Institute for
COMPETITIVENESS & PROSPERITY

Press Release, October 28, 2013

"Institute for Competitiveness & Prosperity delivers a blueprint for smart taxation in Ontario"

Ontario needs to tax smarter by amending personal income tax credits and adjusting current business support measures

Toronto – Ontario has improved its tax system markedly in recent years by introducing the harmonized sales tax, phasing out the capital tax, and lowering corporate tax rates. However, many changes can still be made that would benefit individuals, businesses, and government. In *Taxing for growth: A close look at tax policy in Ontario*, the Institute for Competitiveness & Prosperity picks up on its previous recommendations for tax reform in Ontario and examines current policy to identify ways Ontario can create a tax system that spurs growth, investment, and competitiveness.

The Institute defines three goals for smart taxation: equity, efficiency, and effectiveness. A smart tax system ensures that taxes are proportional to one's ability to pay and minimize economic distortions. A smart tax system also rewards actions that benefit society, such as investments in R&D or education, and discourages actions that have a hidden social cost, like smoking or pollution.

"Tax expenditures," which include credits, deductions, and other forms of special treatment that represent forgone government revenue, play a major role in Ontario's tax system. Recent years have seen an expansion in the availability of tax credits for individuals and businesses in Ontario. But many of them are inequitable, inefficient, and ineffective. Moreover, they often fail to accomplish their intended benefits and cost the government billions of dollars in lost revenue every year. The Institute suggests other ways government can motivate Ontarians without the use of distortionary tax policies.

On the personal income tax side, government should review the Basic Personal Allowance and consider an alternative way of providing income support for the poor. Tax credits for post-secondary education should be converted into grants, which would be more effective in encouraging enrollment. The Ontario Clean Energy benefit should also be eliminated immediately.

On the corporate side, the Institute recommends a re-evaluation of existing business supports to reduce the preferential tax treatment for small businesses and certain industries. Business supports in Ontario increased substantially in the last six years despite overall corporate tax reductions that have made businesses more competitive. These supports put other companies that don't receive the same support at a disadvantage. In addition, current tax breaks for small businesses encourage companies to stay small, even though significant economic gains can be made from expansion.

Tax policy is one of the most powerful tools in the public policy arsenal. With greater consideration of the broader effects of current tax measures, Ontario can ensure it rewards the right actions and puts more money back into the pockets of people who need it. By following the Institute's recommended changes to tax policy, the federal and provincial government can save billions of dollars a year, which can be re-allocated toward more productive uses.

"Ontario needs to tax smarter to improve the province's prosperity," says Roger Martin, Chair of the Institute for Competitiveness & Prosperity. "Rather than focus on high or low taxes, policymakers need to look at the effects of current tax policy and evaluate their success in achieving public policy goals.

Ontario has greatly improved its tax system, but more work must be done to ensure our tax policy is equitable, efficient, and effective."

TAXING FOR GROWTH

Smart taxation

- **Equity**: A smart taxation system is equitable, raising revenues from those with the greatest ability to pay and where it is least likely to impose financial hardship.
- **Efficiency**: A smart taxation system is also efficient, limiting economic distortions that accrue from the imposition of a tax.
- **Effectiveness**: A smart taxation system is also effective, encouraging actions that are beneficial for citizens of a jurisdiction and discouraging those that are not.

Review personal income taxation credits

- **Revise the Basic Personal Allowance.** This benefit is poorly targeted and disproportionately benefits middle and higher income groups.
- **Convert tuition and education credits to grants.** These credits could be more effective at encouraging Canadians to pursue higher education as student grants.
- **Review targeted tax policy measures.** Review the effectiveness of the Children's Fitness Credit and eliminate the Ontario Clean Energy Benefit.

Re-evaluate business support measures

- **Pursue taxation neutrality as a guiding principle.** Industry targeted business supports reduce the neutrality of corporate taxation. Neutrality is an important objective, because it encourages firms to pursue investments based on their perceived profitability rather than the level of business support.
- **Phase out the small business deduction.** This benefit creates an economic inefficiency by discouraging growth beyond the small business income threshold.
- **Implement a cash-flow system of corporate taxation.** This would enable the expensing of capital investments immediately, which would encourage capital investment.

About the Institute
The Institute for Competitiveness & Prosperity is an independent not-for-profit organization established in 2001 to serve as the research arm of Ontario's Task Force on Competitiveness, Productivity and Economic Progress. The Institute is supported by the Ontario Ministry of Economic Development and Innovation. Working Papers published by the Institute are primarily intended to inform the work of the Task Force. In addition, they are designed to raise public awareness and stimulate debate on a range of issues related to competitiveness and prosperity.

The complete report can be downloaded directly at: http://www.competeprosper.ca/work/working_papers/working_paper_18

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