The Canadian Income Tax System Evolution

Before Confederation on July 1st, 1867, government revenue came mostly from customs and excise duties. As early as 1650, for example, Louis XIV of France levied export taxes of 50% and 10%, respectively, on beaver pelts and moose hides leaving his northern American colonies. A century later, Nova Scotia imposed customs duties on sugar, bricks, lumber, and billiard tables. Excise taxes were levied on tea, coffee, and playing cards.

The British North America Act gave the newly formed Canadian Parliament unlimited power of taxation. The power remained largely unused, however, since customs and excise duties still provided for most Dominion expenses. In 1867, the new government simply increased excise duties on liquor and imposed a tax on beer, malt, cigarettes, cigars, and snuff. In 1870, existing taxes were raised and new import duties on vinegar, wheat, and grain were levied.

At Confederation, provinces were given the power to impose direct taxes for provincial purposes. Over the next fifty years, the provinces taxed horses, dogs, cars, gasoline, salmon, canaries, race-tracks, foxes, circuses, traveling shows, restaurants, bowling alleys, and poolrooms. British Columbia levied an income tax and a land tax; Québec imposed corporation taxes; Ontario imposed succession duties; and Prince Edward Island levied both a property tax and an income tax.

In 1914, Canada declared war against Germany. At that time, customs and excise duties still provided 90% of total Dominion government revenue. To finance the war effort, the federal government in 1916 imposed a corporation tax known as the Business Profits War Tax. In 1917, the Income War Tax Act, described by the Borden government as a temporary measure, was introduced, much to the dismay of the provinces that had come to believe that only they, and not the federal government, had the right to impose direct taxes. Unfortunately, the end of the war did not end the need for additional revenue: hospitals for the wounded, homes for the permanently disabled, and pensions for veterans all had to be funded. In addition, the railway that the government had acquired as a result of the war now had to be operated on a much larger scale in order to better serve the national economy. As a result, the new taxes remained in place. A decade later, in 1927, the government created the Department of National Revenue to administer the growing tax system.

In 1930 only three provinces levied taxes on income. However, during the 1930's provincial responsibilities were increased by a variety of court decisions, but no corresponding new sources of revenue were provided. The unsurprising result was that by 1939, seven provinces imposed income taxes. For some taxpayers, the provincial taxes were just as high as the federal taxes, which themselves had risen during the decade. The recommendations of the Rowell-

Sirois Commission, set up in 1937 to define the responsibilities of the provincial and federal governments and to reorganize the tax system, were still under discussion when World War II began.

With the outbreak of World War II, the federal government found that its expenditures greatly exceeded its revenue. In 1941, the provinces surrendered income tax collection to the federal government for the duration of the war plus one year. In exchange, the provinces received fixed annual “rental payments” from the federal government. “Pay as you earn” tax deductions began in 1942. This meant that employers withheld tax from their employees’ pay and remitted it to the government. Self-employed taxpayers were required to pay their tax by instalments.

On January 1, 1949, the Income War Tax Act was repealed and the Income Tax Act came into effect. Since then, the Income Tax Act has undergone some major reforms and many small revisions, but its basic structure has remained intact.

Canadian Income Taxes Today

The federal and provincial governments still have the authority to impose direct taxes. Income tax is, in fact, levied on taxable persons by the federal government and the governments of all ten provinces and three territories. In 1962, the federal and provincial governments established the Tax Collection Agreements, which allow the provinces to impose their own income taxes and to accept federal tax collection and administration of the tax system. The result is that, in all provinces except Quebec (which has operated its own income tax system since 1954), taxpayers complete only one income tax return each year.

On November 1, 1999, Revenue Canada was replaced by the Canada Customs and Revenue Agency (CCRA). The purpose of the change was to streamline the federal and provincial systems to reduce the overlap and duplication of various programs. In December 2003, the short-lived CCRA, which was responsible for customs as well as revenue, was split into the Canada Border Services Agency which deals with customs and the Canada Revenue Agency (CRA) which is responsible for administration of the tax laws. As a result of this change, many tax programs that were previously administered by the provinces are now administered by the CRA. The Income Tax Act is still administered by the Department of National Revenue with the minister of that department remaining accountable to parliament for the administration of the CRA.

In addition to collecting federal tax payable, the CRA continues to collect tax payable to all the provinces and territories (except Quebec) and turns those amounts over to those jurisdictions.

Provincial Taxes

Outside Québec, provincial/territorial taxes and credits are calculated on special forms, and then added to the federal totals, so that the refund/balance due calculated on the federal return includes both federal and provincial taxes. In Québec, however, provincial tax is calculated on a special return that is filed with the Québec government, so the refund/balance due on the federal return includes only federal taxes.

Residence Principle

The Canadian Income Tax Act, unlike the equivalent legislation in a number of other countries, uses residence, not citizenship or nationality, as a criterion to determine how an income is taxed.

Self-Assessment System, Which is Tricky Sometime

In many countries, tax calculations and deductions are made strictly at source by employers or government tax collectors, and no tax return is filed at the end of the year. Canada, however, has a self-assessment income tax system, which requires taxpayers to determine their own tax liability each year.

Under our self-assessment income tax system, taxable individuals are required to determine their taxable income for each taxation year, and then calculate their tax payable. This amount is compared with tax already paid and if the total credits exceed tax payable, the excess is refunded; if the total credits are less than the amount payable, the taxpayer must pay the balance owing. These calculations must be carried out on an income tax return that must be filed with the government.

Progressive Tax System

Canada's present system is called a progressive tax system because it imposes low rates of tax on low incomes and progressively higher rates of tax on higher incomes. For 2014, the federal tax rates were 15% on income of $43,953 or less; 22% on income between $43,953 and $87,907; 26% on income between $87,907 and $136,270; and 29% on income over $136,270. For 2014, the Ontario tax rates were 5.05% on income of $40,120 or less; 9.15% on income between $40,120 and $80,242; 11.16% on income between $80,242 and $514,090; and 13.16% on income over $514,090.

Underlying the system of progressive taxation is the belief that low-income persons should pay relatively less tax because they are obligated to spend a relatively high proportion of their income on the necessities of life; high-income persons, on the other hand, have more discretionary income with which, among other things, they can pay tax.

One of the problems with our current progressive system, however, is that it levies tax individually, not on a family basis. As a result, a family in which one spouse earns $80,000 will pay several thousand dollars more in tax than a family in which each spouse earns $40,000, even though the gross family income is the same in each case. This is because, in the first situation, about half the income is taxed at a federal rate of 15%, and the rest at 22%, while in the second situation, all the income is taxed at 15%.