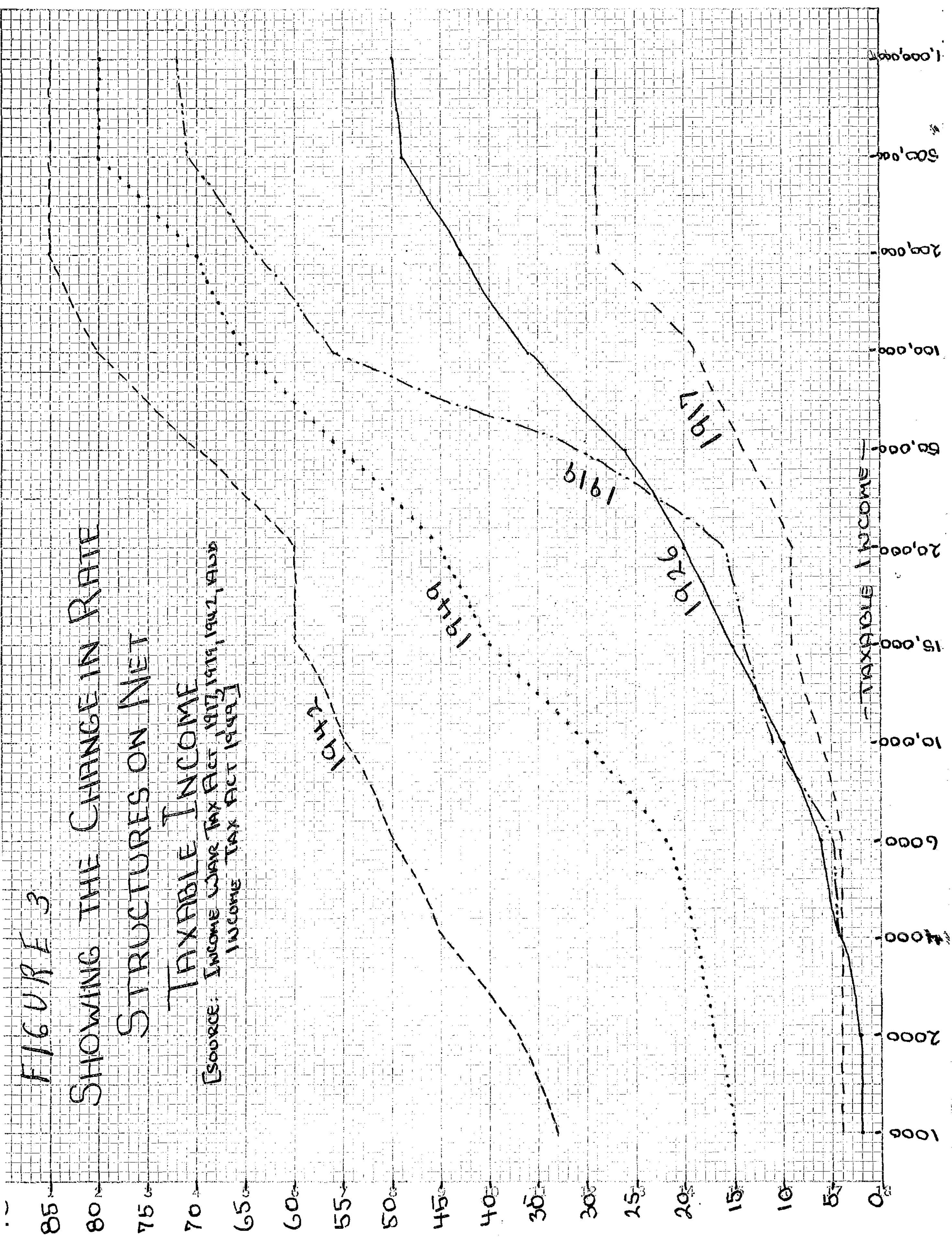

FIGURE 3
SHOWING THE CHANGE IN RATE STRUCTURES ON NET TAXABLE INCOME
[SOURCE: INCOME WAR TAX ACT 1917, 1919, 1942, AND INCOME TAX ACT 1949]

altered appreciably seven times. These changes have altered the relative burden of the different income groups. The changes from 1917 to 1919 increased the taxes on incomes of over $10,000 and particularly those over $50,000 relative to incomes below $10,000. The change in rate structure of 1926 reduced the burden on the larger incomes relative to the lower incomes. The overall deductions of 10 per cent and 20 per cent in 1927-1928 was of more advantage to the larger income groups. A man who earned $100,000 in 1926 paid only $80,000 in 1928, a man paying $5,000 in 1926 paid $4,000. Both paid 20 per cent less but according to the marginal utility theory the smaller income paid far more in actual value. The war time tax structures increased the tax by 30 per cent on incomes of $1,000 and by 30 per cent on incomes of $500,000. Again, according to the marginal utility theory the lower incomes suffered a greater loss. The revisions of 1949 reduced the tax by 50 per cent on incomes up to $10,000 and by 5 per cent on incomes of $100,000

The marginal utility is not a precise concept so it is impossible to say what rate structure brings the least sacrifice to each income group. It is only possible to compare the different rate structures that have been used and consider how certain income groups have been affected relative to others. The table on the following page shows the rates of tax which apply to the different incomes according to the taxation years shown.

Taxable Income*	1917	1919	1926	1940	1942	1949
1,000	4	4	2	8	33	15
2,000	4	4	2	12	37	17
4,000	4	4	4	20	45	19
6,000	4	5	6	27	50	22
10,000	6	11	10	37	55	30
15,000	9	14	15	39	60	40
20,000	9	16	20	39	60	45
30,000	12	21	22	41	65	50
50,000	14	31	26	50	70	55
100,000	19	56	36	53	80	65
500,000	19	71	49	72	85	80
1,000,000	19	72	50	78	85	80

* The rates of tax apply on the group up to the figure shown in the taxable income column. The amount of income in each tax group varies, the percentage applies only to the immediately preceeding $1,000.

The change in rates on the same income is relatively unimportant. It is the change in rates between different incomes in the various years that is important. Between 1917 and 1919 there was no change in the tax rate on incomes up to $6,000 but on incomes over that amount the tax rate increased from 1 per cent to 53 per cent. In 1926 the rate was reduced by 2 per cent on the first $2,000 and by 20 per cent on incomes of over $50,000. The tax increased on incomes between $10,000 and $30,000. In 1940 the tax on $1,000 was increased by 6 per cent and on incomes of $20,000 by 19 per cent up to 28 per cent on incomes of a million dollars, and in 1942 the tax on a $1,000 was increased by 25 per cent on the first thousand and 20 per cent on incomes of $50,000. Therefore the changes in the rate structure have not been consistent if we assume that marginal utility remains the same. Taking 1949 as the closest approximation to marginal utility, and this seems reasonably since it is based on some thirty years of experience and study, the 1917 structure places more of a burden on the lowest taxable incomes, and conversly the 1919 structure places the burden on incomes of over$10,000. The 1926 structure was unjust to incomes between $4,000 and $30,000. The war time tax structure placed the burden on incomes up to $6,000.

The effect of these rate structures in combination with the various exemptions is shown in the table on page 48. In comparing the tax paid on various incomes, we assume that the tax payer is a married man with two children. No deductions have been made for donations, medical expenses, etcetera, but for the $50,000 income earner an investment income of $25,000 is assumed and a surtax on this has been added for the years when it applied.

According to figures on the distribution of income for 1946,[1] out of a total working population of less than 2½ million, over 1½ million earned less than $2,000 a year. Using the 1949 tax structure and allowing only the exemptions for wife and dependents, only 967,000 people paid income tax and three quarters of this number earned less than $5,000 a year. When we consider that in 1946 employment and wages were higher than at any time between 1917 and 1942 and that the basic exemptions allowed from 1917 to 1940, it is obvious that the tax burden

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[1]Extracted from figures contained in Table E, Taxation Statistics, 1948.

with the exception of the war years has rested on the relatively few people whose incomes were $5,000 or more.

If the income tax is recognized as the best means of obtaining revenue so far as equitable distribution of burden is concerned, it would appear that it is not being used to its full advantage. Assuming that the government must have a certain amount of money what it fails to raise by means of the income tax it must obtain from other sources such as custom duties and sales taxes. These latter taxes applying equally to all, bear more heavily on people with small incomes. It would therefore be better to lower the exemptions for wife and dependents and tax the lower income earners on their income rather than their consumption. With possible exemptions reducing the income of people earning $5,000, by 80 per cent, this implies that the first $3,000 or $4,000 earned has perfect utility, that is every dollar is essential. This of course is not a reasonable assumption because the government does not recognize this perfect utility when it imposes sales taxes of 20 per cent to 200 per cent on such goods as cigarettes, gasolene, and liquor.

All the changes which have occurred in the basic allowances and rate structures have affected the numbers of income earners, and the amounts which they must pay. Whether these changes have followed the marginal utility of the different incomes is a relative matter. In general, the smaller income groups have improved their position relative to the larger ones. It would appear that the exemptions are now too high, making the income tax a 'rich man's' tax.

TAX PAID BY A MARRIED MAN WITH TWO CHILDREN
At Digferent Income Levels.

Taxation Year	$2,000 Tax	$2,000 %	$3,000 Tax	$3,000 %	$10,000 Tax	$10,000 %	$50,000 Tax	$50,000 %
1917	...	...	...	...	360	3.6	5,260	10.5
1918	...	...	12	.4	382	3.8	5,790	11.5
1919	...	...	24	.8	558	5.6	9,158	18.3
1920	...	...	24	.8	585	5.8	9,616	19.2
1921	...	...	24	.8	585	5.8	9,616	19.2
1922	...	...	16	.5	524	5.2	9,599	19.2
1923	...	...	16	.5	524	5.2	9,599	19.2
1924	...	...	...	...	420	4.2	9,565	19.1
1925	...	...	...	...	420	4.2	9,565	19.1
1926	...	...	...	...	220	2.2	8,120	16.2
1927	...	...	...	...	198	2.0	7,308	14.6
1928	...	...	...	...	176	1.8	7,296	14.6
1929	...	...	...	...	176	1.8	7,296	14.6
1930	...	...	...	...	176	1.8	7,296	14.6
1931	...	...	...	...	176	1.8	7,296	14.6
1932	...	...	...	...	275	2.7	8,526	17.0
1933	...	...	.6	.2	462	4.6	9,834	19.6
1934	...	...	6	.2	462	4.7	9,834	19.6
1935	...	...	6	.2	462	4.7	11,199	22.4
1936	...	...	6	.2	462	4.7	11,199	22.4
1937	...	...	6	.2	462	4.7	11,199	22.4
1938	...	...	6	.2	462	4.7	11,199	22.4
1939	...	...	7	.2	554	5.5	13,580	27.1
1940	12	.6	73	2.4	1,688	16.9	20,611	41.2
1941	80	4.0	215	7.1	2,710	27.1	26,729	53.4
1942	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1943	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1944	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1945	102	5.1	320	10.6	4,364	43.6	33,213	66.4
1946	89	4.4	280	9.3	3,819	38.1	29,061	58.1
1947	...	...	183	6.1	2,152	21.5	24,268	48.5
1948	...	...	149	4.9	1,810	18.1	21,985	43.9
1949	...	...	29	.9	1,452	14.5	20,120	40.2

Source: The figures are computed on the allowable deductions and rate structures of the Income War Tax Act, 1917, and its amendements. The percentages are the relation of tax to gross income.

TAX PAID BY A MARRIED MAN WITH TWO CHILDREN
At Digferent Income Levels.

Taxation Year	$2,000 Tax	%	$3,000 Tax	%	$10,000 Tax	%	$50,000 Tax	%
1917	...	...	...	...	360	3.6	5,260	10.5
1918	...	...	12	.4	382	3.8	5,790	11.5
1919	...	...	24	.8	558	5.6	9,158	18.3
1920	...	...	24	.8	585	5.8	9,616	19.2
1921	...	...	24	.8	585	5.8	9,616	19.2
1922	...	...	16	.5	524	5.2	9,599	19.2
1923	...	...	16	.5	524	5.2	9,599	19.2
1924	...	...	...	...	420	4.2	9,565	19.1
1925	...	...	...	...	420	4.2	9,565	19.1
1926	...	...	...	...	220	2.2	8,120	16.2
1927	...	...	...	...	198	2.0	7,308	14.6
1928	...	...	...	...	176	1.8	7,296	14.6
1929	...	...	...	...	176	1.8	7,296	14.6
1930	...	...	...	...	176	1.8	7,296	14.6
1931	...	...	...	...	176	1.8	7,296	14.6
1932	...	...	...	...	275	2.7	8,526	17.0
1933	...	...	.6	.2	462	4.6	9,834	19.6
1934	...	...	6	.2	462	4.7	9,834	19.6
1935	...	...	6	.2	462	4.7	11,199	22.4
1936	...	...	6	.2	462	4.7	11,199	22.4
1937	...	...	6	.2	462	4.7	11,199	22.4
1938	...	...	6	.2	462	4.7	11,199	22.4
1939	...	...	7	.2	554	5.5	13,580	27.1
1940	12	.6	73	2.4	1,688	16.9	20,611	41.2
1941	80	4.0	215	7.1	2,710	27.1	26,729	53.4
1942	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1943	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1944	106	5.3	333	11.1	4,546	45.4	34,597	69.2
1945	102	5.1	320	10.6	4,364	43.6	33,213	66.4
1946	89	4.4	280	9.3	3,819	38.1	29,061	58.1
1947	...	...	183	6.1	2,152	21.5	24,268	48.5
1948	...	...	149	4.9	1,810	18.1	21,985	43.9
1949	...	...	29	.9	1,452	14.5	20,120	40.2

Source: The figures are computed on the allowable deductions and rate structures of the Income War Tax Act, 1917, and its amendements. The percentages are the relation of tax to gross income.

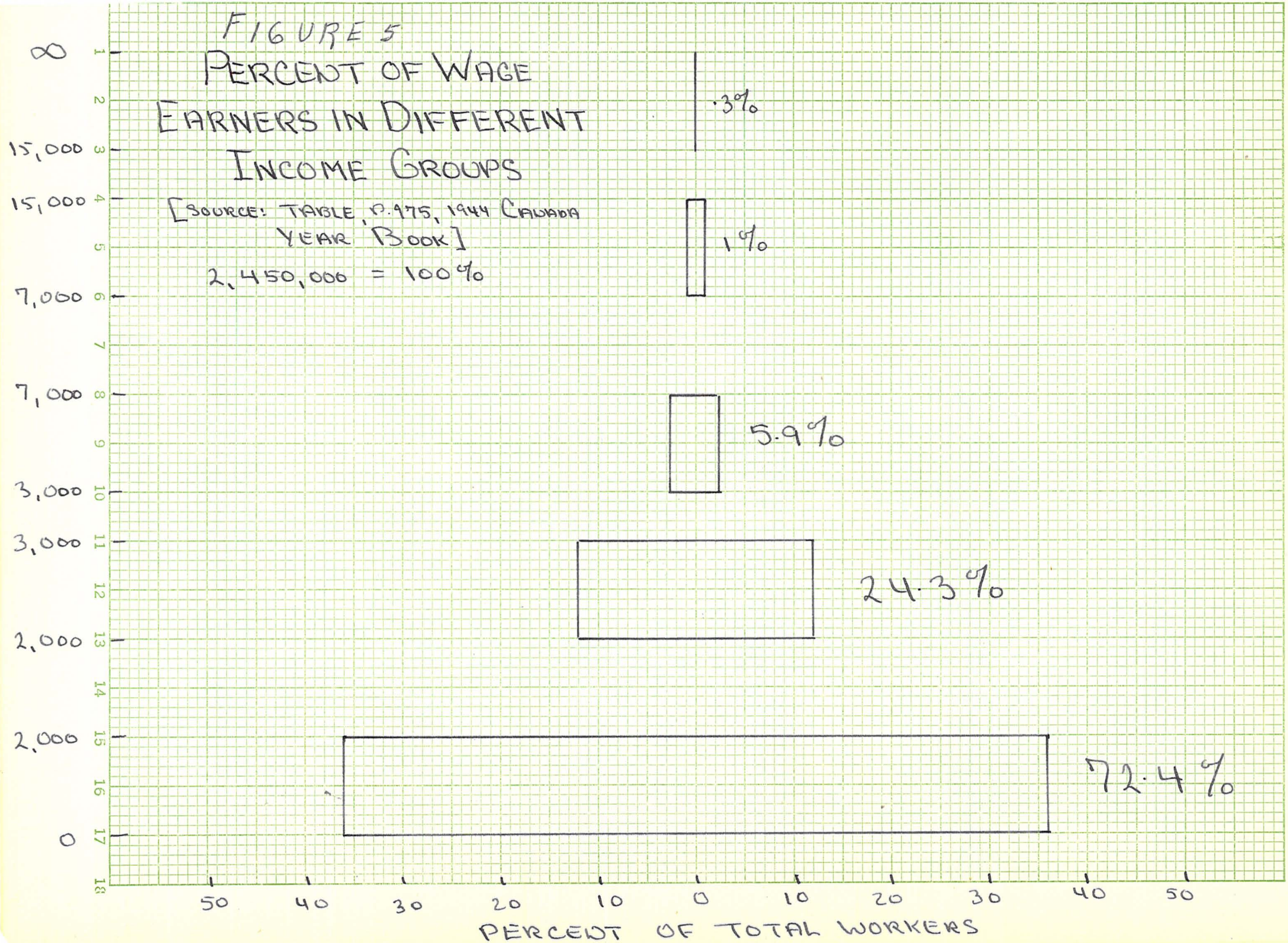
FIGURE 5
PERCENT OF WAGE
EARNERS IN DIFFERENT
INCOME GROUPS
[SOURCE: TABLE, P.975, 1944 CANADA
YEAR BOOK]
2,450,000 = 100%
∞
15,000
15,000
7,000
7,000
3,000
3,000
2,000
2,000
0
·3%
1%
5.9%
24.3%
72.4%
50
40
30
20
10
0
10
20
30
40
50
PERCENT OF TOTAL WORKERS

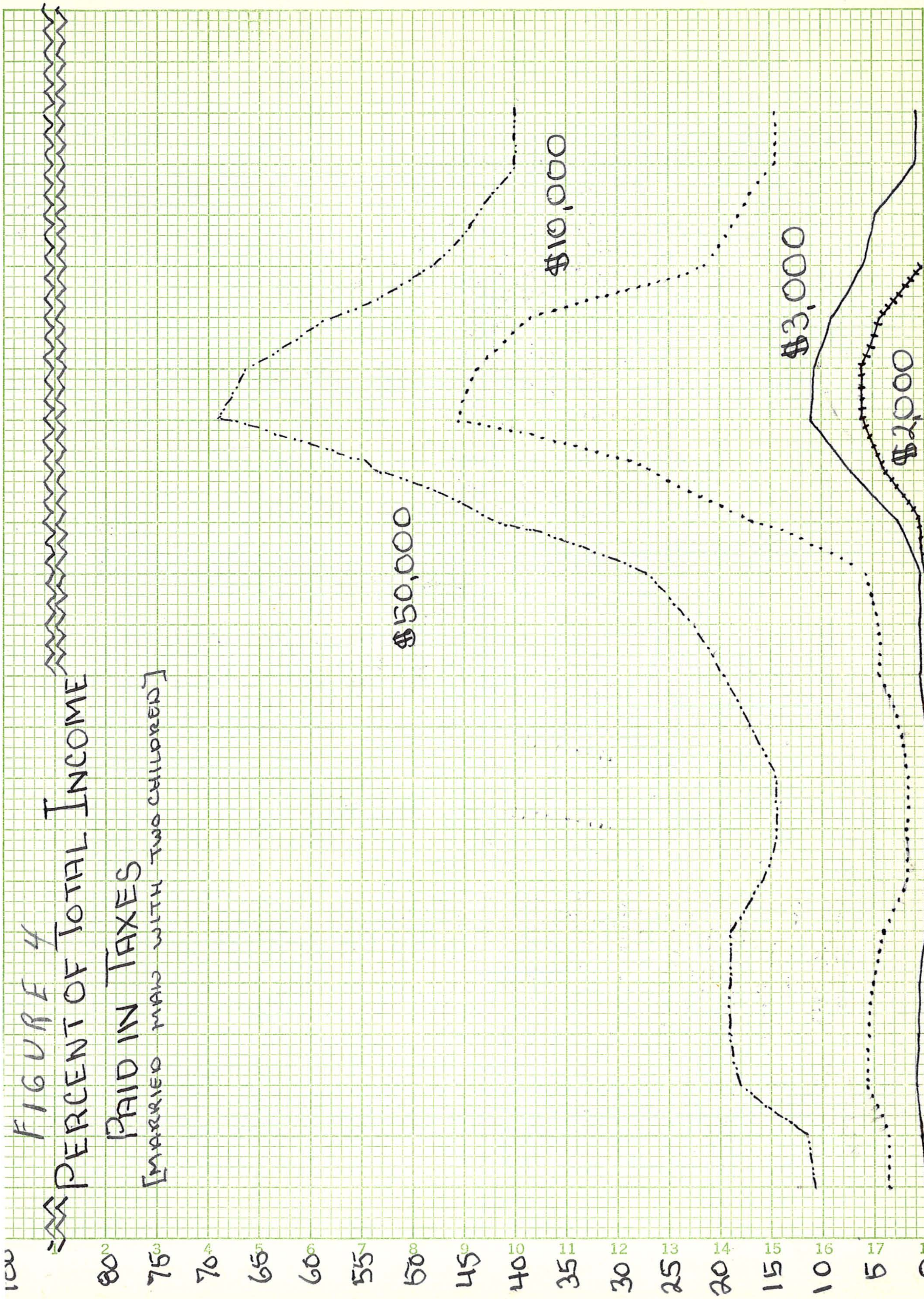
FIGURE 4
PERCENT OF TOTAL INCOME
PAID IN TAXES
[MARRIED MAN WITH TWO CHILDREN]
$50,000
$10,000
$3,000
$2,000
TAXATION YEAR
17 18 19 20 22 24 26 27 28 32 33 35 39 40 41 42 45 46 47 48 49 50
0 5 10 15 20 25 30 35 40 45 50 55 60 65 70 75 80

Chapter VII- COMPARISON WITH UNITED STATES AND BRITAIN

The Canadian income tax is similar in structure to the United States and British income taxes. All three have a 'unified' tax in contrast to a 'series of taxes', each with its own rates and exemptions such as are found in the French and Italian income tax systems. This latter system is based on the idea that the marginal utility is radically different between different types of income. Our system implies that the marginal utility of incomes is the same for a wage-earning taxpayer, a salary-earning taxpayer, a dividends-receiving taxpayer, etcetera. However since 1935 when a surtax on investment incomes was introduced we have had to that extent a 'series of taxes' income tax.

The rate structures on different incomes in the three countries is progressive though the British is not so continuous and reaches its maximum at a much lower income level. These rate structures are best seen by means of a table.[1]

	1917		1921		1926			1946	
Incomes $	Canada	U.S.A.	Canada	U.S.A.	Canada	U.S.A.	Br.	Canada	U.S.A.
6,000	4	5	5	8	6	3	20	45	45
10,000	6	7	11	10	10	6	20	50	55
20,000	9	12	16	16	20	10	23	55	..
50,000	14	16	31	31	26	18	42.7	65	..
100,000	19	31	56	56	36	25	47.6	75	97.5
2,000,000	19	67	72	58	50	25	50	85	97.5

The exemptions and allowances on gross income cover the same situations, but the amounts deductable vary between the

[1]The Canadian rates of tax are taken from the Table on p.45. The United States rates from Tables 1 and 2, Facing the Tax Problem pp. 30 and 36. The British rates are worked out from the British Income Tax, Canadian Almanac, 1926, 1946. The pound is changed into dollars at the exchange rate for 1926 and 1946.

three countries. In 1926, there was a basic exemption of $629 in Great Britain, $1,000 in the United States, $1,500 in Canada. For a married man this was increased to $1,093.50, $2,500 and $3,000 respectively. In Britain there was an unique set of allowances for children and dependents as follows: $172.96 for the first child and $131.22 for each other, and $121.50 for each dependent. In the United States there was an allowance of $400 for each child and dependent and $500 in Canada. In Britain there was an additional deduction of one-sixth of the earned income up to $1,215.

In 1948 the basic exemption was $720 in Britain and $1,500 in Canada for a married man and $440 and $750, respectively for single persons. There was an allowance of $240 for each child in Britain and $300 in Canada. The dependent allowance was $200 and $300 respectively. In addition there was an earned income allowance of one-fifth of the gross income up to $1,600 maximum in Great Britain.

The effect of these deductions and exemptions combined with the rate structure on net taxable income between Canada and Great Britain for the year 1948 is given in the table below:

Gross	Total Deductions		Amount of Tax Paid	
Income	Gr. Br.	Canada	Gr. Br.	Canada
2,000	1,600	2,100	180	...
5,000	2,200	2,100	1,260	598
10,000	2,800	2,100	4,005	2,110

The Canadian income tax paid by a married man with no children as compared to the tax paid in the United States, Great Britain, and France for 1939, is given in the table on following page.

Gross Income*	$ 3,000	$ 10,000	$ 100,000
Canada	30.00	546.00	32,518.00
Great Britain	283.13	1,910.63	50,120.00
France	579.00	3,564.00	54,239.00
United States	28.00	655.00	38,274.00

* Royal Commission on Dominion Provincial Relations, Book II. p. 111.

In general, the Canadian Income Tax has been much more lenient than either the European or United States tax structures. While it appears that the United States tax is less than the Canadian, there is as well a heavy State income tax which raises the amount of tax paid considerably. The reason for the low rates applied in the first years was to encourage immigration. It was felt by the government that heavy direct taxes would be a detriment to their policy of advertising Canada as the land of plenty. Also, Canada, until the Second War, was a 'young' country, and there was always the fear of antagonizing the people.

Chapter VIII - CONCLUSIONS

The development of the Canadian Income Tax falls into two definite periods- 1917-1939 and 1940-1949. During the first twenty-two years it was used sparingly, almost timidly, as a source of revenue, relative to its potentialities. During the past ten years, and particularly from 1941 to 1945, it was used almost too much, so far as its effects on the reduction of normal spending on consumption and investments were concerned.

During the first period, exemptions were high, and bhe tax rates were moderate. It was a period of development and refinement, almost a preparation for when it was to be needed during the forties. For the revenue obtained from the income tax during the war would not have been possible without the experience gained in this early period. Technical and administrative details were worked out, evasion loop-holes were plugged, and means of correcting errors and injustices were developed, and income tax appeal boards were set up for this purpose. The ideals of justice and equitable distribution based on this marginal utility theory, as well as by trial and error, were incorporated in the form of additional allowances for children, dependents, losses, donations, etcetera. Several types of rate structures were applied and refined as their inequalities showed. Methods of taxing foreigners on Canadian income and reciprocal tax agreements with Great Britain and the United States were settled. All these developments took place during the period when only 4 per cent of the income earners were affected by the tax.

The income tax, far more than any other type of tax, affects the individual so directly that the slightest injustice or inaccuracy in the tax is immediately apparent, and these are made known to the government through the Members of Parliament, the tax associations, or attempted evasion, which the government must then attempt to correct.

"The more equitable the tax the greater the revenue", is born out by the income tax. Taken all in all, income is the best test of ability, and it is the only tax which recognizes the different values in the same income to different individuals. Although there is general agreement that the income tax is the best tax to have as the backbone of a revenue system, there will never be complete agreement on the distribution of it amongst different groups. With high basic exemptions, the lower incomes gain, with low progressive rates, the higher incomes gain, and neither will be fully satisfied that the 'other fellow' is paying his share. Since 1917, the tax structure has spread in both directions -- more refined exemptions and higher progressive rates---in general, at the expense of the larger incomes. Whether this means they are paying more than they should or as much as they should is a relative matter. Perhaps the best test would be on the reduction in investment capital, and particularly risk-capital, due to the high rates on the large incomes.

The importance of the income tax will probably continue to increase as it has over the past thirty-three years, and it will continue to be refined and altered as discrepancies appear. It has assumed the position in the revenue system of the 20th century that was held by the customs in the 19th century, whether it will be displaced by a better source of government revenue depends on how the ideals of justice and equitable distribution of the tax burden are altered.

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