Patrick Grady
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Is anyone better off with sales tax reform?

FINANCE MINISTER Michael Wilson has clearly stated the government's "commitment to ensure that families earning less than $30,000 a year are better off as a result of sales tax reform." This is important, because the move to rely more heavily on sales taxes will otherwise bear disproportionately on those ,with low incomes, undermining the basic equity of the tax system.

The government proposes to fulfil its commitment by enriching the sales-tax credit, a novel instrument introduced to cushion the impact of recent Manufacturers' Sales Tax increases.

The sales-tax credit will be increased from $140 per adult to$190, and from $70 to $100 per dependent child. Single parents will also be allowed to take the adult credit for the first dependent child. Single taxpayers, including single parents, will be allowed the basic $190 credit plus 2 per cent of net income over the basic personal amount, to a maximum of $290. The sales-tax credit reduction level, above which the sales-tax credit is recaptured at a rate equal to 5 per cent of the net income of the taxpayer and spouse, will be raised from $18,000 to $24,800.

Unfortunately, independent analysis of the impact of the proposed Goods and Services Tax package on low-income families shows that enriching the sales tax credit is not enough to honor the commitment to make those earning less than $30,000 better off as a result of sales-tax reform.

Estimates I made for a Canadian Tax Journal article (using Statistics Canada's Social Policy Simulation Database and Model) indicate that 2.1 million or 46 per cent of the Canadian families (counting single individuals as families) earning less than $30,000 a year will actually pay higher taxes in 1991 as a result of the GST. These families will pay an average $20 more. It may not be a large sum, but it runs counter to one of the key principles of fairness that the government specified for sales-tax reform.

My estimate contrasts sharply with the government's technical paper on the Goods and Service Tax, which provides the basis for the claim that the commitment to make those earning less than $30,000 better off is being met.

Government estimates of the GST's impact on income distribution lack credibility for two reasons. First, they are not really estimates of the impact in 1991 as they appear to be; they are hypothetical estimates of the impact in equilibrium, incorporating the full impact of indexing of taxes and transfers. Except for the _ Old Age Security pension and Guaranteed Income Supplement, indexed quarterly, no indexation will be triggered in 1991, because of a lag in the indexation formula.

Second, the government has assumed that the full $4-billion of the Manufacturers' Sales Tax currently levied on investment goods will be passed on in lower consumer prices after the manufacturers’ tax is eliminated. This assumption is inconsistent with the government's own estimate that only the portion of the Manufacturers' Sales Tax on consumer expenditures will be passed on, and that the GST will result in an increase in the consumer price index of 1 1/4 per cent in 1991.

It is also more strikingly inconsistent with the increase in the consumerpiice index used by the government in calculating the indexation of taxes and transfers in its own distributional analysis.

If the government is serious about its commitment to ensure that families earning less than $30,000 are better off, it will have to increase the sales-tax credit by more than the proposed amount.

Increasing the credit for adults by an additional $60 per adult, $30 per child and $30 for the additional amount for working singles would, at a cost of $760 million, transform the average tax increase for a family earning less than $30,000 into an $80 net decrease in taxes.

The number of families paying higher taxes would be reduced to 1.1 million, or less than one-quarter of families. About 2.2 million, or more than 70 per cent of families, would be better off.

It is also going to be important to make sure that the sales-tax credit and income-threshold levels are fully adjusted for inflation. This is essential so that low-income families do not have their increases in sales-tax credits taken away by inflation.

With indexation of the credit and threshold limited to the increase in the consumer price index in excess of 3 per cent, the currently proposed increase in the credit and threshold would be almost entirely consumed by inflation over a 10-year period. This would leave low-income families with no real increases in the credit or threshold and facing sharply higher sales taxes. If this is allowed to happen, sales-tax reform will not be equitable.