The Public Purse and the Public Good

A framework for reviewing federal tax expenditures

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FEBRUARY 2017

True North in
Canadian public policy

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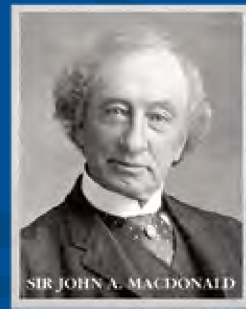

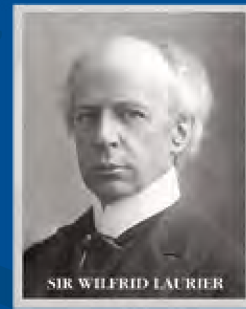

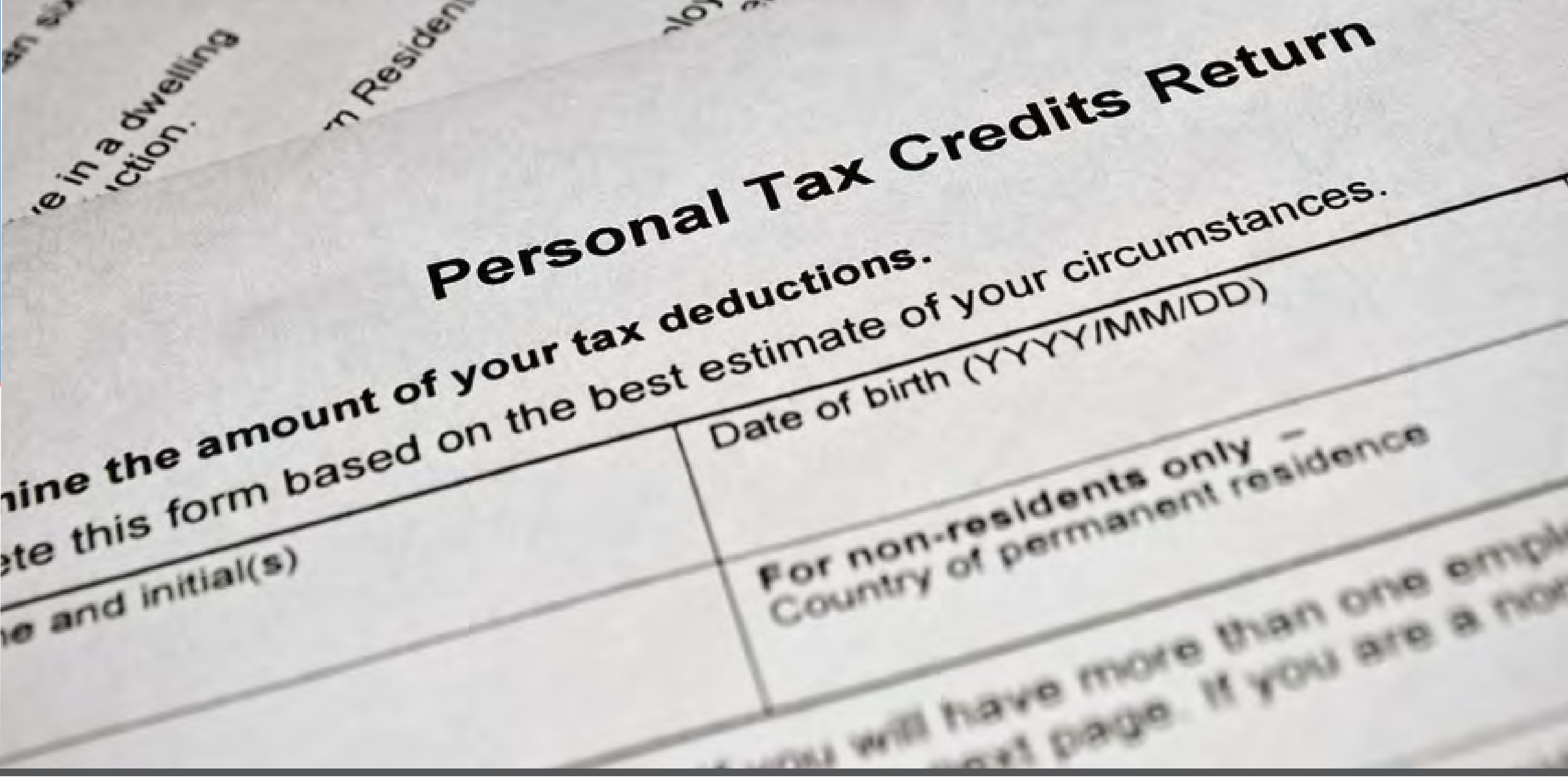

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Executive Summary

The Trudeau government is conducting a comprehensive review of the federal tax system "to ensure that federal tax expenditures are fair for Canadians, efficient and fiscally responsible." A high-profile group of tax experts has been assembled to advise the Department of Finance in carrying out the review. Expectations are that its results will be reflected in the upcoming federal budget.

Such a review is certainly warranted. It has been nearly 30 years since the federal government undertook a serious reform of the credits, deductions, and other special provisions (known as tax expenditures) that litter the tax code. A lot of time has passed and it is starting to show.

Tax expenditures range from tax credits for using public transit to donating to political parties and seemingly everything in between. Some support or promote individual activities and behaviours that provide significant benefits to society as a whole. Others complicate the tax code, drive up tax rates for everyone, and contribute little to overall society.

The cost to government is significant. Tax expenditures in the personal income tax system alone now represent as much as $130 billion in forgone revenue for the federal treasury and roughly $5,900 per tax filer. There is a good case therefore for a review that ultimately leads to a better, fairer, and simpler federal tax system.

> *"There is a good case for a review that ultimately leads to a better, fairer, and simpler federal tax system."*

Yet the government's review is not without challenges. It is already generating considerable media and political attention. Speculation is rampant about which tax expenditures may be eliminated and what the government will do with any resulting revenue. It is set to be among the major story lines of the 2017 Budget.

How will the government and its expert panel evaluate which tax expenditures ought to remain and which ones should be eliminated? What constitutes a "good" tax expenditure and what is a "bad" one? What principles will guide these judgements? These questions must be properly answered if the process is to be evidence-based and substantive, and ultimately produce a more efficient, fairer, and simpler federal tax system.

The purpose of this study is to establish a framework for such a review that is rooted in basic principles and less susceptible to political whims, special-interest calculations, or simply about paying for new spending or balancing the budget.

Our analysis is neither pro-tax expenditure nor anti-tax expenditure *per se*. It seeks a middle ground between those voices who argue that all state intervention should come in the form of direct government spending and others that contend the government should not support or promote any activities and behaviours including through the tax system.

Instead we set out a clear and transparent checklist of questions and tests – including for instance "what is the tax expenditure's purpose and is it being achieved" – that the government can regularly apply to current tax expenditures to determine whether they should be sustained, reformed, or eliminated.

The study then uses the checklist in six case studies to illustrate its application and utility. We conclude that the (1) Charitable Donation Tax Credit and (2) exemption from capital gains taxation on one's primary residence should be sustained; the (3) Disability Tax Credit and (4) non-taxation of employer-provided health and dental benefits should be reformed to enhance their equity and fairness; and the (5) Age Credit and (6) Public Transit Tax Credit should be eliminated.

The long-term goal should be to publish ongoing, regular reviews of tax expenditures using such a checklist. A reasonable goal could be to apply it to one quarter of federal tax expenditures per year, which would allow a full review every four years.

As for the upcoming budget, the government should at least aim to consider some of the basic considerations set out in principle-based checklist and to publicly release its analysis. This would help to ensure that the review process is clear, transparent, and can ultimately withstand policy and political scrutiny.

The ultimate goal of this study is to inform a dispassionate and evidence-based review of federal tax expenditures that follows such a checklist of basic questions about the role of the government, the spillover effects of certain actions or behaviours, and use of tax expenditures versus other policy instruments to support them. It would be a major step in the direction of evidence-based policy and a better, fairer, and simpler tax system.

Sommaire

Le gouvernement Trudeau entreprend une revue complète du régime fiscal fédéral « en vue de veiller à ce que les dépenses fiscales fédérales soient équitables pour les Canadiens, efficaces et responsables sur le plan budgétaire ». Un groupe d'experts a été mis sur pied pour conseiller le ministère des Finances en la matière. On s'attend à ce que les résultats de ce processus soient pris en compte dans le prochain budget fédéral.

Une telle revue est tout à fait justifiée. La dernière réforme sérieuse du gouvernement fédéral visant à revoir la panoplie de crédits d'impôt, de déductions et d'autres dispositions spéciales contenues dans le code fiscal (ce qu'on appelle les dépenses fiscales) remonte à près de 30 ans. Le poids des années commence à se faire sentir.

Les dépenses fiscales comprennent des mesures de toutes sortes qui vont des crédits d'impôt pour utilisation du transport en commun jusqu'aux incitatifs fiscaux pour dons aux partis politiques. Certaines d'entre elles appuient ou favorisent les activités et les comportements d'une grande valeur pour la société dans son ensemble. D'autres compliquent le code fiscal, exercent une pression à la hausse sur les taux d'imposition en général et contribuent peu au bien-être général.

Les dépenses fiscales coûtent très cher à l'État. Celles du régime d'impôt sur le revenu des particuliers font perdre à elles seules jusqu'à 130 milliards de dollars de recettes au trésor fédéral, soit environ 5 900 $ par contribuable. Il est donc tout à fait légitime de mener un examen qui pourrait ultimement améliorer le régime fiscal fédéral et le rendre plus équitable et plus simple.

Néanmoins, l'examen du gouvernement pose des défis. Il fait déjà l'objet d'une attention politique et médiatique considérable. Les spéculations vont bon train quant à l'avenir des crédits d'impôt, déductions et autres dispositions spéciales (les dépenses fiscales) à brève échéance et à l'utilisation des recettes qui pourront être dégagées. Toutes ces considérations devraient trouver une conclusion dans les grandes lignes du budget de 2017.

Comment le gouvernement et son groupe d'experts détermineront-ils si une dépense fiscale doit être maintenue ou éliminée? Qu'est-ce qui différencie une « bonne » d'une « mauvaise » dépense fiscale? Sur quels principes ces décisions seront-elles fondées? Il faudra répondre correctement à ces questions si l'on cherche à suivre un processus rigoureux fondé sur des éléments probants et proposer ultimement un régime fiscal fédéral plus efficace, plus juste et plus simple.

> “ *Qu'est-ce qui différencie une « bonne » d'une « mauvaise » dépense fiscale? Sur quels principes ces décisions seront-elles fondées?”*

Le but de cette étude est de définir un cadre d'évaluation qui repose sur des principes fondamentaux et indépendants des humeurs politiques, des intérêts spéciaux, ou tout simplement des nouveaux programmes de dépenses ou des impératifs budgétaires.

Notre analyse n'est en soi ni favorable ni défavorable aux dépenses fiscales. Elle cherche un juste milieu entre ces voix qui affirment que toute intervention étatique doit prendre la forme de dépenses directes et les autres qui soutiennent au contraire que l'État ne doit ni appuyer ni favoriser quelque activité que ce soit, y compris par le biais du régime fiscal.

Par conséquent, nous avons dressé dans cette étude une liste claire et transparente de questions et de contrôles – comprenant notamment « l'objectif fixé par la dépense fiscale et sa capacité à le réaliser » – qui peut servir au gouvernement pour déterminer périodiquement si les dépenses fiscales courantes doivent être maintenues, faire l'objet d'une réforme ou être éliminées.

Pour illustrer l'application et l'utilité de cette liste de contrôle, nous présentons dans cette étude six analyses de cas. Nous avons conclu que : (1) le crédit d'impôt pour don de bienfaisance et (2) l'exemption des gains en capital réalisés sur la résidence principale doivent être maintenus; (3) le crédit d'impôt pour personnes handicapées et (4) la non-imposition des services d'assurance-maladie et de soins dentaires payés par l'employeur doivent faire l'objet d'une réforme afin de les rendre plus justes et équitables; (5) le crédit en raison de l'âge et (6) le crédit d'impôt pour le transport en commun doivent être éliminés.

L'objectif à long terme est de faire en sorte qu'une telle liste de contrôle soit utilisée pour réaliser une analyse périodique des dépenses fiscales et publier les résultats obtenus. On pourrait raisonnablement attendre du gouvernement qu'il revoie le quart des dépenses fiscales fédérales chaque année, ce qui permettrait un examen complet tous les quatre ans.

En ce qui concerne le prochain budget, le gouvernement devrait au moins envisager certaines des questions essentielles énoncées dans la liste de contrôle à base de principes et publier les résultats de son examen. Cela aiderait à assurer la clarté et la transparence de son processus de revue et en dernière analyse, à le mettre à l'abri de la politique ou du contrôle politique.

L'objectif ultime de cette étude est d'appuyer la tenue d'une revue des dépenses fiscales fédérales qui soit objective et fondée sur des données factuelles au moyen d'une liste de questions de base sur le rôle du gouvernement, les effets d'entraînement de certains comportements ou actions et le recours aux dépenses fiscales et à d'autres instruments de politique pour les appuyer. Procéder de cette manière serait une étape importante dans la préparation de politiques fondées sur des données factuelles et d'un régime fiscal amélioré, plus équitable et simplifié.

Introduction

The Trudeau government is conducting a comprehensive review of the federal tax system "to ensure that federal tax expenditures are fair for Canadians, efficient and fiscally responsible" (Department of Finance 2016b). A high-profile group of tax experts was assembled to advise the Department of Finance in carrying out the review. Expectations are that its results will be reflected in the upcoming federal budget.

Such a review is certainly warranted. It has been nearly 30 years since the federal government undertook a serious reform of the credits, deductions, and other special provisions (known as tax expenditures) that litter the tax code. A lot of time has passed and it is starting to show. The federal tax system is now replete with dozens of tax expenditures that cost billions of dollars each year in foregone revenue. These policies range from tax credits for using public transit to donating to political parties and seemingly everything in between. There is a good case therefore for a review that ultimately leads to a better, fairer, and simpler federal tax system.

How will the government and its expert panel evaluate which tax expenditures ought to remain and which ones should be eliminated? What constitutes a "good" tax expenditure and what is a "bad" one? What principles will guide these judgements? These questions must be properly answered if the process is to be evidence-based and substantive, and ultimately withstand policy and political scrutiny.

The purpose of this study is to help inform this debate, and provide recommendations for the government as it seeks to preserve, reform, or eliminate tax expenditures in the 2017 budget and over the course of its mandate. We aim to establish a framework for evaluating tax expenditures that is rooted in basic principles and less susceptible to political whims, special-interest calculations, or being simply about balancing the budget.

Our analysis is neither pro-tax expenditure nor anti-tax expenditure *per se*. It seeks a middle ground between those voices who argue that all state intervention should come in the form of direct government spending and others who contend the government should not support or promote any activities or behaviours including through the tax system.

The key problem with many tax expenditures is not the general strengths or weaknesses of tax expenditures but rather that the underlying activities or behaviours do not justify public subsidies, especially after accounting for the cost of government intervention. Any judgements about establishing a new tax expenditure or eliminating an existing one should therefore follow a clear and transparent policy checklist: basic questions about the role of the government, the spillover effects of certain actions and behaviours, and use of tax expenditures versus other policy instruments to support them.

The first section provides a basic primer on tax expenditures including their purpose, scope, and design. The second shows how tax expenditures proliferated since the last major federal review and demonstrates the need for a new one. The third elucidates the concept of "externalities" and the role for tax expenditures to support activities and behaviours that produce positive spillover effects. The fourth considers the limits of measuring and accounting for such social benefits in policy development. The fifth sets out the case for an evidence-based review of federal tax expenditures. The sixth sets out a clear and transparent framework to use for the purposes of conducting such a review. The final examines six case studies to show how this policy checklist can be used to inform the government's own review of the federal tax system.

A Basic Primer on Tax Expenditures

What are tax expenditures? What are their purpose? These questions are the focus of this first section of the paper.

Tax expenditures are special provisions of the tax code such as exemptions, deferrals, deductions, and credits that benefit specific activities, types of income, or groups of taxpayers (see table 1). The concept was introduced in 1967 by Stanley Surrey, the assistant secretary of the US Treasury Department for tax policy, to describe tax provisions that function similar to direct government spending (McBride 2013). Surrey's point was that these special provisions were result of discretionary policy choices by government that often act as an alternative to direct spending or regulations.

Table 1: Forms of Tax Expenditures

Type of Tax Expenditures	Purpose
Tax Exemption	Removes an obligation to pay tax
Deferrals	Delays a payment of tax
Deductions	Reduce total taxable income
Credits	Reduce the amount of tax payable

Tax expenditures serve several different policy purposes. Their policy goals can cover a wide range of objectives, including:

- Correcting for externalities – that is, supporting or promoting activities and behaviours such as raising children that produce positive spillover effects;
- General redistribution – such as the basic personal amount;
- Adjusting for the cost of earning income – such as interest expense deduction or the child-care deduction;
- Adjusting for involuntary expenses that do not contribute to well-being – such as the Medical Expense Tax Credit; and
- Relieving taxation on savings and investment – such as Registered Retirement Savings Plans or Registered Education Savings Plans.

Tax expenditures advance these goals typically by reducing one's taxable income or tax liability in order to achieve equitable tax treatment or to support or promote activities and behaviours with positive spillover effects for society.

Think of an example like the Charitable Donation Tax Credit that is claimed by nearly six million Canadians each year (Department of Finance 2016a). The tax credit enables individuals to reduce their tax bill in exchange for contributing to a charity that carries out activities that benefit broader society. The government has determined that charitable giving produces considerable social benefit and thus ought to be subsidized in the form of a tax credit. Economists would say the purpose of the Charitable Donation Tax Credit is to balance the private costs of charitable giving with the social returns from charitable activities.

Defining or evaluating tax expenditures seems straightforward. The Organisation for Economic Co-operation and Development (OECD) defines them as steps "to reduce or postpone revenue for a comparatively narrow population of taxpayers relative to a benchmark tax" (OECD 2010). But applying this definition can be challenging and the subject of some debate and controversy.

The benchmark typically includes tax rates, accounting conventions, deductibility of compulsory payments, provisions to facilitate tax administration, and international tax obligations. It establishes, in effect, the basic parameters of a straightforward tax system prior to the inclusion of any credits, deductions, or other special provisions. Any deviations from this basic structure – particularly ones that are not broad-based – tend to be characterized as tax expenditures.

The federal Department of Finance "takes a broad approach" in assessing what constitute Canada's benchmark tax system (Department of Finance 2012). According to one of its annual *Tax Expenditures and Evaluation* reports:

> The benchmark for the personal and corporate income tax systems is defined by considering the tax base, existing tax rates and brackets, the unit of taxation, the time frame for taxation, and the treatment of inflation for calculating income. In addition, the benchmark includes measures that reduce or eliminate double taxation, recognize expenses incurred to earn business income, and allow business losses to be claimed over a number of years. Finally, the constitutional immunity for Canada and the provinces from taxation is recognized as part of the benchmark system for income taxation. (Department of Finance 2010)

The result is that any tax measures apart from these ones are considered tax expenditures for the purposes of public reporting, including costing individual items in the form of foregone revenue. The department's *Tax Expenditures and Evaluations* report provides costs estimate and additional information about purpose and take-up.

Economists and policy analysts can often hold opposing views on what is in the benchmark. This drives many of the differences in defining and evaluating tax expenditures. It can be the subject of considerable confusion and debate. As a 2000 study published by the Department of Finance explains:

> This lack of consensus has been attributed to the fact that "in a many-consumer economy, there is an indefinitely large number of efficient tax structures, no one of which has prior claim to being the best." As a result, a variety of possible benchmarks have been developed. These benchmarks vary in their treatment of certain fundamental components such as the tax unit, tax base and tax period. Each benchmark is unlike the others in how it defines one or more of these components and, therefore, each benchmark produces a different set of tax concessions. (Department of Finance 2000)

"*Tax expenditures can sometimes be in the eye of the beholder, claimant, or economist.*"

The Foreign Tax Credit is a prime example. Its purpose is to minimize double taxation for those Canadians who earn income and pay taxes abroad by enabling a Canadian tax filer to claim the foreign taxes he or she paid. Preventing double taxation is basic tax policy principle and many would therefore see the tax credit as part of the benchmark system. Yet the Department of Finance characterizes it as an expenditure and some scholars have called for its elimination (Macdonald 2016). Tax expenditures can sometimes be in the eye of the beholder, claimant, or economist.

The idea that the tax system is rife with a laundry list of superfluous and costly "boutique tax credits" is a bit overstated. Many of the existing tax expenditures have defensible justifications. But that does not mean a review is unwarranted or the tax system is optimal. Far from it. The next section documents the extent to which we have witnessed a proliferation of tax expenditures in the past 30 years. It is just that both the Left and Right tend to exaggerate the distributional and fiscal upside of ridding the system of poorly-conceived and indefensible tax expenditures and part of the problem is ultimately definitional.

A Proliferation of Tax Expenditures

The evidence shows a proliferation of tax expenditures at the federal level in the three decades since the last major tax reform exercise. Successive governments have enacted a number of credits, deductions, and other special provisions with the stated goal of supporting or promoting certain activities and behaviours, though sometimes it can seem more about currying favour with a particular constituency or voter group.

The past decade in particular has witnessed tax expenditures become a commonly-used policy tool. Virtually every budget since 2006 has included new or expanded tax credits related to a specific activity or group of individuals. There are, for example, credits for using public transit, volunteering as a firefighter, or earning pension income.

"Virtually every budget since 2006 has included new or expanded tax credits related to a specific activity or group of individuals."

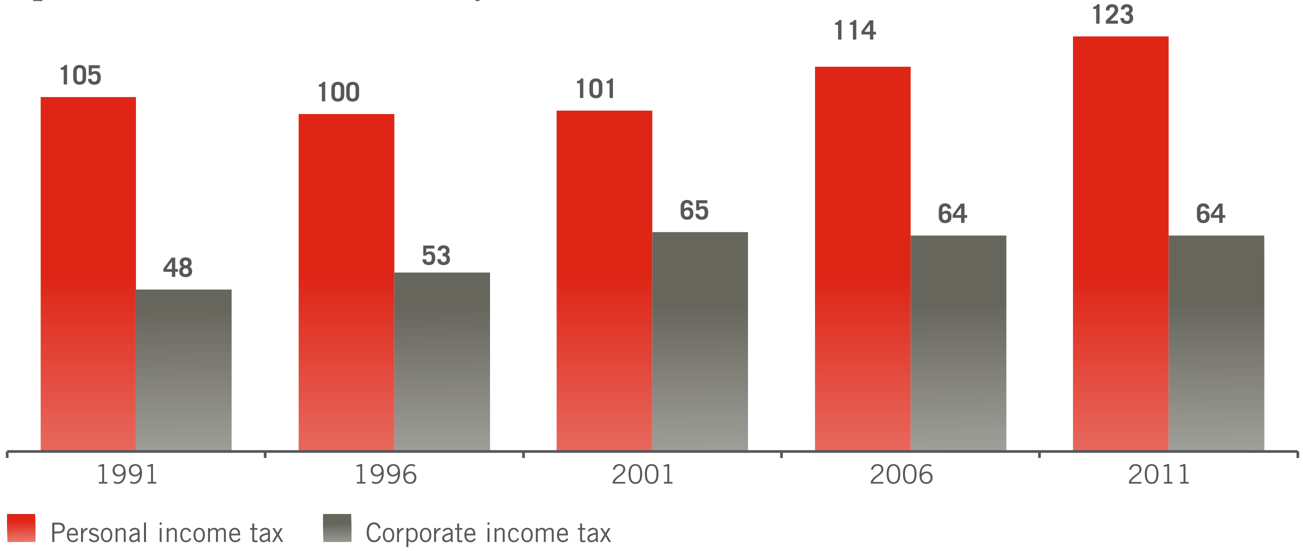
A change in government has done little to erode Ottawa's support for delivering subsidies and benefits through the tax system. The most recent federal budget established new ones for teachers who purchase supplies for their classrooms and restored a tax incentive for investing in a labour-sponsored venture capital corporation.

Some of these changes have involved clear and obvious connections to the objectives discussed earlier, such as positive spillover effects or adjusting taxable income for horizontal equity. Income splitting for families with children is a good example. But others have had more tenuous links to tax policy principles. The Children's Arts Tax Credit is a good (or bad) example.

"The upshot is nearly 130 federal tax expenditures are in the personal income tax system alone and the tax code is more than 2,600 pages."

The upshot is nearly 130 federal tax expenditures are in the personal income tax system alone and the tax code is more than 2,600 pages (Vaillancourt et al. 2016). One calculation found that the number of federal personal tax expenditures increased by nearly 20 percent between 1991 and 2011. The number of corporate tax expenditures rose to 64 from 48 over the same period (see figure 1).

Figure 1: Number of federal personal income tax expenditures and corporate income tax expenditures in Canada, selected years, 1991-2011



Source: Vaillancourt et al. (2015).

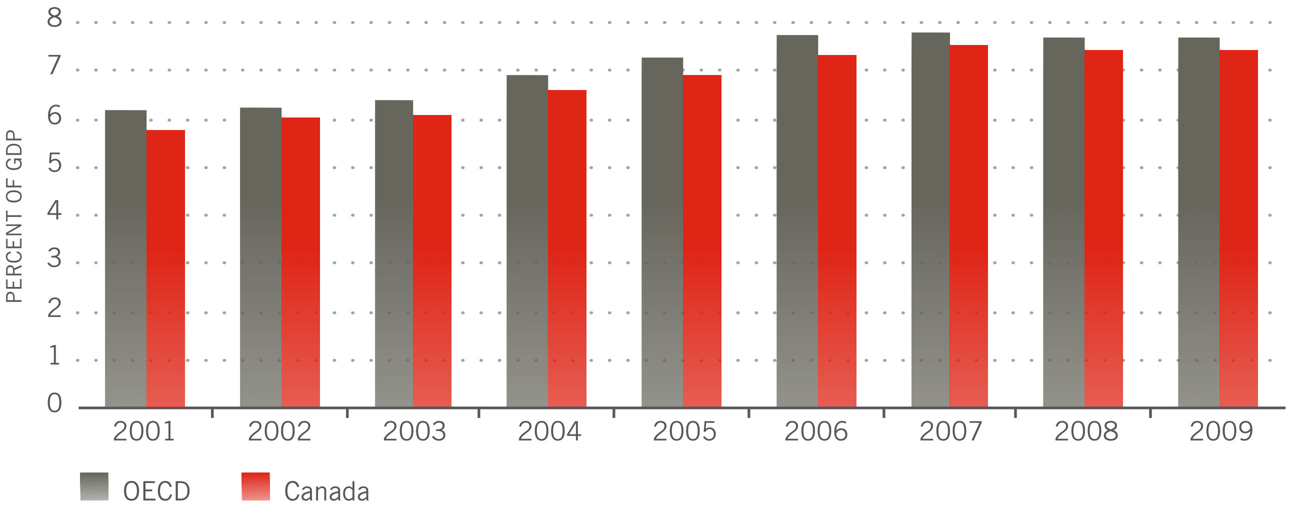
Remember that these tax credits, deductions, and other special preferences are carved out of the benchmark tax base. As a result, the government collects substantially less revenue than it otherwise would at the same tax rates. Overall tax rates must therefore be higher to collect the same amount of revenue.

Foregone revenue in the form of tax expenditures is substantial. Estimates place this cost as high as $130 billion per year for personal income tax expenditures, which is roughly the same amount the federal government collects in personal income tax revenues (Lammam and MacIntyre 2014). Put differently: the value of these tax expenditures is now $5,918 per tax filer as of 2013 (Lammam 2016). If the government could eliminate some share of existing tax expenditures, it could offset personal income tax reductions with limited or no incremental cost.

As for the impact on size and scope of government, the increase of tax expenditures conceals the extent to which the state continues to play an activist role in our lives and the broader economy, even if direct spending has remained stable or fallen in recent decades. A previous Macdonald-Laurier Institute (MLI) study estimates the size of government in Canada, when accounting for tax expenditures, increases from 44 percent to 54 percent of Gross Domestic Product (GDP) (Sheikh 2014). Federal tax expenditures alone represent as much as 7.5 percent of GDP (see figure 2).[1]

The recent proliferation of tax expenditures is not necessarily negative – some of them may be justified on grounds of tax fairness or positive spillover effects. But, as noted above, after 30 years a review is certainly warranted to test whether existing tax expenditures are justified and achieving positive results. The outcome of a hard look at tax expenditures can be a more efficient, fairer, and simpler federal tax system.

Figure 2: Estimate of Canadian tax expenditures: Canadian and OECD sources, 2001-2009



Source: OECD (2010).

Positive Spillover Effects and a Role for Tax Expenditures

Evaluating the federal tax system has its challenges. It is not insurmountable but it requires a clear and transparent framework to navigate complicated and often politically fraught questions. It is essential that any steps to eliminate or reform current tax expenditures are rooted in an evidence-based foundation that can stand up to policy and political scrutiny.

A principal consideration is the proper role for public policy in general and tax expenditures in particular to support activities or behaviours that produce broad-based social benefits. This is a critical question for two reasons. The first is that it is often difficult to judge the magnitude of such social benefits and whether it justifies public subsidies, and thus conclusions can be subjective. The second is that while positive spillover effects are only one of many reasons for tax expenditures (and indeed may explain just a small number of them at least in terms of foregone revenue), the ones with this objective may be the best candidates for elimination precisely because the social benefits cannot always be measured or public subsidies may be unjustified. Most of the rest of the study will therefore focus on tax expenditures that have the policy objective of supporting or promoting activities and behaviours intended to produce positive spillover effects for society.

It is useful therefore to explore these basic economic ideas a bit further.

Some activities and behaviours by individuals or businesses have broader implications that affect other people. Sometimes these indirect effects are minor. But other times they can be significant. These larger effects are what economists call "externalities." These spillovers are among the main reasons why governments intervene in the economy or society.

British economist James Meade (1973) defined externalities in the following way:

> An external economy (diseconomy) is an event which confers an appreciable benefit (inflicts an appreciable damage) on some person or persons who were not fully consenting parties in reaching the decision or decisions which led directly or indirectly to the event in question.

This is an academic description of activities and behaviours that confer broad-based benefits or costs that were the result of individual rather than collective action. Hence the term externality: the action is taken external to the person or persons affected.

Externalities or external spillovers can be positive or negative (see table 2 for examples). Pollution is a classic example of a *negative externality*. A company makes decisions based only on the direct cost of and profit opportunity from production without considering the indirect cost to those harmed by any pollution it produces. The social – that is, total – costs of the company's activities are larger than its private costs. These indirect costs can be borne by the broader community in the form of decreased quality of life, higher health-care costs, and diminished opportunities for other sectors such as tourism. The private costs then are lower than the social costs.

There are also *positive externalities.* Raising children is a prime example. Children provide broad-based economic benefits in the form of a large workforce for firms to employ in the future, more people paying taxes, and more workers supporting non-working retirees. But the cost of raising children, including the opportunity costs of forgone income or consumption, are fully borne by the parents.

Table 2: Examples of positive and negative externalities

Type of Externality	Examples
Positive	Raising children, some research and development, and volunteering and charitable giving
Negative	Different forms of pollution, systemic risk in banking, and overfishing

When there are differences between private and social costs or private and social returns, the main problem is that we may end up with more of what we do not want and less of what we want. That is to say, individuals or firms will tend to make decisions without accounting for the full benefits or costs and the result can be an underproduction or overproduction in terms of a society's overall condition.

Public policy, including tax expenditures, can play a role in ensuring that social returns are maximized and social costs are minimized. It can do this by aiming to ensure that all costs and benefits are internalized by people or companies in making decisions.

Consider again the example of raising children. When couples decide how many children to have, they make this decision based solely on their private costs and benefits, since the external benefits of having more babies are realized by society as a whole rather than the parents themselves. Therefore, if left to individual judgements, we will have fewer babies than is socially optimal. Government policy such as child-care subsidies or general child benefits can help to better align the private costs and social returns so that couples are not discouraged from having children because they are fully responsible for the costs but share the benefits.

Limits of Measuring and Accounting for Positive Spillover Effects

But there are limits to the utility of government policies that aim to correct for externalities. It does not follow that the government should seek to subsidize every activity and behaviour that purportedly produces broad-based benefits. Magnitude is an essential consideration. The offsetting costs of "government failure" is another. Let us explain.

Economists measure externalities based on the marginal benefit to society from a particular activity or behaviour. But these are typically much harder to measure in practice than in theory. Sometimes the full extent of the externalities is not known. Other times it is hard to quantify such as an increase in civic engagement.

The potential for political calculations rather than empirical ones to drive policy choices can thus be significant. This is how we end up with the Trudeau government's Teacher and Early Childhood Educator School Supply Tax Credit or its predecessor's Children's Arts Tax Credit. Do these activities or behaviours produce external benefits? Maybe, though particularly in the latter case the benefits mostly accrue to the child participating in arts activities. Can they be quantified? No. Are they of a magnitude that justifies public expenditure? Almost certainly not. That is not a comment about the general utility or suitability of tax expenditures. It is a contention that these activities or behaviours are unworthy of government subsidies.

The point is: the absence of a clear and transparent framework can lead to heightened risks of politics ultimately dictating policy choices. This is as true regarding tax expenditures as it is with government spending programs, or regulations.

Nobel Prize-winning economist James Buchanan warned of "government failure" – that is, the combination of inherent government inefficiencies and politically-motivated determinations – eroding the utility of public policies designed to correct externalities (Buchanan 2001). As one survey text on the theory of externalities notes:

> Recent studies have shown that the cost of correction may on occasion outweigh the benefits associated with correction (*i.e.*, the gain in efficiency derived from the correction). In such cases, the market failure should be maintained. (Cornes and Sandler 1986)

So even if we assume a market failure with regards to positive externalities or broad-based benefits, the solution implemented by government is often inefficient and determined not by social welfare but by political considerations. We should therefore be careful about jumping to the conclusion that government intervention is justified, even if it is likely there are significant positive externalities. As Nobel Prize-winning economist George Stigler famously wrote:

> For some, market failures serve as a rationale for public intervention. However, the fact that self-interested market behavior does not always produce felicitous social consequences is not sufficient reason to draw this conclusion. It is necessary to assess public performance under comparable conditions, and hence to analyze self-interested political behavior in the institutional structures of the public sector. We may tell the society to jump out of the market frying pan, but we have no basis for predicting whether it will land in the fire or a luxurious bed. (Stigler 1975)

The takeaway is that any government intervention must involve a clear-eyed cost/benefit analysis that is not based on a false choice between market failure and an idealized version of government. Any government intervention will invariably involve inefficiencies and distortions (or what economists call "deadweight loss"). The list of real-life examples of government failure is long and cannot be ignored (Lammam et al. 2013).

Yet, notwithstanding these limitations, there is general support for government policies to support or promote individual activities and behaviours that are thought to significantly benefit society as a whole. Effective public policy can do so by increasing the supply of, and the demand for, goods, services, and resources that generate positive externalities. As three US economists, including former Obama administration adviser, Peter Orszag, have written:

> Government can enhance efficiency by correcting for positive externalities through regulation, through direct expenditures on the activity in question or… through tax incentives called Pigouvian subsidies. (Batchelder et al. 2006)

The upshot is that such policies must be designed carefully and be based on a clear and realistic weighing of the benefits and costs of government intervention.

The Case for and Against Tax Expenditures

Tax expenditures have strengths and weaknesses with regards to supporting activities and behaviours that confer broad-based social benefits. It is worth exploring them briefly.

Pro-tax expenditures

Public policy commentator Ken Boessenkool (2015) lays out the case for tax expenditures in a 2015 essay in the *Canadian Tax Journal*. He evaluates tax expenditures relative to other forms of government programming as opposed to considering tax expenditures in the abstract. The choice of policy instrument should be based on a relative assessment of efficiency, simplicity, and one's ability to pay. Applying these tests shows that tax expenditures can be an effective and even optimal policy tool in different circumstances.

Efficiency

Tax expenditures can be a more efficient means of supporting certain activities or behaviours than direct government spending. Delivering government subsidies through the tax system is often less administratively costly and burdensome than a government-administered grant program. It does not require significant bureaucracy to administer or manage, so the deadweight loss of government intervention can be minimized. Put differently: it avoids what economist Filip Palda (1996) has called "fiscal churn" whereby tax dollars churn through bureaucracy and then are returned to taxpayers in the form of transfer payments but of course with overhead costs deducted.

It also places most decision-making in the hands of private individuals rather than the government. A tax expenditure can better defer to individual preferences than an application-based grant program. Eligibility is flexible and based on a personal assessment rather than determinations by public servants with less information about local conditions or circumstances.

Simplicity

As for simplicity, while tax expenditures may add complexity to the tax system, they are often simpler than direct government programming. The tax system already collects much of the data to administer incentives, and the administration of the system is increasingly automated. Direct government spending generally requires applications, processes, and bureaucracy for administration.

The question then is not whether tax expenditures make the tax system more complex and costly but rather, is the incremental cost less than if the government tried to achieve the same goals through direct programming? As Weisbach and Nussim write:

> [I]f we mistakenly look only at the tax system instead of overall government policy, we will draw the wrong conclusion. Putting a program into the tax system makes the tax system look more complicated, but there is unseen simplification elsewhere. The tax system will seem less efficient, but the efficiency of government policy is unchanged. (Weisbach and Nussim 2004)

The upshot is that any critique of the greater tax complexity caused by tax expenditures should consider the relative complexity and costs associated with direct government programming to achieve the same objectives. Policy development cannot be conducted in abstraction.

One's ability to pay

The third consideration is one's ability to pay, or what tax experts call "horizontal equity." It basically assumes that those in similar circumstances should pay the same amount in taxation. Parents with children have expenses that those without children do not, and so even if their incomes are the same their ability to pay is different. Tax expenditures – particularly tax deductions – help to adjust taxable income in the name of horizontal equity. As Boessenkool (2015) has frequently written, "kids are not boats" and the tax system ought to treat them differently.

Anti-tax expenditures

There are also sound arguments against tax expenditures. Critics of tax credits, deductions, and other special preferences span the intellectual and political spectrum and rely on a range of critiques. The four most compelling are the resulting costs in the form of higher taxes on everyone, the added complexity, the distributional effects of tax expenditures, and the relative lack of scrutiny.

Higher taxes for everyone

The principal downside of tax expenditures is that they narrow the tax base, thereby requiring higher tax rates than would otherwise be needed to raise the same level of tax revenues. This may not be self-evident. When a government creates a new tax credit, it reports on the costs. Importantly, however, it never explains that this is foregone revenue that erodes the tax base by providing targeted benefit for some and requiring the maintenance of higher tax rates for everyone. But that is effectively the result. This is what US economist Mancur Olson (1971) described as "concentrated benefits and dispersed costs."

A broader tax base enables lower tax rates, which is the most effective means of inducing higher economic activity and wealth creation. It also allows individuals to engage in whatever activities and behaviours they wish with higher after-tax income without concern for government incentives or preferences. Importantly, this assumes that the government ceases subsidizing these activities or behaviours altogether rather than shifting to direct expenditures.

Added tax complexity

A second problem is the added complexity and compliance costs caused by tax expenditures. Tax compliance costs exceed $7 billion per year in Canada. These costs come in the form of accountant services or tax software as well as the opportunity costs of time and money. This represents a major expense for tax filers (roughly $500 per household) and the cost is borne disproportionately by low-income Canadians who spend a greater share of their disposable income on tax compliance (Speer 2014).

Tax expenditures are a major cause of these high compliance costs. Claiming a tax credit or deduction typically requires a tax filer to maintain receipts or fill out additional forms in order to be eligible. It can require complex calculations to sum up different types of spending over the course of the year or income earned in different jurisdictions. A 2014 study estimates that tax filers who claimed tax expenditures spent, on average, 20 percent more on tax compliance than those who did not (Speer et al. 2014). A simpler tax system with fewer tax expenditures would therefore reduce compliance costs for Canadians.

“A recent study examined the income distribution from 64 personal income tax expenditures and found 59 of them provide disproportionate benefit to the top 50 percent of income earners.”

Distributional effects

A growing body of research shows that tax expenditures can disproportionately benefit high-income earners. This is somewhat intuitive. To the extent that tax expenditures – particularly non-refundable tax credits – reduce a tax filer’s tax liability they will invariably help those who must pay higher taxes. If one does not earn enough to pay taxes, he or she does not benefit from tax credit.

Yet, by linking one’s eligibility to his or her income level and tax payable, tax expenditures can produce inequities. Think of the Disability Tax Credit, for instance. The cost of dealing with a disability is independent of one’s income or tax payable. But, by reducing the amount of tax payable up to a maximum amount, the tax credit can result in someone with higher income being able to recover more of the costs associated with the disability. Those with limited or no income may get less or no public support.

A recent study examined the income distribution from 64 personal income tax expenditures and found 59 of them provide disproportionate benefit to the top 50 percent of income earners (Macdonald 2016). This is consistent with research from elsewhere that shows that tax expenditures often tend to skew to high-income earners (US Congressional Budget Office 2013). Eliminating tax expenditures could therefore increase progressivity in the tax system and create the fiscal room to lower marginal tax rates for low- and middle-class Canadians.

Lack of accountability and scrutiny

A final critique is that tax expenditures are subject to less scrutiny and oversight than regular government spending. Departmental spending must be voted on in Parliament on an annual basis and is subject to legal requirements with regards to reporting and evaluation. Tax expenditures, by contrast, are voted on once and thereafter remain in effect unless the government chooses to revisit them. It is notable for instance that tax expenditures were excluded from the previous government’s comprehensive reviews of government spending. It is partly the reason that the Auditor General of Canada (2015) concluded that the Department of Finance “does not systematically evaluate all existing tax-based expenditures” in its 2015 audit of federal tax expenditures.

This lack of accountability and scrutiny is not unique to Canada. Tax expenditures in other jurisdictions also evade regular review or evaluation. As one World Bank study notes:

> [T]he lack of scrutiny [of tax expenditures] is in stark contrast to scrutiny generally applied to the spending side of government finances. In these situations, it is difficult, if not impossible, to evaluate the cost, efficiency, and equity impact of tax expenditures and the extent to which resources could be rationalized or better allocated to strengthen government finances and to support progress toward broader economic and social objectives. (Polackova Brixi et al. 2004)

The result is that tax expenditures can make the government larger, more complex, and less accountable. These effects must be considered in determining whether the government should intervene to support certain activities or behaviours and if tax expenditures are the most effective policy instrument to do so.

Why a Review of Federal Tax Expenditures is Necessary

The chief observation of this study thus far is that tax expenditures are neither uniformly good nor bad. There is a case for government to support certain activities and behaviours that produce broad-based social benefits and often tax expenditures can be the most efficient and simple means of doing so. We have even argued elsewhere that the government ought to create a new tax expenditure to help Canadians purchase private health insurance (Crowley and Speer 2016b).

But this involves a big "but." It requires government to clearly and transparently assess the magnitude of economic and social benefits from different activities and behaviours, to weigh these benefits against the cost of government intervention, and then ultimately to design a tax expenditure that broadly aligns the marginal benefits with the marginal private cost. Only tax expenditures that can pass such a cost/benefit analysis ought to be preserved. As University of Calgary economist Duanjie Chen writes:

> [T]ax incentives can only be justified only if they bring net benefits to society as a whole. That is, the well-anticipated losses in revenue and economic efficiency and increased cost in administration have to be outweighed by the intended and achievable long-term economic growth and revenue growth to justify a tax incentive program, both before its introduction (*i.e.*, appraisal) and on an on-going basis (*i.e.*, evaluation). (Chen 2015)

We would extend his observation to include tax expenditures that not only contribute to economic growth but also confer significant social benefits, such as higher civic engagement, strengthened civil society, and stronger families. But otherwise his basic point is precisely right.

It is also important to note that the same applies to any form of government intervention. That is, critiques of tax expenditures often amount to criticism that the government should not have intervened at all, irrespective of what policy instrument it ultimately selected. This is often a fair criticism.

It is thus essential that any review of tax expenditures follows a sequential checklist that first considers whether the government ought to intervene in the first place. If the answer is affirmative, then policymakers should weight the strengths and weaknesses of different policy options. The use of tax expenditures may often be the right choice.

The same considerations should apply to a review of existing tax expenditures. Does this activity or behaviour produce sufficient spillover effects to justify public support especially after accounting for the inherent inefficiencies of government intervention? If so, what are the relative merits of using a tax-based policy versus direct government spending? Is the current tax expenditure producing measurable results?

The result of such a dispassionate, evidence-based process would be to sustain or reform tax expenditures that meet these tests and to eliminate those that do not. The key is for the exercise to be transparent and less prone to politics, and ultimately able to withstand scrutiny.

> *"One final yet essential consideration is what to do with any resulting revenue from eliminating existing tax expenditures."*

The alternative is for the government to continue simply eliminating the policies of predecessor and replacing them with its own. The tax system will not be more efficient, simple, and equitable if the government substitutes the Teacher and Early Childhood Educator School Supply Tax Credit for the Children's Fitness Tax Credit and new tax incentives for talk shows or tax incentives for the donation of real estate to charities. This has to be about more than politics. And following a clear checklist can help to accomplish this goal.

One final yet essential consideration is what to do with any resulting revenue from eliminating existing tax expenditures. The 1987 exercise led to a substantial flattening of federal tax rates. It is less clear what the Trudeau government intends to do with any revenue that results from the current exercise.

Remember that the problem with many tax expenditures is that the underlying activities and behaviours do not produce sufficient spillover effects to justify public support. It would make no sense then to shift from a tax expenditure to direct government spending. The whole point is that there is no role for government intervention in a particular area. It stands to reason then that any resulting revenues are returned to taxpayers in the form of tax reductions or enhancements to existing tax expenditures. Using them to offset new spending or pay down the federal deficit could amount to a tax hike for millions of Canadians.

What a Principle-Based Review Would Look Like

This exercise should be transparent and evidence-based. The goal is to limit the role of politics in the decision-making process and to apply a cost/benefit assessment that accounts for positive spillover effects to the extent possible and considers the potential for government inefficiencies and distortions. As a study for the Ontario government puts it:

> It is important that the government has an accurate understanding of the costs and benefits associated with certain tax expenditures. While some tax expenditures are consistent with smart taxation, others fail this assessment and are in existence for political rather than social or economic reasons. (Institute for Competitiveness and Prosperity 2013)

The US Government Accountability Office (GAO) has produced a useful checklist for evaluating tax expenditures that can be used by the Canadian government and its advisory panel. The 2012 framework was produced in response to a request by two Democratic members of Congress.

The guide sets out criteria and analytical questions for policymakers to consider in weighing competing priorities and evaluating the merits or effectiveness of a particular tax expenditure (GAO 2012). The GAO recognizes there is no "one-size-fits-all" framework for evaluating tax expenditures and that reasonable judgements must be made. But its proposed framework can be an effective tool for Canadian policy makers.

The framework consists of five sequential topics or sections.

1. What is the tax expenditure's purpose and is it being achieved?
2. Even if its purpose is being achieved, is the tax expenditure good policy?
3. How does the tax expenditure relate to other federal programs?
4. What are the consequences for the federal budget of the tax expenditure?
5. How should evaluation of the tax expenditure be managed?

Each one consists of multiple questions or tests. The first one, for instance, asks basic questions about a tax expenditure's "intended purpose" and whether "performance measures" have been established to monitor its success or failure. The second sets out metrics for positive externalities including whether there are ways to measure the "benefits to society." The third considers whether "spending or other non-tax policy tools[s] are preferable to the tax expenditure." Annex A sets out the full framework for reference.

These basic tests strike us as sensible and useful for the purposes of the government's review of federal tax expenditures. We would make two tweaks. The first is to change (2) to add "is the tax expenditure the best way to achieve this goal?" There may be worthy goals that are not best supported or promoted through the tax system. The second is to change (4) to consider the interaction and effect of federal changes on provincial responsibilities such as health care and education.

The Canadian government should establish a similar framework or adopt the GAO's for the purposes of establishing new tax expenditures and reviewing existing ones. It should publish ongoing, regular reviews of tax expenditures using such a consistent set of questions and tests. A reasonable goal could be to review 25 percent of federal tax expenditures per year, which would allow a full review every four years. This is how the previous government's strategic reviews of direct spending was envisioned prior to the global economic recession in 2008 (Treasury Board of Canada 2011).

As for the upcoming budget, the government should have been considering at least some of the basic considerations set out in the GAO framework. The tests with regards to a tax expenditure's intended purpose and assessment of whether it is being achieved, the magnitude of positive spillover effects, and consideration of different policy tools should be addressed and publicly released. This would provide greater public confidence that the review process has been principle-based and is not only about politics or reducing the government's substantial budgetary deficit.

The absence of such a clear and transparent methodology will invariably lead to accusations of politics. The 2016 Budget reversed the previous government's decisions on income splitting for families, tax credits for children's fitness and arts activities, and for certain types of charitable gifts but created new tax expenditures and left others with little explanation or justification (Canada 2016). The perception of political calculus can be difficult to defend against. This type of principle-based framework can help mitigate such criticism.

Case Studies of a Principle-Based Review

Adopting such a framework would invariably lead to some tax expenditures being sustained or reformed and others being eliminated altogether. It is beyond the scope of this study to conduct a full review of federal tax expenditures but here are some case studies to show the application of a clear and transparent checklist.

Tax expenditures to be sustained

The *Charitable Donation Tax Credit* should be sustained since philanthropy, charitable giving, and civic engagement provide significant benefits to Canadian society that the state could not replicate.

These positive spillover effects are a result of leveraging private wealth for the public good in the form of small-scale donations to local or community-based organizations up to large-scale donations to national or international organizations (Ealy and Ealy 2006). It is tough to fully measure the benefits of charitable giving but the latest data show that Canadians donated nearly $13 billion in 2013 (Turcotte 2015). Charities have come to play key roles in the delivery of social services and financing of major capital projects for hospitals and schools.

Research by the Department of Finance (2016a) shows that the Charitable Donation Tax Credit plays a considerable role in encouraging such giving. The tax credit, which has existed in some form or another for several decades, is claimed by roughly 5.7 million Canadians and costs nearly 2.9 billion per year in forgone revenue (Department of Finance 2016a). Eliminating it would thus impose significant social costs with a minimal efficiency or revenue gains for the government. It would also invariably lead to cost pressures on the federal and provincial governments to provide direct funding to charitable organizations or to substitute government programming for lost charitable activities and services.

The present *exemption from capital gains taxation on one's primary residence* should also be sustained. It has contributed to high levels of homeownership and more equity accumulation rather than rising debt (Crowley and Speer 2016a).

The benefits of homeownership are far-ranging, including better educational and health outcomes, safer communities, more civic engagement, and higher wealth (Speer and Crowley 2016). These positive spillover effects are measurable for the homeowner, his or her family, and their community.

The current tax treatment costs roughly $5 billion per year in foregone revenue and benefits an indeterminate number of homeowners (Department of Finance 2016a). Eliminating it would impose significant economic and social costs with minimal efficiency or revenue gains for the government. It may also discourage labour mobility and cause homeowners to be less able divest a home in difficult times due to tax penalties.

Tax expenditures to be reformed

The *Disability Tax Credit* should be reformed to better assist those with limited incomes. The tax credit has evolved since 1944 to cover a broader range of disabilities and has come to act as a gateway for other public benefits. It continues to serve an important purpose but requires further reform.

There is a clear public policy role to help Canadians with disabilities cover any costs associated with living with a disability. It both helps to adjust taxable income to reflect one's ability to pay and recognizes that there are costs outside of one's control. The present non-refundable tax credit achieves the first purpose but it fails the second since there are costs associated with living with a disability irrespective of one's tax payable. A new refundable tax credit would ensure that these costs are supported irrespective of one's income. This would ensure that the poorest and most vulnerable are eligible for the tax credit's benefits (Mendelson 2015).

The present tax credit costs roughly $850 million per year and is claimed by 630,000 recipients. The cost of making it refundable would depend on whether other changes are made to its generosity, interaction with provincial tax credits, and the take-up rates. Estimates of the incremental costs range from $80 million to roughly $1 billion (Simpson and Stevens 2016; Medelson, 2016). But doing so would improve the efficiency and fairness of the tax credit and ensure it is producing broad-based social benefits. It may also reduce pressures on other federal and provincial direct spending since individuals would now have direct, targeted support irrespective of one's income.

The present *non-taxation of employer-provided health and dental benefits* should also be reformed. The current tax treatment advantages Canadians who receive health and dental insurance from their employer over those Canadians who do not. Those with such workplace benefits effectively receive a sizeable tax subsidy and those without must purchase insurance with after-tax dollars and minimal government support. This is manifestly arbitrary and unfair (Crowley and Speer 2016b).

The solution is a "tax swap," whereby the government ceases treating workplace health and dental insurance as non-taxable and in turn uses the resulting revenues to establish a new refundable tax credit to help defray the costs of buying private insurance. The new tax credit might involve a redesign of the existing Medical Expense Tax Credit and would be available to all Canadians, irrespective of their employment circumstances, including in the form of a cash transfer for low-income citizens who do not pay income taxes.

> *"We should not be subsidizing people because they are old but rather because they are poor."*

One such proposal, as recommended by the Advisory Panel on Healthcare Innovation, is to provide an annual tax benefit of up to $750 for individuals with incomes less than $44,000 and up to $1,500 for families with incomes less than $89,000. This particular scenario would be largely paid for by changing the current tax treatment of workplace insurance but could be adjusted if the government chose to supplement it with additional monies (Canada 2015).

Extending accessibility to private health insurance to more Canadians would not only reduce out-of-pocket spending, it may enable a gradual shift of greater health-care financing from the government to private insurance.

Tax expenditures to be eliminated

The *Age Credit* should be eliminated since it is not associated with any broad-based spillover effects and has since been superseded by a range of direct government programming.

The credit was established in 1972 to help low-income seniors cover their cost of living. Expansions to the Guaranteed Income Supplement and other forms of assistance to elderly Canadians have diminished its need or utility and yet it continues to provide public benefits to seniors earning as much as $75,000 per year (Lammam et al. 2015). It is now basically a tax benefit for being aged 65 or more. Longevity is positive for the individual but it is not a broad-based social benefit.

Put bluntly: we should not be subsidizing people because they are old but rather because they are poor. And old age is no longer a proxy for poverty. On the contrary. Canada has been extremely successful in improving the position of its seniors (Conference Board of Canada. n/d).

Yet the credit is still claimed by roughly 5.2 million tax filers and set to rise. It presently costs more than $3 billion per year (Department of Finance 2016a). Eliminating the Age Credit would free up the fiscal room to raise the basic personal amount for all tax filers by more than $1,000 or substantially lower the third or fourth tax rates (Parliamentary Budget Officer n/d).

The *Public Transit Tax Credit* should also be eliminated because it fails basic tests with regards to positive spillover effects. Public transit may be a worthwhile activity but it is difficult to determine whether the tax credit directly leads to more ridership and the broad-based social benefits derived from greater transit use.

The tax credit is notionally associated with encouraging the use of public transit in the name of social and environmental objectives. But the Department of Finance concedes it has no sense of whether it is effective in this regard. A 2011 departmental analysis could not assess the contribution of the tax credit in contributing to higher levels of public transit usage (Department of Finance 2011). A similar conclusion was reached by Queen's University economist Vincent Chandler (2014) who evaluated the Public Transit Tax Credit and found "no economic justification for this tax credit especially when considering the compliance costs associated with tax credits."

The tax credit is claimed by roughly 1.7 million tax filers per year and costs more than $200 million per year in foregone revenue (Department of Finance 2016a). Eliminating it would enable the government to raise the GST/HST credit for low-income families by $200 for each dependent benefit or nearly lower the fourth tax rate from 29 percent to 28 percent (Parliamentary Budget Officer n/d).

Conclusion

The Trudeau government has committed to conducting a comprehensive review of the federal tax code with the goal of making it more efficient, fair, and simple. And for good reason. A proliferation of tax expenditures – some good yet most bad – over the past thirty years has caused a need for such a review.

But it will not be easy. The politics of eliminating tax expenditures can be tricky. Recent media and political attention demonstrate the immense scrutiny that any resulting decisions will face. It is critical therefore that an evaluation of tax expenditures for the 2017 budget and in subsequent years draws on a clear and transparent framework.

This study has aimed to help the government think about how to conduct a principle-based review of federal tax expenditures. The goal has been to establish a clear and transparent framework so that the review is rooted in basic principles and less susceptible to political whims, special-interest calculations, or simply about balancing the budget.

Our analysis seeks a middle ground between those voices who argue that all state intervention should come in the form of direct government spending and others that contend the government should not support or promote any activities and behaviours including through the tax system.

Instead the study sets out a checklist for the government to use in its review that starts with basic questions about the role of the government, the spillover effects of certain actions or behaviours, and use of tax expenditures versus other policy instruments to support them. Using such a checklist would ensure that the review is credible and transparent. The outcome would be that some tax expenditures are sustained or reformed and others are eliminated altogether. But the process would be principle-based and better establish it to withstand scrutiny and ultimately deliver a better, fairer, and simpler tax system.

About the Author

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He previously served in different roles for the federal government including as senior economic advisor to the Prime Minister. He has been cited by *The Hill Times* as one of the most influential people in government and by *Embassy Magazine* as one of the top 80 people influencing Canadian foreign policy.

He has written extensively about federal policy issues, including taxes and government spending, retirement income security, social mobility, and economic competitiveness. His articles have appeared in every major national and regional newspaper in Canada (including the *Globe and Mail* and *National Post*) as well as prominent US-based publications (including the *Wall Street Journal* and *National Review Online*). Sean holds an M.A. in History from Carleton University and has studied economic history as a PhD candidate at Queen's University.

Appendix 1:

GAO's Background and Evaluation Criteria and Questions for Tax Expenditures

1. What is the tax expenditure's purpose and is it being achieved?
- What is the tax expenditure's intended purpose?
- Have performance measures been established to monitor success in achieving the tax expenditure's intended purpose?
- Does the tax expenditure succeed in achieving the intended purpose?

2. Even if its purpose is being achieved, is the tax expenditure good policy?
- Does the tax expenditure generate net benefits in the form of efficiency gains for society as a whole?
  - What is the benefit to society of the activity the expenditure encourages?
  - Do any performance measures established for the tax expenditure measure these benefits to society?
  - What are the costs of the resources used to generate the tax expenditure's benefits?
  - Do the benefits of the tax expenditure exceed its costs?
- Is the tax expenditure fair and equitable?
  - Does the tax expenditure result in different benefits for similarly situated taxpayers?
  - Do taxpayers with different abilities to pay receive different benefits from the tax expenditure?
  - Who actually benefits from the tax expenditure?
- Is the tax expenditure simple, transparent, and administrable?
  - What are planning, record-keeping, reporting, and other compliance costs for taxpayers in using the tax expenditure?
  - Can taxpayers understand how the tax expenditure works?
  - What are the costs to IRS and third parties in administering the tax expenditure?

3. How does the tax expenditure relate to other federal programs?
- Does the tax expenditure contribute to a designated cross-agency priority goal?
- Does the tax expenditure duplicate or overlap with another federal effort?
- Is the tax expenditure being coordinated with other federal activities?
- Would an alternative to the tax expenditure more effectively achieve its intended purpose?
  - Is a different tax expenditure design preferable?
  - Is a spending or other non-tax policy tool preferable to the tax expenditure?

4. What are the consequences for the federal budget of the tax expenditure?
- Are there budget effects not captured by Treasury's or the Joint Committee on Taxation's tax expenditure estimates?
  - Would eliminating or creating the tax expenditure affect revenue loss estimates for other tax expenditures?
  - Would eliminating or creating the tax expenditure affect other federal taxes, such as payroll taxes?
  - Would eliminating or creating the tax expenditure change taxpayer behaviour in ways that affect revenue?
  - Would eliminating or creating the tax expenditure affect the amount the government spends on other programs?
  - How does it interact with provincial policies or responsibilities?

5. How should evaluation of the tax expenditure be managed?
- What agency or agencies should evaluate the tax expenditure?
- When should the tax expenditure be evaluated?
- What data are needed to evaluate the tax expenditure?

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Endnotes

1 The OECD estimates are available up to 2009. While estimates surely have changed ever since, a review of changes in the Canadian tax expenditures reports published since 2009 suggests that the latest estimates are broadly representative of their present size.

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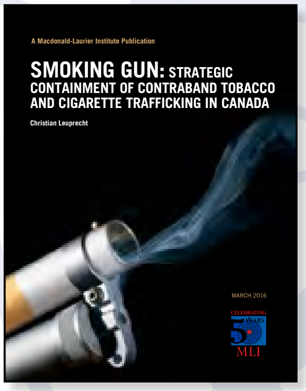

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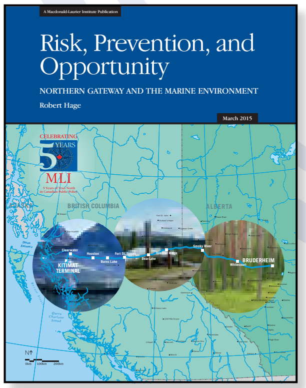

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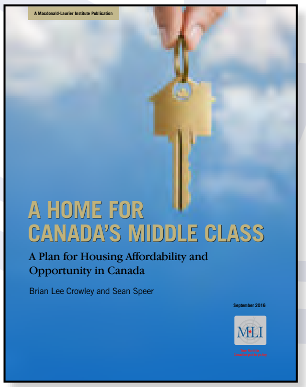

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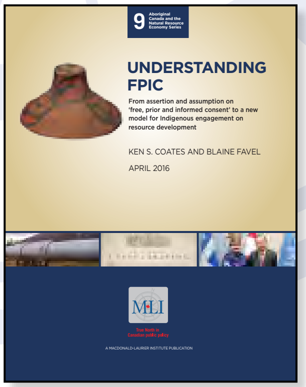

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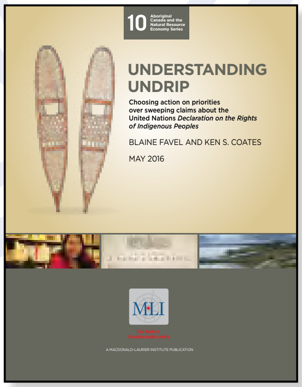

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