Munich Personal RePEc Archive

A Separate Personal Income Tax Collection System For Alberta: Advantages and Disadvantages

Grady, Patrick

Global Economics Ltd.

11 May 2004

Online at https://mpra.ub.uni-muenchen.de/21722/
MPRA Paper No. 21722, posted 29 Mar 2010 08:17 UTC

A Separate Personal Income Tax Collection System For Alberta: Advantages and Disadvantages

Commissioned by
The Alberta Finance Ministry

As a Background Study for
The Legislative Committee on
The Role of Alberta in Confederation

By
PATRICK GRADY

May 11, 2004

Table of Contents

Executive Summary ii
  Introduction ii
  Advantages iii
  Disadvantages iv
  Opportunities and Challenges v
Introduction 1
Constitutional Authority for the Personal Income Tax 1
The Tax Collection Agreement 2
  History 2
  Federal Cost of Administration of the TCA 5
  Fees for Administering Alberta Measures 9
  Provincial Complaints About the TCA 9
The Personal Income Tax in Alberta 11
The Personal Income Tax in Quebec 12
The Personal Income Tax in Other Provinces 13
Advantages of a Separate Personal Income Tax Collection System 15
Disadvantages of a Separate Personal Income Tax Collection System 18
Costs of a Separate Personal Income Tax System 19
  Administrative Costs 19
    Estimate of Administrative Costs Based on Quebec System 20
    Estimate of Administrative Costs Based on Federal System 20
  Compliance Costs 26
Opportunities and Challenges of the New TCA 29
References 30

Executive Summary

Introduction

The Province of Alberta has been a participant in the Tax Collection Agreements (TCAs) with the Federal Government covering the personal income tax since their inception in 1962. Under the terms of this agreement, the Federal Government undertakes to collect the Alberta personal income tax at no charge provided that the Government of Alberta agrees to levy its tax within a commonly agreed framework.

In the past, this agreement was considered overly restrictive by some provinces including Alberta because it required the provinces to levy their tax as a proportion of Federal Basic Tax. But, under pressure from the provinces, the Federal Government agreed to a new approach that now enables the provinces to levy their taxes on taxable income and that gives them additional flexibility with respect to non-deductible credits and other measures. Under this new approach, the provinces/territories are able to specify: their own tax brackets (including a zero rate on a first income bracket, if desired); their tax rates on these brackets; surtaxes; low-income tax reductions; their own non-refundable tax credits (to be multiplied by the lowest non-zero provincial/territorial tax rate); and their own refundable tax credits.

Concerning the non-refundable tax credits, the provinces/territories are allowed to supplement federal credits or add any additional unique provincial/territorial credits. This means that they are no longer locked in to any federal increases in a credit, but can maintain the value of a gross provincial/territorial credit equal to the minimum of the 1997 value and the current year value of the corresponding federal credit.

For expenditure-based credits such as those for the Canada Pension Plan (CPP), Employment Insurance (EI), tuition fees, medical expenses, charitable donations, the provinces/territories are able to increase credits beyond the level of the gross federal credit, but would not be able to fall below the level of the federal credit.

Any other provincial/territorial tax measures will be required to be consistent in the view of the Federal Minister of Finance with the principles set out in the draft guidelines being negotiated to go along with the new TCA. According to these principles, the tax measure should not "materially alter the Common Tax Base" or "impede the free flow of capital, labour, goods and services." The province/territory is required to pay the Federal Government an appropriate, relatively modest, administrative fee set out in the TCA. In Alberta's case, this was only the minuscule sum of $20,434 in the 2001 taxation year.

Quebec remains the only province that does not take advantage of the Federal Government's offer to administer its personal income taxes for virtually nothing. This is not due to any sophisticated calculation of the financial costs and benefits to Quebec of participation in the TCA. Like any other province Quebec would definitely be better off financially if the Federal Government were to pay the costs of collecting its income taxes. The primary advantage to

Quebec, given the ongoing issue of the future constitutional status of Quebec, is entirely non-financial, namely the control over its own revenue streams. The existence of a separate provincial income tax regime ensures that, should the constitutional status of Quebec ever be changed in the direction of greater sovereignty, the tax collection infrastructure would already be in place to ensure the continued flow of tax revenues without needing to depend on the cooperation of the Federal Government. It is unlikely that a Quebec Government of any political stripe will join the TCA given the symbolic nature of its own personal income tax and the high political cost likely to be associated with giving it up.

The overall assessment of the TCAs is that they have worked very well in enabling Canadian governments to achieve their shared tax policy objectives. As was concluded in a 1991 Department of Finance paper on tax-coordination: "The Tax Collection Agreements serve the national interest. They help to reduce complexity and duplication; promote tax harmony; and thus the free flow of labour and capital across Canada and economic prosperity; help Canadians identify which order of government is responsible for their taxes; and, at the same time, provide provinces with a degree of flexibility over their tax systems." (Department of Finance, 1991, p.i). With the additional flexibility imparted by the new TCA framework with its tax-on-income option, the TCAs should work even better and be able to accommodate the legitimate tax policy objectives of provincial governments

Advantages

In theory, there are a number of advantages that can be derived from a separate income tax collection system, most of which vanish on closer inspection. A separate personal income tax system would give the Alberta Government greater control over the collection of its income taxes by allowing it to assume full responsibility for the collection of its personal income taxes.

Another advantage is that it would make it clearer to the Alberta taxpayer how much tax was going to the Federal Government and how much to the Alberta Government.

In addition, a separate personal income tax system would give Alberta greater scope to modify the personal income tax to pursue its economic and social goals.

To benefit from a separate income tax, however, the Alberta Government would have to be desirous of making major changes in the structure of the personal income tax. To justify pulling out of the TCA and bearing the full costs of administering its own personal income tax, the contemplated changes would have to be more far-reaching than would be allowed under the new TCA, otherwise there would be no additional benefit to Alberta to collecting its own tax. In addition, the policy changes would have to be of such a nature that they could not be accomplished more cheaply through direct government expenditures instead of tax expenditures.

While Alberta would undeniably gain policy flexibility by establishing its own personal income tax system, any use of that flexibility would be limited by Alberta's desire to avoid creating a tax

jungle and thus balkanizing the Canadian economic union. All provinces gain by agreeing to respect certain rules of good tax conduct and not to poach jobs from one another. It is telling that Alberta has not taken advantage of its flexibility on the corporate side and has remained largely harmonized with the federal government and the other provinces. There is no reason to expect it not to exercise the same restraint with respect to the personal income.

The Government of Alberta is much more oriented to the free market and less interventionist than the Government of Quebec, which is the only provincial government with a separate personal income tax system. It is hard to see why the Alberta Government would want to set up a personal income tax system that would enable it to adopt the more active Quebec approach to economic and social development, particularly since its own approach seems to have been more successful.

Disadvantages

There are many obvious disadvantages to a separate personal income tax, particularly given that the Federal Government is paying the full administrative cost of provincial personal income taxes under the TCA. From the point of view of individual taxpayers, the greatest disadvantages would be the additional unwanted complexity that they would face at tax time and the additional Alberta tax form they would have to fill out. Rough estimates of these additional compliance costs range from a couple of million dollars to $50 million dollar range depending on the complexity of the new tax system adopted with the most expensive estimate being attached to a system like the one in Quebec.

Under a separate tax system, Alberta taxpayers would also have the additional inconvenience of having to send a check to the Alberta Government, which could not be offset against any refund they might have coming from their federal tax. Needless to say, none of this additional paperwork would be welcomed, nor would it endear the Alberta Government to Alberta taxpayers.

From the point of view of Alberta companies, there would also be the additional compliance costs of reporting income to the Alberta Government and making source deductions, which are estimated to be around $74 million. This additional paperwork burden would increase the cost of doing business in Alberta and make Alberta firms less competitive.

Alberta taxpayers would also have to pay the additional startup and administrative costs of a separate personal income tax system, which are currently being borne by the Federal Government on behalf of all Canadians. The administrative costs of a separate personal income tax can be estimated based on the experience of the Quebec Ministry of National Revenue and the Canada Revenue Agency. These estimates, which are presented in this paper, are $71 million and $160 million per year respectively. On top of this would have to be added the additional costs associated with the extent to which the bad debts from uncollectable taxes are in excess of interest and penalties taking into account the time value of money. According to information provided by the Federal Government, this amounted to an average of $2.4 million per year over the 1993-94 to 1997-98 period. The corresponding staff requirements needed to run the system

are estimated to be one or two thousand full-time equivalent person-years depending on the approach. And it is worth noting that these person years do not necessarily represent additional jobs in Alberta. The Alberta Government would have to find the money required to pay the increased administration costs by cutting back elsewhere or raising taxes. It is also worth noting that these estimates, high as they are, could be on the low side if per-taxpayer costs turn out to be higher than in Quebec or federally because of the lower scale of the tax processing operations.

Concerning startup costs, the Alberta Ministry of Finance estimates that a new computer system might cost in the range of $30 to $40 million dollars. In addition, initial capital costs for infrastructure and equipment of uncertain magnitude would be incurred. The inevitable difficulties that would be encountered in setting up a new system would no doubt be a source of much irritation to Alberta taxpayers.

The establishment of a separate personal income tax for Alberta would contribute to the fragmentation of the economic union from which all Canadians benefit. The TCA is an important integrating force Canada. By ensuring a common tax base, it encourages the free movement of capital, labour, goods and services. These movements would be impeded if provinces leave the TCA and exercise their additional policy control to deviate from a common tax base and implement tax provisions favouring investment and economic activity within their own borders at the expense of the other provinces. By being the first province to leave the TCA for personal income tax, Alberta would be perceived by the other provinces as a balkanizing force. This might jeopardize cooperation on other fronts.

Opportunities and Challenges

Alberta has not taken full advantage of the additional flexibility allowed under the new "tax on income" system. This is not necessarily a bad thing. The single-rate tax system pioneered by Alberta is very appealing in its simplicity. In general, a single-rate tax has the advantage of reducing the distortions inherent in a progressive rate structure (but only, of course, for the provincial component of personal income tax). Since everyone in a taxfiling family unit faces the same provincial marginal tax rate, it reduces work disincentives for dependent spouses and children. A single-rate tax also reduces the need for income splitting and income averaging.

The specific single-rate tax system in Alberta also has additional advantages of promoting equity and competitiveness. The personal and spousal amounts are the most generous in the country, which means that Albertans can earn the greatest amount of income free of provincial tax. This benefits individuals all the way up the income scale, but particularly lower income earners. In addition, the single rate has been set at 10 per cent, which makes it the lowest top marginal tax rate in Canada. This promotes competitiveness, and encourages people to work, save and invest in Alberta.

As long as Alberta continues to follow its current strategy of having a simple, low-rate personal income tax system that imposes a minimum compliance burden on taxpayers, there is really no compelling need to establish a separate personal income tax. Indeed, even if Alberta were to decide that it wishes pursue a more activist tax policy such as that being pursued by Quebec, it

could go a long way down that road before it would come up against the constraints of the new draft TCA. In these circumstances, a reasonable strategy for Alberta would be to continue to make the tax policy that it thinks is most appropriate and only to worry about constraints imposed by the TCA when it actually starts to run into them, which given the tax policy preferences of Albertans, may very well be never.

And if Alberta does ever start to run into constraints, it needs to ask the fundamental question of whether they make sense. If, for instance, the constraints are designed to prevent provinces from pursuing tax policies that undermine the economic union, Alberta will need to seriously consider whether the introduction of such policies would really be in its long-term interests. On the other hand, if the constraints do not make sense because they impede the province from introducing desirable personal income tax reforms, perhaps it would be better to try to work within the TCA system and get the constraints relaxed or even to get the reforms introduced by the Federal Government for the Federal personal income tax. Only in the extreme case, which is difficult to envisage in practise, where the reform is so important to the province that it is worth bearing the substantial additional costs of setting up and administering a separate personal income tax system and running the risks of balkanizing the economic union should the province seriously contemplate pulling out of the TCA.

Introduction

Constitutional Authority for the Personal Income Tax

Canada has a "federal" system of governance. The Federal Government and the provincial governments both have their own legislative powers as set out in the Canadian Constitution. This includes the power to raise money by taxation.

The power of the Federal Parliament to tax as defined in Subsection 91(3) of the Constitution Act 1867 is "The raising of Money by any Mode or System of Taxation," which confers upon it very broad authority to tax. The power of the provincial legislatures as set out in Subsection 92(2) is "Direct Taxation within the Province in order to the raising of a Revenue for Provincial Purposes," which limits the provincial government to "direct taxes." Clearly, both the Federal and provincial governments have the constitutional authority to impose direct taxes -- provincial governments because the power is explicitly listed and the Federal Government because it falls under the more inclusive heading of "any Mode or System of Taxation." This raises the question of whether the personal income tax is a "direct tax." To answer this question, it is necessary to examine the interpretation put on the term by the courts.

The distinction between a direct and indirect tax has been drawn by the courts based on the incidence of the tax as defined by a strictly literal interpretation of the words of John Stuart Mill in his *Principles of Political Economy*, which was the standard economic text back in the later nineteenth century at the time the decision was made. According to this definition, a direct tax is one which is "demanded from the very persons who it is intended or desired should pay it."[1] Since an income tax is levied on the physical or legal person expected to pay, the provincial governments as well as the Federal Government have the power to levy a personal income tax under this definition.

Both levels of governments have long recognized this shared power to levy personal income taxes in the tax rental and tax collection agreements they have concluded over the years. With respect to the TCA, a 1998 decision in British Columbia confirmed that although a province "cannot delegate its legislative powers to the federal government, it can constitute Canada as its agent to collect the tax imposed by it under its own provincial Income Tax Act."[2]

This decision confirms that the fact that Federal Government has collected the personal income tax on Alberta's behalf does not in any way detract from its constitutional power to levy and collect its own personal income tax. There is thus no constitutional barrier to prevent Alberta like Quebec from collecting its own personal income tax in the future if it so chooses.

[1] This was quoted by Lord Hobhouse of the Judicial Committee of the Privy Council in overturning a Quebec Court of Queen's Bench in the case of *Bank of Toronto v. Lambe*, 1987 as cited in Olmstead (1954, Vol 1., p.222).
[2] Guillemette v. Canada , Between Michael R. Guillemette, Appellant, and Her Majesty the Queen, Respondent, Bowman T. C. J, Court File No. 96-3678(IT)G,Vancouver, British Columbia , February 20, 1998

The Tax Collection Agreement

History

In 1917, the federal government entered the income tax field in order to finance the costs of World War I. This marked the beginning of the joint occupancy of the personal income tax field, which until then had been used exclusively by the provinces and municipalities.

It was not until the Depression, when federal, provincial, and municipal governments were all attempting to raise income tax revenues to meet increasing demands, that joint occupancy became an issue. At that time, there was little or no co-ordination between governments on the design or administration of their respective tax systems. The lack of a common tax structure and the non-uniformity of tax bases and rates produced large variations in tax burdens between provinces. In addition, tax administration was extremely complex, with a multiplicity of forms, rates, and methods of calculation.

In evaluating this situation (which is frequently referred to in the literature as the "tax jungle") the Royal Commission on Dominion-Provincial Relations (1940) recommended that provinces withdraw from the income tax field in order to avoid "increasing friction between governmental units, increasing double taxation, increasing arbitrary, discriminatory, and confiscatory tax levies, increasing costs of tax compliance, increasing disparities in taxation burdens and government services between regions, and increasing disparities between burdens on and opportunities open to individuals."

Although the provinces initially rejected this recommendation, Canada's involvement in World War II necessitated changes to give the federal government access to sufficient funds to finance the war effort. In 1941, the provinces agreed to vacate the income tax and estate tax fields in return for "rental" payments. The tax rental agreements continued until 1962, although with significant changes: Ontario and Quebec withdrew in 1947 but did not (at the time) impose personal income taxes. In 1952, Ontario re-entered the agreement; Quebec implemented its own personal income tax in 1954.

Although the tax rental agreements provided the benefit of uniformity of personal income tax across the country, they were subject to criticism. In particular, they prevented the provinces from raising revenues in the face of increasing expenditure demands. The provinces could neither set tax rates nor use the personal income tax as a policy instrument. Even though personal income tax revenues were shared with the provinces, the fact that the federal government set tax policy and collected taxes meant that the federal government tended to be seen as the sole taxing authority by taxpayers.

To move beyond the limitations of the tax rental agreements and thus to allow provinces flexibility in the design of income tax policies, the federal and provincial governments agreed in 1962 to a new form of co-ordination — the tax collection agreements. The TCAs were signed by all provinces except Quebec (which chose to retain its own personal income tax system). In

addition, all provinces, including Quebec, adopted a common formula for allocating income among them for tax purposes — namely, taxation of individuals on the basis of residence (the province of residence as of December 31 of the year). Under the 1962 TCAs, the provinces were also required to levy their tax as a percentage of federal tax (i.e. "tax on tax").

From time to time, some of the provinces voiced their concerns about the way their TCAs exposed them to federal tax policy changes that were taken without notification and often without prior consultation. A particularly egregious example occurred in 1981 when a federal budget was introduced which restricted the deductibility of interest expense and replaced the income-averaging provisions with limited forward averaging. In reaction, the Treasurer of Ontario asked the Ontario Economic Council to consider whether Ontario should withdraw from the TCA to "enhance the ability of the Government of Ontario to pursue economic objectives and to meet the needs of the province efficiently." Following a careful review, the Ontario Economic Council recommended that Ontario "should not move to a separate personal income tax at this time," but that a Tax Structure Committee should be established to look into moving to a "tax on base," extending the tax credit system, and establishing a code of economic conduct to prevent provinces from introducing "beggar-thy-neighbour" tax measures (Ontario Economic Council, 1983).

In the late 1990s, some of the provinces began pushing again for additional policy control within the TCA by requesting that the base for provincial taxation be moved from federal tax to federally defined taxable income (i.e. "tax on income"). Ontario, in particular threatened to pull out of the TCA in its 1997 budget if the Federal Government did not become more accommodating. Following extensive discussions, the Committee on Taxation completed a joint federal/provincial/territorial "tax-on-income paper" in October 1998. The Deputy Ministers of Finance of the participating provinces and the Federal Government affirmed their agreement with this paper on behalf of their governments.

In their 1999 and 2000 budgets, provincial Governments began gearing up for 2001 when "tax on income" was to become a reality. All was going along smoothly until the May 2000 Ontario budget when the Ontario Minister of Finance introduced three measures that involved changes in the definition of income and hence went well beyond what was permitted under the new "tax on income" system. The most important of these was a reduction in the inclusion rate for capital gains to 50 per cent. Fortunately, the Federal Government lowered its own capital gains inclusion rate to 50 per cent later in the year, thus avoiding a showdown with Ontario.

By 2001, based on the agreement to allow "tax on income," all provinces had adopted taxable income as their base for taxation. The provinces (except Quebec) are currently in negotiations with the federal government to finalize new TCAs, which will give formal recognition to the move to "tax on income, and confirm the additional policy flexibility granted to the provinces.

In the interim, the provinces and the federal government have agreed to modify the existing TCAs to allow provinces to immediately adopt taxable income as the base for their taxation instead of basic federal tax if they so chose as long as they still use the federal definition of income, and thus maintain a common tax base. This means that provinces/territories are able to

specify: their own tax brackets (including a zero rate on a first income bracket, if desired); their tax rates on these brackets; surtaxes; low-income tax reductions; their own non-refundable tax credits (to be multiplied by the lowest non-zero provincial/territorial tax rate); and their own refundable tax credits.

Concerning the non-refundable tax credits, the provinces/territories may supplement federal credits or add any additional unique provincial/territorial credits. This means that in the future they will not have to follow any federal increases in a credit, but will be able to maintain the value of a gross provincial/territorial credit equal to the minimum of the 1997 value and the current year value of the corresponding federal credit.

For expenditure-based credits such as those for the CPP, EI, tuition fees, medical expenses, charitable donations, the provinces/territories will be able to increase credits beyond the level of the gross federal credit, but will not be able to fall below the level of the federal credit.

Provinces/territories also have the flexibility to maintain a two-tier credit structure for charitable gifts.

For the sake of simplicity and consistency, provincial/territorial credits are required to use the same definitions as federal credits, where federal definitions exist.

The provincial/territorial tax measures must be consistent in the view of the Federal Minister of Finance with the principles set out in the draft guidelines being negotiated to go along with the new TCA. According to these principles, the tax measure should not "materially alter the Common Tax Base" or "impede the free flow of capital, labour, goods and services." Specifically, the tax measure should not:

- "create incentives or disincentives to locate potentially mobile income, capital or labour in a particular jurisdiction;" or
- "provide preferential tax treatment only to income, capital or labour located outside the province's borders with the requirement that these factors relocate to the province offering the measure."

The tax measure may "grant relief by way of a credit in respect of an outlay or an expense," but "should be consistent with Canada's international obligations."

The province/territory will be required to pay the Federal Government an appropriate, relatively modest, administrative fee set out in the TCA.

The shift to "tax on income" from "tax on tax" need not adversely affect the progressivity of provincial personal income taxes. Whether it does or not depends on changes in rates and credits made by provinces and varies from one province to another. Saskatchewan and British Columbia have flattened their tax schedules, reducing progressivity, but Ontario has applied

steep surtax rates, increasing progressivity. And while Alberta has implemented a flat tax, which by itself tends to make the system less progressive, it has also substantially increased tax credits, which has the opposite effect.

Quebec remains the only province that does not participate in a TCA with the federal government for personal income taxes. This is not due to any sophisticated calculation of the financial costs and benefits to Quebec of participation in the TCA. Like any other province Quebec would be better off financially if the Federal Government were to pick up the costs of collecting its income taxes. The primary advantage to Quebec, given the ongoing issue of the future constitutional status of Quebec, is non-financial, namely the control over its own revenue streams for largely political reasons. The existence of a separate provincial income tax regime ensures that, should the constitutional status of Quebec ever be changed in the direction of greater sovereignty, the tax collection infrastructure would already be in place to ensure the continued flow of tax revenues without having to depend on the cooperation of the Federal Government. It is unlikely that Quebec Government of any political stripe will join the TCA given the symbolic nature of its own personal income tax and the high political cost likely to be associated with giving it up.

Overall, the TCAs have worked very well in enabling Canadian governments to achieve their tax policy objectives. As was concluded in a 1991 Department of Finance paper on tax-coordination: "The Tax Collection Agreements serve the national interest. They help to reduce complexity and duplication; promote tax harmony; and thus the free flow of labour and capital across Canada and economic prosperity; help Canadians identify which order of government is responsible for their taxes; and, at the same time, provide provinces with a degree of flexibility over their tax systems." (Department of Finance, 1991, p.i). This view was supported by the OECD in its 1997 Canada Review: "The benefits of decentralized taxing authority can be achieved without sacrificing a harmonized and administratively simple tax system by federal-provincial tax collection agreements. This has been a success story in the case of income taxes in Canada" (OECD, p.96). With the additional flexibility imparted by new TCA with its tax-on-income option, it should work even better and be able to accommodate the legitimate tax policy objectives of provincial governments.

Federal Cost of Administration of the TCA

Under the current Tax Collection Agreement (TCA) the federal government administers Alberta's personal income tax. It absorbs the costs of collection and in return, Alberta is required to follow the federal definition of taxable income. The Federal Government keeps the fines and penalties associated with Alberta taxes. The Federal Government also keeps interest on outstanding Alberta taxes. This compensates Ottawa for remitting the revenue to Alberta prior to actually receiving the tax payments. If Alberta were to administer personal income tax itself it would be able to keep the fines, penalties, and interest on Alberta taxes. However, it would have to bear the full collection costs, including the assumption of any bad debts that prove to be uncollectable.

The Federal Government's cost of collecting provincial personal income tax under the TCA can be broken down into two categories. The first pertains to the tax liabilities that are paid on time and collected by the Federal Government. The cost of collecting these can be estimated by applying to the agency's overall budget the fraction of the overall Canada Revenue Agency's budget that can be reasonably assigned to the collection of provincial personal income tax revenues. The second category is the net cost to the Federal Government associated with the collection of late personal tax accounts. This includes the administrative costs of collecting late accounts, the value of any accounts that cannot be collected or bad debts, and the time value of the money that is not collected on time. These costs are offset by the value of the interest and penalties that the taxpayer must pay to compensate the Federal Government for late payments. Interest and penalties charged by the Federal Government exceed the time value of money because they incorporate a premium interest rate defined as the "prescribed rate" plus 4 per cent (or plus 2 per cent prior to July 1, 1995) as well as a penalty equal to 5 per cent of the balance owing, plus an additional 1 per cent for each full month that the return is late, to a maximum of 12 months. It is worth noting that that the value of interest and penalties are offset completely by the cost of bad debts and late payments making the provinces net financial beneficiaries under this arrangement.

Over the five-year period from 1993-94 to 1997-98, for which data has been provided, the Federal Government spent an estimated $1.3 billion or $260 million per year to collect provincial personal income tax for the provinces participating in the TCA (Table 1). The province of Alberta's share of these costs is estimated to be $144 million over the five-year period or $29 million per year (Table 2).

The net cost of collecting late accounts over the same five-year period is estimated to be $314 million or $63 million per year. The province of Alberta's share of these costs is estimated to be $12 million or $2.4 million (Table 2).

The total costs of collecting personal income taxes for the provinces participating in the TCA is thus estimated at $1.6 billion over the five-year period or $323 million per year, of which Alberta's share was $157 million or $31 million per year (Table 2).

Table 1

The Costs of Federal Administration of Provincial Personal Income Taxes

	Cost of Administer-ing Provincial Tax[1]	**Cost of Collecting Late Accounts ($ millions)**					**Total Costs**
Fiscal Year	($ millions)	Interest and Penalties[1]	Time Value of Money[2]	Adminis-tration Cost[1]	Bad Debts[1]	Net Cost[3]	($ millions)
1993-94	283.3	-206.3	80.8	31.8	123	29.3	312.6
1994-95	252.2	-158.5	77.3	25	130.8	74.6	326.8
1995-96	252.9	-265.9	124.7	19.4	171.7	49.9	302.8
1996-97	246.6	-211.3	71.9	17	245.2	122.8	369.4
1997-98	264.8	-203.5	62	25.9	152.7	37.1	301.9
Five-year Total	1,299.8	-1045.5	416.7	119.1	823.4	313.7	1,613.5

Notes:

1. Source: Revenue Canada and Department of Finance Canada
2. Source: Department of Finance Canada
3. Net Cost = Interest & penalties + Time value of money + Administration cost + Bad debts
4. "-" indicates an inflow of funds.

Table 2
The Alberta Share of the Costs of Federal Administration of Provincial Personal Income Taxes

	Cost of Administer-ing Provincial Tax[1]	**Cost of Collecting Late Accounts ($ millions)**					**Total Costs**
Fiscal Year	($ millions)	Interest and Penalties[1]	Time Value of Money[2]	Adminis-tration Cost[1]	Bad Debts[1]	Net Cost[3]	($ millions)
1993-94	31.5	-24.8	8.8	3.5	12.1	-0.4	31.1
1994-95	28.0	-18.7	8.6	2.8	17.0	9.7	37.7
1995-96	28.1	-27.9	12.8	2.2	19.7	6.8	34.9
1996-97	27.4	-24.7	7.7	1.9	16.0	0.9	28.3
1997-98	29.4	-23.6	6.6	2.9	9.2	-4.9	24.5
Five-year Total	144.4	-119.7	44.5	13.3	74	12.1	156.5

Notes:
1. Source: Revenue Canada
2. Source: Department of Finance Canada
3. Net Cost = Interest & penalties + Time value of money + Administration cost + Bad debts
4. “-“ indicates an inflow of funds.

Fees for Administering Alberta Measures

Under the current "interim TCA," The Federal Government administers some tax credits and rebates for the Government of Alberta. The "Final Determination of Payments under the Tax Collection Agreements for the 2001 Taxation Year" prepared in February 2003 lists five Alberta tax credits and rebates currently being administered for the 2001 and prior taxation year (Table 3). The most expensive of these tax measures is the political contributions tax credit, which is worth $1.5 million. All of the credits and rebates taken together are valued at about $2 million or 67 cents per capita. This makes Alberta the province with by far the lowest value of tax credits and rebates. The next lowest province has ten times the per-capita value of Alberta's tax credits and rebates and the highest province/territory has 430 times the value of Alberta's. According to the formula for administrative fees, which specifies 1 per cent of the value of credits in rebates for amounts of up to $50 per capita (above that the fee declines to 2/3 per cent up to $75 per capita and 1/3 per cent between $75 and $100 per capita), Alberta was only required to pay the minuscule sum of $20, 434 to the Federal Government for administering its tax credits and rebates in the 2001 taxation year. Since there was no additional charge for administering Alberta's single-rate tax, the total cost to the province of having the Federal Government collect personal income tax on its behalf is thus virtually zero.

Table 3

Alberta Tax Credits and Rebates for Individuals and the Administrative Fee charged by the Federal Government
(dollars)

	2000 and Prior	**2001**	**Total**
Royalty Tax Rebate	244,876	236,226	481,103
Royalty Tax Credit	252		252
Renter's Assistance Tax Credit	172	0	172
Political Contributions Tax Credit	26,542	1,531,150	1,557,692
Stock Savings Plan Tax Credit	-738	3,467	2,729
Total	271,104	1,770,843	2,041,947
Administrative Fee			20,434

Source: Department of Finance (2003, Tables 4 and 7).

Provincial Complaints About the TCA

Provincial governments have voiced complaints about the TCA from time to time. The Government of Ontario has perhaps been the most vociferous. A perennial concern has been whether provincial income taxes have been correctly determined and whether they are being

remitted to the province in as timely manner as possible. A related concern is the province's belief that the Federal Government has benefited from its retention of interest and penalties revenue in excess of bad debts written off from Ontario personal income taxpayers. It is not clear that this would be the case if the time value of money were taken into consideration given that the province is paid based on liabilities, behind which the collections by the Federal Government should lag. However, Ontario does not feel that it has been provided adequate information to allay its concerns. Moreover, the Provincial Auditor of Ontario claimed in his 2001 annual report that for the 1998-99 fiscal year, "revenue forecasts and therefore in-year cash flows, were significantly less than the final determination of personal income tax revenues for the last three years." It is estimated that "the cost to the province of the resultant cash flow deficiencies for those years totaled $189 million" (Provincial Auditor of Ontario, 2001, p.300).

The Province of Alberta was not as concerned as Ontario about a perceived gap between the collections of provincial personal income taxes and their subsequent payments to the province. Its main concern was about getting the Federal Government to administer a single-rate tax on income under the TCA, which the Federal Government has already agreed to do in the new TCA.

A recent irritant under the TCA is the $3.4 billion overpayment made to all the provinces, including $2.8 billion to Ontario, which was discovered by the Auditor General and announced by the CCRA on January 29, 2002. Apparently, since 1972 the CCRA had not been properly deducting from personal income tax remitted to the provinces the provincial portion of capital gains refunds paid to mutual fund trusts. The value of this federal error was only calculated for the years 1993 through 1999, even though it goes all the way back to 1972 when capital gains taxation was initiated.

In recognition of the adverse effect that such a recovery would have on provincial government finances, including its indirect effect on equalization-receiving provinces, the Federal Government proposed to reduce the amount of money it will recover from the four provinces affected. No money at all will be recovered from Alberta and British Columbia and the amount to be recovered from Manitoba will be reduced to $91-million from $364-million and from Ontario to $1.3-billion from $2.1-billion. Moreover, the two provinces will be given 10 years — starting in 2004-2005 — to repay the money. And because of a special arrangement under equalization, Manitoba will also receive $140-million in adjustment funds to soften the impact of the repayment. This, of course, has left Ontario bearing the brunt of the error and still feeling understandably dissatisfied with the working of the TCA.

The Ontario Government (2002) has complained that this error in calculating personal income tax provides more evidence "that the federal government's collection of Personal Income Tax is not sufficiently accountable to the provinces." Consequently, unless the election of a Liberal Government last year causes the Ontario Government to change its approach, it is still pushing in the negotiations for the new TCA that "strong and specific accountability provisions be enshrined in any new agreement," including making the CRA "directly accountable to the Ministers of Finance of all provinces for which it collects tax." Greater accountability in administering the TCA is something that would benefit all participating provinces, including Alberta.

The Personal Income Tax in Alberta

Alberta has the simplest personal income tax of all the provinces. Its tax structure is characterized by a single rate and a relatively high, income threshold before tax is paid due to the high basic personal and spousal amounts. The basic personal amount at $13,250 is much higher than the Federal amount of $7,756 and the amount in the other provinces.

The basic tax form in Alberta -- Alberta Tax and Credits (AB428) -- which only need be included with the federal form sent to the CRA, is quite straightforward and is well explained in a five-page book that accompanies it. At the top of the short 1½ page form, taxable income is entered and then multiplied by a flat 10 per cent to get tax on taxable income.

The Alberta non-refundable tax credits are calculated in the next section of the form by adding up a number of amounts and then multiplying the total by 10 per cent. The amounts are: the basic personal amount; the age amount; the spouse or common law partner amounts adjusted for income; the amount for an eligible dependent again adjusted; the amount for infirm dependents 18 or older; Canada Pension Plan Contributions; Employment Insurance premiums; the pension income amount; the caregiver amount; the disability amount (and transferred from dependent); interest paid on a student loan; tuition and education amounts (from Schedule AB(S11)); amounts transferred from spouse or common law partner (from Schedule AB(S2)); and medical expenses.

The form also includes: the dividend tax credit; the overseas employment tax credit; the minimum tax carryover; the additional tax for minimum tax purposes; the provincial foreign tax credit; and the Alberta political contribution tax credit.

The Personal Income Tax in Quebec

The Quebec personal income tax is at the other extreme from Alberta in terms of complexity. Its structure is fairly similar to the federal personal income tax, particularly with respect to the definition of income, with some important exceptions. The tax rates for the 2003 taxation year are 16 per cent on taxable income of $27,095 or less, 20 per cent from $27,095 to $54,195, and 24 per cent over $54,195 (Table 4). Taking into account the 16.5-per-cent reduction for federal tax paid granted by Federal Government on filing the Federal T1 Tax Form, the tax rates are 13.4 per cent on taxable income of $27,095 or less, 16.7 per cent from $27,095 to $54,195, and 20 per cent over $54,195. Tax rates in Quebec are significantly higher than in all the provinces to its west. Its tax rates for the bottom income class are higher than in the Atlantic Provinces and its tax rates for the top income class are higher than in New Brunswick, but similar to those in Nova Scotia, Prince Edward Island and Newfoundland. Non-Refundable tax credits are all calculated at a rate of 20.0 per cent to reflect the higher tax rates in Quebec. The basic personal amount at $6,150 is significantly lower in Quebec than the Federal amount of $7,756 and lower than the amounts in the other provinces.

Other differences with the Federal personal tax system are that child-care expenses are more generous, and automobile expenses are subject to different restrictions. In addition, there is a tax reduction for families, tax credits for individuals living in Northern villages, and tax credits respecting the housing of a parent who lives with the taxpayer. Quebec also offers certain deductions that are not available in the federal personal income tax. One is the deduction for strategic investments, which includes the Quebec Stock Savings Plans (QSSP), R&D venture capital corporations, Quebec Business Investment Companies (QBIC), and Cooperative investment plans (CIP). Deductions for strategic investments are designed to promote economic development in Quebec by favouring investments in local companies. It goes without saying that this is something that can undermine the Canadian economic union if carried too far.

Another distinctive feature of the Quebec tax is the option of filing an income tax return under a simplified system, which is designed to be more advantageous for taxpayers with fewer deductions and credits. Under this system, a flat amount of $2,870 replaces several deductions and credits including the credits for union or professional dues, Employment Insurance, and Quebec Pension Plan contributions. The Quebec Government estimates that 80 per cent of taxpayers will find it advantageous to file a simplified return. The fact that a simplified return had to be introduced tells something important about the perceived complexity of the Quebec personal income tax, and should serve as a caution to other provinces considering following Quebec's example. Judging from the Quebec example, it appears that a separate provincial income tax system once introduced tends to become increasingly complex over time.

The Quebec personal income tax forms, which are as complex as the federal, come complete with a 66-page guide providing necessary information on how to fill out the forms. The form booklet itself is very lengthy containing both the return for the general tax system and for the simplified tax system. It also contains a two-page explanation of the difference and a two-page work chart for the taxpayer to fill out to see which of the two tax systems is most advantageous in his or her particular case. All in all there are 8 pages for the two tax forms and 18 pages for

the 13 schedules, which run from A to M and some of which are on the back of others. And finally there are 4 pages of the work charts at the back of the booklet that contain supplementary calculations that the taxpayer may be required to fill out to provide information needed to complete the tax return or one of the schedules. In total, there are a maximum of 26 pages of forms that the taxpayer could be required to fill out. This contrasts sharply with the 3 or 4 pages of forms that an Alberta taxpayer is usually required to fill out.

The Personal Income Tax in Other Provinces

The other provinces, which participate in the TCA and whose tax forms are also appended to the federal tax return, all have more complicated personal income tax systems than Alberta, albeit falling far short of that in Quebec. All of these provinces have progressive rates and four of them have surtaxes (Table 4), whereas Alberta has a single tax rate. In addition, as noted above, they all have much lower basic personal and spousal amounts and much higher per capita amounts of tax credits and rebates.

Table 4
Personal Income Tax Rates for 2003 by Province

	First Rate (%)	Second Rate (%)	Third Rate (%)	Fourth Rate (%)	Fifth Rate (%)	Basic Personal Amount	Spousal Amount	Surtax (%)	Health Tax
B.C.	6.05	9.15	11.7	13.7	14.7	$8,307	$7,113	n.a.	$54/month
Alberta	10	10	10	10	10	$13,525	$13,525	n.a.	$44/month
Sask	11	13	15	none	none	$8,000	$8,000	n.a.	n.a.
Man	10.9	14	17.4	none	none	$7,634	$6,482	n.a.	n.a.
Ontario	6.05	9.15	11.16	none	none	$7,756	$6,586	20.0/36.0	n.a.
Quebec	16	20	24	none	none	$6,150	$6,150	n.a.	n.a.
N.B.	9.68	14.82	16.52	17.84	none	$7,756	$6,586	n.a.	n.a.
N.S.	9.77	14.85	16.67	none	none	$7,231	$6,140	10	n.a.
P.E.I	9.8	13.8	16.7	none	none	$7,412	$6,298	10	n.a.
Nfld.	10.57	16.16	18.02	none	none	$7,410	$6,055	9	n.a.

Notes: Tax on Income System. Accurate as of December 22, 2003.

British Columbia: Tax Threshold - First $31,653 or less, Second $31,653 to $63,308, Third $63,308 to $72,685, Fourth $72,685 to $88,260 and Fifth $88,260 or higher. Non-refundable tax credits, all calculated at a rate of 6.05%. Indexed for inflation. Health care premiums levied at rate of $52/month per individual.

Alberta: Single Flat Tax. Non-refundable tax credits all calculated at a rate of 10%. Indexed for inflation. Health care premiums levied at $44/month per individual.

Saskatchewan: Tax thresholds - First $35,000 or less, Second $35,000 to $100,000 and Third $100,000 and up. Non-refundable tax credits, all calculated at a rate of 11% - Child $2,000 and Seniors $750.

Manitoba: Tax Thresholds - First $30,544 or less, Second $30,544 to $65,000 and Third $65,000 and up. Non-refundable tax credits all calculated at a rate of 10.9%. Not indexed for inflation.

Ontario: Tax threshold - First $32,121 or less, Second $32,121 to $64,306, Third $64,306 and up. Non-Refundable tax credits, all calculated at 6.05%. Indexed for inflation.

Quebec: Tax thresholds - First $27,095 or less, Second $27,095 to $54,195 and Third $54,195 and up. There is a 16.5% reduction for federal tax paid granted by Federal Government. Non-Refundable tax credits all calculated at a rate of 20.0%. Indexed for inflation.

New Brunswick: Tax thresholds -- First $32,183 or less, Second to $32,183 to $64,368, Third $64,368 up to $104,648 and Fourth $104,648 and up. Non-Refundable tax credits, all calculated at a rate of 9.68%. Individuals with income up to $12,500 will receive a rebate, phased out at 5% of income over $10,000 (no net provincial Income tax). Families with income up to $20,000 will receive a rebate, phased out at 5% of income over $10,000 (no net provincial income tax). Indexed for inflation.

NovaScotia: Tax thresholds - First $29,590 or less, Second $29,590 to $59,180 and Third $59,5180 and up. Non-Refundable tax credits, all calculated at a rate of 9.77%.

Prince Edward Island: Tax thresholds - First $30,754 or less. Second $30,754 to $61,509 and Third $61,509 and up. Non-Refundable tax credits, all calculated at a rate of 9.8%.

Newfoundland: Tax thresholds - First $29,590 or less, Second $29,590 to $59,180 and Third $59,180 and up. Non-Refundable tax credits, all calculated at a rate of 10.57%.

a) The federal personal amount is $8,012 and spousal exemption is $6,784; federal tax rates are 16% on taxable income of $32,183 or less; 22% on taxable income of $32,183 to $64,368 and 26% on taxable income between $64,368 and $104,648; and 29 % on taxable income over $104,648. b) The high income surtax is applied above certain thresholds that vary among provinces. In PEI it is $5,200 of provincial tax payable, and in Nova Scotia it is $10,000 of provincial tax payable. Ontario has two high income surtax rates called the "fair share health levies": 20% on provincial income tax paid above $3,560 and 56% on provincial income tax paid above $4,468. BC has incorporated surtaxes into a fourth and fifth income tax bracket. Newfoundland has a rate of 9% on taxable income over $60,000 (tax payable exceeding $7,032).
Source: Canadian Taxpayers Federation, http://www.taxpayer.com/Facts/TaxRates_By_Province_2003.pdf

Advantages of a Separate Personal Income Tax Collection System

In theory, there are a number of advantages that can be derived from a separate income tax collection system. A separate personal income tax system would give the Alberta Government greater control over the collection of its income taxes by allowing it to assume full responsibility for the collection of its personal income taxes. Once this was done, it would have no one but itself to blame for any administrative or forecasting errors.

Another advantage is that it would make it clearer to the Alberta taxpayer how much tax was going to the Federal Government and how much to the Alberta Government. There is nothing like having to fill out a separate check to focus the taxpayer's mind on where exactly his/her money is going and who is responsible for spending it. Greater transparency in government would be a definite plus. However, it cannot be denied that taxpayers who pay attention to the form they are already filling out really have no excuse for not being aware of the amount of their tax dollars going to the different levels of government.

In addition, a separate personal income tax system would give Alberta greater scope to modify the personal income tax to pursue its economic and social goals. These might include using the Alberta personal income tax much more aggressively to pursue allocative, distributive and stabilization objectives.

But to really benefit from a separate income tax, the Alberta Government would have to be desirous of making major changes in the structure of the personal income tax. To justify pulling out of the TCA, the contemplated changes would have to be more far-reaching than would be allowed under the new TCA, otherwise there would be no additional benefit to Alberta from collecting its own tax, just the additional cost. In addition, the policy changes would have to be of such a nature that they could not be accomplished more cheaply through direct government expenditures rather than tax expenditures.

The ability to levy tax on income under the new TCA already gives the Government of Alberta much more scope to change the distribution of income than it is actually using. Concerning

stabilization, it is important to recognize that the openness of the Alberta economy probably acts as a much greater constraint on the ability of the Alberta Government to stabilize the economy than the TCA. In fact, the Government of Alberta is already free to introduce tax cuts or tax increases that are as large as it considers necessary to stabilize the economy. That it chooses not to do so is an indication that it probably does not really believe that Keynesian tax policies would be very effective in stabilizing the provincial economy.

The tax changes that the Government of Alberta is prohibited from making by the TCA are those that "materially alter the common tax base" or "impede the free flow of capital, labour, goods and services." An example of a major change in tax base that might be considered, but that would be precluded by the TCA, is the adoption of a comprehensive tax base such as was advocated by the Carter Commission on Taxation back in 1966. Such a comprehensive tax base would include all income, even imputed rent on owner occupied housing, and would tax all income such as capital gains at full rates on an accrual basis. Another example of a major tax change that has been discussed by economists in the past and that would be prohibited by the TCA is the elimination of taxes on savings and investment through the replacement of the income tax by a personal expenditure tax. The aim of such a reform would be to encourage savings and investment.

While economists have often discussed wide-ranging proposals such as these to reform the personal income tax in the past, there is no consensus on the exact nature of the reform that should be introduced. There is even less consensus among members of the general public about what changes would be desirable or even acceptable. And, of course, even if there were a consensus on the desired changes, there would be no guarantee that they would be successful in achieving their intended objectives. Furthermore, if a consensus on the benefits of a wide-ranging fundamental reform of the personal income tax were to be reached, it would apply to the overall federal and provincial income tax taken together not just the provincial income tax. The benefits from introducing the reform only at the provincial level would be much reduced by the additional complexity of the resulting tax system. A better approach might be to try to convince the Federal Government to introduce the desired changes so that the benefits of the improved tax structure would apply to the whole income tax system and across the country, and hence be much larger.

It has been argued that one possible advantage of a separate personal income tax for Alberta is that it would give the Alberta Government more leverage over federal tax policy. However, this is a matter of faith. There is no convincing evidence that having a separate personal income tax has given the Quebec Government any greater degree of influence over federal tax policy.

There are also less wide-ranging modifications to the personal income tax structure that would be prohibited by the new TCA that the Alberta Government might wish to consider introducing. However, many of such "tax expenditures" could be introduced as government spending measures if the Government was really convinced of their desirability. Indeed, it is hard to envisage a specific tax measure that could not be alternatively formulated as a spending initiative.

While Alberta would definitely gain policy flexibility by establishing its own personal income tax system, any use of that flexibility would be limited by Alberta's desire to avoid creating a tax jungle and thus balkanizing the Canadian economic union. All provinces gain by agreeing not to poach jobs from one another. It is noteworthy that Alberta has not taken advantage of its flexibility on the corporate side in order to remain largely harmonized with the federal government and the other provinces. There is no reason to expect it not to exercise the same degree of restraint with respect to the personal income tax, particularly given that the potential for incentives to relocate economic activity are much greater under the corporate income tax than under the personal.

The Government of Alberta is much more oriented to the free market and less interventionist than the Government of Quebec, which is the only provincial government with a separate personal income tax system. It is hard to see why the Government of Alberta would want to set up a personal income tax system that would enable it to adopt the more active Quebec approach to economic and social development, particularly since its own approach seems to have been more successful.

The draft TCA has already substantially improved Alberta's flexibility. It allows the province to create any expenditure-based credit it desires without breaching the TCA. These types of credits would include; a mortgage interest credit, a credit for school fees, or a credit for bus passes. However, the draft TCA still requires Alberta to impose the provincial tax on federally defined income. Consequently, it continues to impose restriction on the types of income-related credits Alberta could create. Under the draft TCA, the province could create an income-related credit, but only if the credit impacts less than 0.5 per cent of our tax filers, and impacts less than 0.5 per cent of provincial income tax revenue. This means that Alberta could not unilaterally eliminate the tax on larger income inclusions like capital gains, or interest, but could likely eliminate the tax on smaller income inclusions like fishing income.

An advantage of self-administration in the eyes of some is that it would move some civil service jobs from the Canada Revenue Agency into Alberta. But this ignores the fact that the Alberta Government would have to pay for these jobs and that it could create a similar amount of employment by spending the same amount of money on other government goods and services desired by Albertans. In this case, Albertans would be better off because they would get the desired goods and services as well as the jobs.

Disadvantages of a Separate Personal Income Tax Collection System

There are many obvious disadvantages to a separate personal income tax. From the point of view of the individual taxpayer, the greatest disadvantages would, of course, be the additional unwanted complexity that he or she would face at tax time and the additional Alberta tax form that would have to be filled out. (Rough estimates of these additional compliance costs for Alberta taxpayers are provided below.)

Alberta taxpayers would also have the additional inconvenience of having to send a check to the Alberta Government, which could not be offset against any refund they might have coming from their federal tax, which would put the taxpayer temporarily out-of-pocket. Needless to say, none of this additional paperwork would be welcomed, nor would it endear the Alberta Government to the taxpayer.

In addition, Alberta taxpayers would face increased uncertainty in making economic decisions because they would have to take the impact of two different tax systems into account. This would make their tax planning more difficult than in other provinces participating in the TCA.

From the point of view of Alberta companies, there would also be the additional compliance costs of reporting income to the Alberta Government on behalf of taxpayers and remitting the source deductions. The additional paperwork burden would increase the cost of doing business in Alberta and make Alberta firms less competitive. (Estimates of the compliance costs for Alberta companies are also presented below.)

Alberta taxpayers would also have to pay the additional startup and administrative costs of a separate personal income tax system, which are currently borne by all Canadians. (Estimates of the administrative costs are provided below, one of which is based on the costs of collecting the personal income tax of the Canada Revenue Agency and the other based on the Quebec Ministry of Revenue.) There are also the inevitable difficulties that would be encountered in setting up a new system that would no doubt upset Alberta taxpayers.

In addition to the administrative systems, Alberta would need to implement data tracking and analysis systems to ensure the appropriate information was available to support policy decisions. An underlying concern is that the sharing of tax information with the federal government could be jeopardized. This would have ramifications for the sharing of corporate income tax information, for which the Government of Alberta still depends heavily on the Federal Government in spite of having its own collection system.

The establishment of a separate personal income tax for Alberta would contribute to the fragmentation of the economic union from which all Canadians benefit. The TCA is an important integrating force in Canada. By ensuring a common tax base, it encourages the free movement of capital, labour, goods and services. These movements would be impeded if provinces leave the TCA and exercise their additional policy control to deviate from a common tax base and implement tax provisions favouring investment and economic activity within the

province at the expense of the other provinces. If Alberta were to be the first province to leave the TCA for the personal income tax, the other provinces would perceive it as a balkanizing force. This could very well jeopardize cooperation on other fronts.

If Alberta were to establish its own personal income tax with full flexibility over the tax preferences that could be introduced, it would open itself up to much more intensive lobbying from special interest groups. It would also no longer be able to claim that its hands were tied by the provisions of the TCA, which serves the useful purposes of binding provinces not to pursue tax policies that are not in their mutual interest as participants in the Canadian economic union.

Costs of a Separate Personal Income Tax System

Administrative Costs

It is difficult to estimate precisely the administrative costs likely to be incurred by the Alberta Government if it were to set up its own personal income tax system. The personal income tax is an extremely complex system, involving many aspects. Establishing a new system from scratch would involve many different steps. Some of the steps like drafting income tax legislation and regulations have already being done by the Alberta Government for the purposes of its existing personal income tax, which is administered by the Federal Government. However, a standalone provincial personal income tax system would require additional legislation and regulations covering things such as the definition of income that are now handled by the Federal Government. New forms would have to be developed to incorporate all the necessary information from both the Alberta and Federal tax forms. Educational material would have to be prepared to help taxpayers comply with the new provincial tax. Taxpayer help lines and websites would have to be set up. Perhaps most difficult of all, a new computer system would have to be developed to process the required tax forms. Administrative structures would also have to be set up to oversee the processing of returns, assess them, audit them for compliance, enforce compliance, deal with taxpayers complaints, and hear appeals to assessments.

There are always problems when complex new administrative and computerized systems are established. Computer systems, in particular, often cost much more than anticipated, are not ready on time, and do not perform as expected. This could lead to taxpayer dissatisfaction, which could undermine compliance with a personal income tax system based on self-assessment and even promote the growth of the underground economy. This is no trifling matter as any disruptions in the flow of tax revenues resulting from the establishment of a new personal tax system could impair the delivery of important government services like health and education.

It was estimated by the Alberta Ministry of Finance that a new computer system might cost in the range of $30 to $40 million. In addition, initial capital costs for infrastructure and equipment of uncertain magnitude would be incurred.

Estimates of the operating costs and full time equivalent employment of a separate personal income tax system can be made based on the experience of the Quebec Ministry of Revenue and the Canada Customs and Revenue Agency. While the scale of these two agencies is much larger than an Alberta Agency would be, they basically carry out the same function.

Estimate of Administrative Costs Based on Quebec System

The Quebec Ministry of Revenue spent $573 million on tax administration in 2002-03 (Table 5). It collected $62 billion in taxes, of which about $20 billion cent was personal income tax. If the same 32-per-cent share of tax administration expenses was for personal income taxes as was the share of personal income taxes in total taxes collected, the administrative costs of the personal income tax would be $183 million. Given that there were 5,429,350 returns processed in Quebec, the administrative cost per return would be $33.72 per return. Applying this amount to the 2,117,460 returns filed in Alberta in the same year would yield an estimated administrative cost for a separate Alberta personal income tax system of $71 million. Following a similar approach for Full Time Equivalent person years, it could be estimated that a separate personal income tax system would require 1,051 FTE person years based on the Quebec experience (Table 6).

Estimate of Administrative Costs Based on Federal System

The Canada Customs and Revenue Agency spent $3.16 billion in 2002-03 to collect all taxes except customs duties (Table 7). The total amount of all such taxes collected was $234.8 billion. Of this, the total amount of personal income tax collected in Alberta accounted for $15.8 billion, of which $4.4 billion went to the Alberta Government and $11.4 billion to the Federal Government. Thus 6.738 per cent of total tax revenues collected by CRA came from Alberta. If it were assumed that administrative costs could be prorated based on this same share, which reflects the cost of processing personal income taxpayers from Alberta, the administrative costs to the Federal Government of collecting the personal income tax in Alberta would be $213 million. Since Alberta would not be required to process quite as many forms as are currently being processed from Alberta taxpayers, an estimate of the administrative costs to Alberta of collecting its own personal income tax would be lower. For example, it would be possible to drop the two Alberta tax forms and integrate them in the four Federal tax forms. Consequently, a rough estimate of the administrative costs to Alberta of collecting its own personal income tax would be 75 per cent of the current Federal cost or $160 million. Following a similar approach for Full Time Equivalent person years, it could be estimated that a separate personal income tax system would require some 2,000 FTE person years based on the Federal experience (Table 8).

This is higher than the estimate based on the Quebec experience reflecting in part the higher salary cost at the federal level. [3]

There are some offsets that need to be considered. If Alberta Revenue collected personal income tax, the cost of administering the other taxes that Revenue currently administers may go down due to economies of scale. The cost of collecting health care insurance premiums might also go down if Revenue collected personal income tax. While it is not possible to precisely quantify these offsets, they are unlikely to be large.

On the other hand, it should be noted that these administrative cost estimates could be on the low side if per-taxpayer costs were to turn out to be higher in Alberta than in Quebec or federally because of the lower scale of the processing operations as appears likely.

[3] Total compensation in Federal Public Service is 8 per cent higher than in the Quebec Public S ervice according to Institut de la statistique du Québec (2003,p.3).

Table 5
Estimate of the Cost of a Separate Personal Income Tax for Alberta
Based on Quebec Experience in 2002-03
($ thousands)

Row	Item	Amount	Source
1	Total global expenses of Min. du Rev.	$892,654	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 3.
	Less		
2	Provision for bad debts	$278,100	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 3.
3	Fond des pensions alimentaires	$41,049	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 3.
4	Expenditure on tax administration	$573,505	Estimate: Row 1 minus 2 and 3.
5	Personal income tax receipts	$19,897	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 14.
6	Total global receipts	$62,328	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 14.
7	PIT share	31.9%	Estimate: Row 5 divided by 6.
8	Expenditure on PIT administration	$183,080	Estimate: Row 6 times 7.
9	Number of returns - all returns	5,429,350	CCRA, *Income Tax Statistics 2003 - 2001 Tax Year*
10	Cost per return	$33.72	Estimate: Row 8 divided by 9.
11	Number of returns – Alberta	2,117,460	CCRA, *Income Tax Statistics 2003 - 2001 Tax Year*
12	Administration Cost of Separate PIT for Alberta	$71,402	Estimate: Row 11 times 10.

Table 6

Estimate of the Full Time Equivalent Person Years of a Separate Personal Income Tax for Alberta Based on Quebec Experience in 2002-03

(number of FTEs)

Row	Item	FTEs	Source
1	Total global FTEs of Min. du Rev.	8,970	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 12.
	less		
2	Fond des pensions alimentaires	527	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 12.
3	FTEs on tax administration	8,443	Estimate: Row 1 minus 2.
5	Personal income tax receipts	$19,897	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 14.
6	Total global receipts	$62,328	Min. du Rev., *Report annuel de gestion 2002-03,* Tableau 14.
7	PIT share	31.9%	Estimate: Row 5 divided by 6.
8	FTEs on PIT administration	2,695	Estimate: Row 6 times 7.
9	Number of returns - all returns	5,429,350	CCRA, *Income Tax Statistics 2003 -2001 Tax Year*
10	FTE per 1,000 returns	0.4964	Estimate: Row 8 divided by 9.
11	Number of returns - Alberta	2,117,460	CCRA, *Income Tax Statistics 2003 -2001 Tax Year*
12	FTEs for Separate PIT for Alberta	1,051	Estimate: Row 11 times 10.

Table 7
Estimate of the Cost of a Separate Personal Income Tax for Alberta
Based on Experience of CRA in 2002-03
($ thousands)

Row	Item	Amount	Source
1	Actual spending of CRA	$3,824,924	CRA, *Annual Report to Parliament 2002-03*, Table 2.
	Less		
2	Customs services	$660,680	CRA, *Annual Report to Parliament 2002-03*, Table 2.
3	Spending excluding customs	$3,164,244	Estimate: line 1 minus line 2.
4	Total net tax receipts	$238,005,647	CRA, *Annual Report to Parliament 2002-03.*
5	Customs duties	$3,221,000	Finance Canada, *Economic and Fiscal Update 2003*, p.98.
6	Total net tax receipts ex. customs	$234,784,647	Estimate: line 4 minus line 5.
7	Provincial PIT Collected in Alberta	$4,444,019	2002 Tax Sharing Statements
8	BFT Collected in Alberta	$11,375,008	2002 Tax Sharing Statements
9	PIT collected in Alberta	$15,819,027	Estimate: line 7 plus line 8.
8	Alberta PIT as share of tax collected	6.738%	Estimate: line 9 divided by line 6.
9	Alberta share of CRA Spending	$213,196	Estimate: line 8 times line 3.
10	Adjustment to one tax form	75.000%	Assume 2 current Alberta forms and 4 federal forms to be assessed, but Alberta forms simpler.
11	Adjusted Alberta PIT as share of tax collected	5.053%	Estimate: line 8 times line 10.
12	Alberta share of CRA Spending	$159,897	Estimate: line 11 times line 3.

Table 8

Estimate of the Full Time Equivalent Person Years of a Separate Personal Income Tax for Alberta Based on Experience of CRA in 2002-03

($ thousands)

Row	Item	Amount	Source
1	FTEs of CRA	47,479	CRA, *Annual Report to Parliament 2002-03*, Table 2.
	Less		
2	FTEs Customs services	7,855	CRA, *Annual Report to Parliament 2002-03*, Table 2.
3	FTEs excluding customs	39,624	Estimate: line 1 minus line 2.
4	Total net tax receipts	$238,005,647	CRA, *Annual Report to Parliament 2002-03.*
5	Customs duties	$3,221,000	Finance Canada, *Economic and Fiscal Update 2003*, p.98.
6	Total net tax receipts ex. customs	$234,784,647	Estimate: line 4 minus line 5.
7	Provincial PIT Collected in Alberta	$4,444,019	2002 Tax Sharing Statements
8	BFT Collected in Alberta	$11,375,008	2002 Tax Sharing Statements
9	PIT collected in Alberta	$15,819,027	Estimate: line 7 plus line 8.
8	Alberta PIT as share of tax collected	6.738%	Estimate: line 9 divided by line 6.
9	Adjustment to one tax form	75.000%	Assume 2 current Alberta forms and 4 federal forms to be assessed, but Alberta forms simpler.
10	Adjusted Alberta PIT as share of tax collected	5.053%	Estimate: line 8 times line 9.
11	Alberta share of CRA FTEs	2,002	Estimate: line 10 times line 3.

Compliance Costs

A separate personal income tax system would involve substantial compliance costs for Albertans. Some of these costs would be out-of-pocket for taxpayers and employers who would engage professionals to complete their returns or to provide them with tax planning advise. Other costs would take the form of the opportunity costs of filling out additional provincial forms or doing their own tax planning.

The costs would stem from the fact that taxpayers in Alberta would be required to file two separate personal income tax returns and deal with two tax collection agencies. In addition, companies in Alberta would incur additional costs. For instance, firms with employees would have to file T4-like reports on the wages and salaries of their employees and financial institutions would have to file T5 and T600-like slips reporting on interest and dividends paid to Alberta investors to Alberta Revenue. There are various ways of estimating these two types of compliance costs to individual taxpayers and to companies.[4]

One rough way of estimating the cost of compliance for individual taxpayers is to see how much extra tax-preparers charge in Quebec for a provincial and federal form compared to what they charge in Ontario for a single return. A quick canvassing of some H&R Block offices in the Ottawa-Hull area suggests that the extra cost is of the order of $20 to $30 depending on the number of provincial forms required. If a cost of $25 was assumed to apply to the 2.1 million Alberta taxpayers, an estimate of the additional compliance cost of a system like Quebec's for Alberta would be over $50 million per year.

An estimate of the compliance cost of the Quebec personal income tax to employers in Quebec, who are currently the only employers in the country that must maintain two separate accounts for source deductions and remittances, was made recently by Robert E. Plamondon and David Zussman (1998, pp.767-768). Based on a survey of previous estimates of compliance costs for payroll taxes, they concluded that the compliance cost at the federal level for the personal income tax, Employment Insurance, and Canada Pension Plan was between 0.75 per cent and 1.5 per cent of the taxes collected. Since there are few differences between the Quebec and federal systems, they judge that "the incremental cost for Quebec employers may be calculated as a fraction of the cost for federal withholdings." They estimate that the fraction should be half so the compliance cost for the Quebec personal income tax would be between 0.375 per cent and 0.75 per cent of the revenue collected or between $58 and $115 million. Given that the number of taxpayers in Alberta is 39 per cent of those in Quebec, an equivalent estimate of the compliance cost of employers in Alberta would be between $22 and $45 million.

Another more sophisticated estimate of compliance costs was prepared by Eard and Vaillancourt (1993) for the Fair Tax Commission in Ontario in 1992. It was based on an innovative methodology earlier developed by Vaillancourt (1989) that calculated the compliance burden for

[4] John Thompson (1984, p.215) provides an estimate for these costs in Ontario as they would have been in 1982. For individual taxpayers, compliance costs are estimated to be $75 to $225 million; and for employers, $30 to $60 million.

taxpayers by counting the lines on the tax forms, estimating the time spent per line by the taxpayer, and imputing a cost based on the average value of time for taxpayers assumed to be the average hourly wage. It also used estimates of the compliance costs of employers and financial institutions provided in the same study. Eard and Vaillancourt estimated the steady state compliance cost based on three different scenarios using 1991 tax forms and values. These three scenarios are: 1) Ontario adopts a personal income tax similar in structure and complexity to Quebec's; 2) Ontario administers its own tax with the Federal taxable income base; and 3) the Federal Government administers the Ontario tax system with the Federal taxable income base as it in fact did.

Estimates for Alberta were calculated using these same three scenarios and Eard and Vaillancourt's compliance cost per taxpayer estimates, updated for price changes between 1991 and 2003 using the consumer price index. The calculation was straightforward involving multiplying the number of Alberta taxpayers by the compliance cost per taxpayer (Table 9). It is worth noting that it is only meaningful to the extent that the Ontario and Alberta personal income tax forms are comparable and that there has no been significant change in the relative complexity of the Quebec, Ontario, and Alberta tax systems since 1991 the year analyzed by Eard and Vaillancourt. At best it provides a ballpark estimate.

The total additional compliance cost in Alberta resulting from going from a personal income tax system administered by the Federal Government to one administered by the provincial government depends on the complexity of the provincial personal income tax system adopted. If it were to be as complicated as Quebec's, the additional compliance cost would be $120.9 million ($134.5 million minus $13.6 million). But if Alberta were only to administer the existing system based on Federal definitions of income, the additional compliance cost would only be $74.7 million ($88.3 million minus $13.6 million). In this scenario, most of the additional cost would be made up of the compliance costs of employers ($72.5 million), which is not affected by the complexity of the tax system, but merely by the fact that they have to handle two separate source deductions. This is an important point for Alberta to consider as it underlines the additional overhead compliance costs of setting up a separate system even if it is not any more complex than the existing system. It is worth noting that the compliance cost to individual taxpayers under this scenario at $0.8 million or 34 cents per tax filer estimated in this way is rock bottom and would not even cover the cost of the envelope and stamp required to mail in the additional Alberta tax form.

Table 9

Estimated Changes in Compliance Costs for Alberta Based on Eard and Vaillancourt's Estimates for Ontario

	Scenario 1: PIT Similar in Structure and Complexity to Quebec PIT System	**Scenario 2: PIT System with Federal Taxable Income Base and Provincial Administration**	**Scenario 3: PIT System with Federal Taxable Income Base and Federal Administration**
Number of Alberta Taxpayers	2,117,460	2,117,460	2,117,460
Taxpayers			
Average change per taxpayer (1991 $)	$23.04	$5.46	$5.19
Average change per taxpayer (2003 $)	$28.61	$6.78	$6.44
Total Change ($ millions)	$60.6	$14.4	$13.6
Employers			
Average change per taxpayer (1991 $)	$27.59	$27.59	$0.00
Average change per taxpayer (2003 $)	$34.26	$34.26	$0.00
Total Change ($ millions)	$72.5	$72.5	$0.0
Financial Institutions			
Average change per taxpayer (1991 $)	$0.53	$0.53	$0.00
Average change per taxpayer (2003 $)	$0.66	$0.66	$0.00
Total Change ($ millions)	$1.4	$1.4	$0.0
All Groups			
Average change per taxpayer (1991 $)	$51.16	$33.58	$5.19
Average change per taxpayer (2003 $)	$63.53	$41.70	$6.44
Total Change ($ millions)	$134.5	$88.3	$13.6

Note: Uses average change per taxpayer estimated in Eard and Vaillancourt (1993), p.161.

Opportunities and Challenges of the New TCA

Alberta has not taken full advantage of the additional flexibility allowed under the new "tax on income" system. This is not necessarily a bad thing. The single-rate tax system pioneered by Alberta is very appealing in its simplicity. In general, a single-rate tax has the advantage of reducing the distortions inherent in a progressive rate structure (but only, of course, for the provincial component of personal income tax). Since everyone in a tax-filing family unit faces the same provincial marginal tax rate, it reduces work disincentives for dependent spouses and children. A single-rate tax also reduces the need for income splitting and income averaging.

The specific single-rate tax system in Alberta also has additional advantages of promoting equity and competitiveness. The personal and spousal amounts are the most generous in the country, which means that Albertans can earn the greatest amount of income free of provincial tax. This benefits individuals all the way up the income scale, but particularly lower income earners. In addition, the single rate has been set at 10 per cent, which makes it the lowest top marginal tax rate in Canada. This promotes competitiveness, and encourages people to work, save and invest in Alberta.

As long as Alberta continues to follow its current strategy of having a simple, low-rate personal income tax system that imposes a minimum compliance burden on taxpayers, there is really no compelling need to establish a separate personal income tax. Indeed, even if Alberta were to decide that it wishes to pursue a more activist tax policy such as that being pursued by Quebec, it could go a long way down that road before it would come up against the constraints of the new draft TCA. In these circumstances, a reasonable strategy for Alberta would be to continue to make the tax policy that it thinks is most appropriate and only to worry about constraints imposed by the TCA when it actually starts to run into them, which given the tax policy preferences of Albertans may very well be never.

And if Alberta does ever start to run into constraints, it needs to ask the fundamental question of whether they make sense. If, for instance, the constraints are designed to prevent provinces from pursuing tax policies that undermine the economic union, Alberta will need to seriously consider whether the introduction of such policies would really be in its long-term interests. On the other hand, if the constraints do not make sense because they impede the province from introducing desirable personal income tax reforms, perhaps it may be better to try to work within the TCA system and get the constraints relaxed or even to get the reforms introduced by the Federal Government for the Federal personal income tax. Only in the extreme case, which is difficult to envisage in practise, where the reform is so important to the province that it is worth bearing the substantial additional costs of setting up and administering a separate personal income tax system and running the risks of balkanizing the economic union should the province seriously contemplate pulling out of the TCA.

References

Conklin, David W. (ed.) (1984) *A Separate Personal Income Tax for Ontario: Background Stuedies*, Ontario Economic Council, Special Research Report.

Department of Finance (1991) *Personal Income Tax Coordination: The Federal-Provincial Income Tax Collection Agreements*, June.

Department of Finance (2003) *Federal Administration of Provincial Taxes*, January.

Department of Finance (2003) *Final Determination of Payments under the Tax Collection Agreements for the 2001 Taxation Year, February 2003*.

Eard, Brian and Francois Vaillancourt (1993) "The Compliance Costs of a Separate Personal Income Tax System for Ontario: Simulations for 1991," in Allan M. Maslove (ed.), Taxation in a Sub-National Jurisdiction (Toronto: University of Toronto Press).

Federal-Provincial Committee on Taxation (1998) *Tax on Income*, October.

Hartle, Douglas et al. (1983) *A Separate Personal Income Tax for Ontario: An Economic Analysis*, Ontario Economic Council, Special Research Report.

Institut de la statistique du Québec (2003) Rémunération des salariés État et évolution comparés, novembre 2003 Faits saillants.

Ministère du Revenu du Québec (2003) *Forms: Income Tax Return 2003*.

Ministère du Revenu du Québec (2003) *Guide: Income Tax Return 2003*.

Olmstead, R.A. (1954) *Decisions Relating to the BNA Act, 1867 and the Canadian Constitution 1867-1954* (Ottawa: Queen's Printer), 3 Vols.

Ontario Economic Council (1983) *A Separate Personal Income Tax for Ontario: An Ontario Economic Council Position Paper*, March 7.

Organization for Economic Co-operation and Development (1997) *Canada Review* (Paris).

Ontario Ministry of Finance (2002) *Budget 2002, Budget Paper B, Ontario's Fiscal Plan*.

Plamondon, Robert E. and David Zussman (1998) "The Compliance Costs of Canada's Major Tax Systems and the Impact of a Single Administration," Canadian Tax Journal, Vol.46, No. 4.

Thompson, A.E. John (1984) in David W. Conklin. (ed.) (1984) *A Separate Personal Income Tax for Ontario: Background Studies*, Ontario Economic Council, Special Research Report.

Vaillancourt, Francois (1989) *The Administrative and Compliance Costs of the Personal Income and Payroll Tax System in Canada, 1986* (Toronto: Canadian Tax Foundation).