

June 2005

# **TAX FREEDOM DAY**

**A Flawed, Incoherent,  
and Pernicious Concept**

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0-88627-438-9



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# Tax Freedom Day

## A Flawed, Incoherent, and Pernicious Concept

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### Summary

In an attempt to convince working people that Canadian taxes are unduly burdensome, right-wing think tanks and conservative politicians have been exaggerating the level of taxes paid by Canadian families for years. Presumably, they see this as their best strategy for convincing the general public that they should go along with more tax cuts for the wealthy and more cuts in government spending programs.

As part of this propaganda campaign, each year the Fraser Institute issues a press release announcing the imminent arrival of tax freedom day. In its press release, the Institute states that until the arrival of tax freedom day Canadians are working for the government; only after that date do they start working for themselves. Last year, tax freedom day fell on June 28, implying that Canadian families spend about one-half of their annual income on taxes.

The Fraser Institute has been enormously successful in promoting the concept of tax freedom day, yet the whole notion is incoherent. The term suggests that Canadians derive no benefit from the taxes they pay, but instead that their taxes simply go down some dark hole. It implies that the goods and services that Canadians provide to themselves through democratically controlled institutions—such as police protection,

highways, national parks, schools, disaster relief, and medical services—do not enlarge their freedoms or enrich their lives.

If, as the Institute claims, Canadians are working for the government until they have earned enough each year to pay their taxes, does that mean that for the rest of the year—or at least until they have earned enough to start saving—they will be working for Loblaw's, Ford Motors, Canadian Tire, and Famous Players, as they shop for their groceries, service their cars, purchase chain saws, and attend movies?

Even if it were useful to inform Canadians how many days they had to work in order to earn enough to pay their taxes, the Institute's calculations are preposterously exaggerated. Their calculations understate the income of Canadians, overstate their taxes, misuse the concept of averages, and are often misleadingly applied only to families with at least two members.

Inexplicably, the Institute's statisticians do not include all of a family's economic income in calculating the effective tax rate paid by a family. They include only what they refer to as the "cash income" of the family. Indeed, since they attribute all taxes paid in Canada to individual families—including those paid by employers, corporations, and taxes paid on capital gains—their calculations treat families as having paid a good deal of their taxes out of income they are not treated as having received.

If the Institute had used an average family's total income, as they calculate it, instead of just their cash income, tax freedom day in 2003 would have fallen on April 24 instead of June 22, a full 58 days earlier than that announced by the Institute. Indeed, if the Institute had just used the method of calculating tax freedom day as used by the right-wing Tax Foundation in the United States, instead of their own tortured math, tax freedom day in Canada would have fallen on June 7. But even designating this date as tax freedom day would have substantially overstated the taxes paid by the typical family.

The Institute's calculations of the taxes paid by the average family are meaningless for most taxpayers for another reason. Because income is distributed so unequally in Canada, the average income of families is much higher than the income of the median family, or the family right in the middle of the income distribution scale. Thus the majority of families earn much less than the average income and their effective tax rates are lower than that of the statistical average family.

Although the Institute does not calculate the taxes paid by the median family, it does calculate the effective tax rate of families in different income deciles. On the basis of their total income, as calculated by the Institute, the poorest 10% of families had an effective tax rate of 12% in 2003, which meant their tax freedom day would be on February 15; those families in the fifth decile (their income placed them in the 40% to 50% of families) had an effective tax rate of 28.8%, which meant their tax freedom day would be on April 17; and the richest 10% of families had an effective tax rate of 39%, which meant their tax freedom day would be on May 24.

In the detailed calculations in its publication *Tax Facts 13*, the Institute calculates that, based upon their cash income, tax freedom day for the average family would fall on June 22 in 2003. In their press release for that year, they announced

it fell on June 28. This difference is due to the fact that, in its monograph, when the Institute refers to the average family it is referring to the total of what Statistics Canada refers to as families and unattached individuals. In its press release, however, when referring to families, it is referring only to families with two or more individuals. In its press release, it ignores unattached individuals, whose average incomes — and therefore average effective tax rates — are lower than those for families with at least two members.

Another concept the Institute has promoted in an attempt to mislead Canadians about the taxes they pay is a concept it refers to as the consumer tax index, which purports to show how much our taxes have increased in the last few decades. The Institute calculates that taxes have increased by a staggering 1,550% since 1961. But once again it arrives at this through chicanery. It fails to factor out inflation, and also fails to note that much of the increase is due to the significant real increase in the incomes of Canadians over this period. Once these two factors are taken into account, a different picture emerges: the effective tax rate in Canada has risen by about 40% over this period — not 1,550%. The larger but meaningless number was obviously used to delude Canadians into believing that they are grossly over-taxed.

Ironically, the Institute claims that its purpose in presenting its information is to stimulate rational public debate about taxes, in the interests of encouraging sensible tax policy. This is a ludicrous assertion. In the guise of helping Canadians to understand their tax system, the Institute presents information that is deeply flawed and misleading — information that in fact seriously limits the public's ability to understand and participate meaningfully in the shaping of tax policy. Given the importance of what's at stake, it is hard to see the Institute's campaign as anything other than pernicious.

# 1 Misleading Canadians about the Amount and Purposes of the Taxes They Pay

With their taxes, Canadian citizens buy themselves their most valued goods and services such as high-quality public schools, world-class universities, excellent medical services, public parks and libraries, safe streets, and liveable cities.

Taxes also assist citizens in spreading their incomes out over their lifetimes in order to maximize their lifetime well-being by, for example, transferring income from their high-income years to their retirement years, from when they are supporting dependent children to when they are not, and from when they are well and able to take care of their own needs to when they are ill or suffer from a disability.

Taxes also allow Canadians to discharge their moral responsibility to one another. They enable us to construct democratically controlled public institutions to prevent exploitation in market exchanges and family relations. As a result, taxes buy citizens a relatively high degree of social cohesion and social equality and thus enable us to enjoy the benefits of living in a local and a national community.

Just as importantly as the specific public goods and services Canadians purchase with their taxes, taxes unquestionably leave working Canadians more economically secure, healthier, and better educated — and therefore better able to protect themselves against business threats of capital withdrawal and more able to win their fair share of the national income in the long run.

Even though the public goods and services that Canadians purchase with their taxes greatly enrich the quality of their lives, no one likes paying taxes. Unlike prices paid for private goods, there is no immediate connection between taxes and the public goods and services that citizens receive in return. Moreover, since the taxes that each person pays appears to be so inconsequential given the total cost of government services, each of us, if we could, would probably prefer not to pay taxes but instead to free-ride on the benefits provided by other people's taxes.

Consequently, instead of attacking the value of government services directly, those who think that our lives should be governed primarily by the forces of the marketplace — and that we should make fewer choices collectively following democratic deliberation — have long ago determined that the most effective way of achieving this objective is by trying to convince people that their taxes, which pay for the public goods and services we all enjoy, are too high and too burdensome.

The Fraser Institute, Canada's most market-zealous research group, has led the assault in misinforming Canadians about the nature of taxes and in exaggerating the taxes paid by working people. And one of their most effective political stunts has been the announcement each year, usually around the end of June, of the imminence of tax freedom day.

Tax freedom day, according to the Institute, is the day when the average Canadian family will have earned enough money to pay off its tax bill for the year. As the Institute frequently puts it, “only from that day forward do Canadians stop working for the government and start working for themselves.”

The Institute’s annual announcement of tax freedom day is picked up—somewhat surprisingly since it would not appear to be news—by most of the Canadian media. Often the print media reproduces the Institute’s annual tax freedom day press release almost word for word. Gullibly accepting the Institute’s calculation of tax freedom day and its implications, some newspapers accompany the story with a lament about the onerous taxes that Canadians must bear. Typical headlines include: “Freedom from taxes,” “Move tax freedom day back,” “Canadians start working for themselves on June 28,” “We all need a little tax freedom,” and “Taxman gets off Canadian backs June 28.”

Early press coverage of tax freedom day usually mentioned something to the effect that it was a day “celebrated annually by the Fraser Institute.” However, as an indication of the success of the Institute’s propaganda efforts in establishing the language of public debate, the concept of tax freedom day is now frequently reported without any mention that it is a gimmick devised by a devoutly right-wing think-tank, and without in any way questioning its empirical premises or conceptual incoherence. It is simply presented as a value-free idea to assist citizens in thinking about taxes and government.

The Canadian Press summary of the Fraser Institute’s press release in 2004, which ran in numerous newspapers, borrowed a line from the Institute’s release—which appears to have been intended to be cited out of context—stating that, “According to Statistics Canada and government

information, Ontario’s tax freedom day fell on...” Thus making it appear as if the government of-  
ficially recognized the day.

As a further indication of the pervasiveness of the concept, tax freedom day is now used in some economic textbooks authored by conservative economists as a teaching aid to assist students in thinking about the tax structure.

Parenthetically, this deference to the findings and sense of the Institute’s tax freedom day might be contrasted with the skepticism the media accorded to a similar propaganda effort by trade unions and social policy groups. As a parody of the Fraser Institute’s tax freedom day, in the early 1990s the British Columbia Federation of Labour launched the first annual “corporate tax freedom day.” Noting that personal income taxes made up 50% of tax revenues and corporate income taxes only 7.5%, it pronounced January 27 as corporate tax freedom day. To observe the day, the Federation rented a penthouse in a Vancouver financial district hotel and hosted a black-tie affair where a race was staged between 10 battery-operated toy pigs. Each pig was named after a large corporation that had earned substantial profits but had successfully avoided paying any corporate income tax whatsoever that year. The winner was the first pig that reached and fell snout first into a large trough filled with cash. Social policy and labour unions in a number of provinces staged similar events over the course of the next few years. When the press bothered reporting the events at all, the tone was uniformly critical. Headlines included ones asserting, “Fodder for [unions] symbolic hog race just so much more swill,” “Get a grip...,” “Union lies fuel student protests,” and “Deferred tax myth.” The Fraser Institute hastened to discredit the event by issuing a denunciatory press release, and, thereafter, adding a section to its biennial tax incidence analysis entitled “The myth of the untaxed corporation.”



Along with the notion of tax freedom day, the Fraser Institute uses two other devices to mislead Canadians about their taxes. It has constructed a Canadian consumer tax index that purports to show the rate at which taxes have increased since 1961, and it uses tables and graphs that purport to show how the taxes families pay compare unfavourably with how much they pay for necessities such as food, clothing, and shelter and how this ratio has been changing since 1961.

Tax freedom day suggests that the average Canadian family pays almost 50% of its income in taxes; the Canadian consumer tax index suggests that the tax bill of the average family grew by 1,550% since 1961; the comparison of taxes paid by the average family with the amounts paid

for necessities suggests that taxes have unjustifiably far outstripped these expenditures.

All of this information, and the calculations behind them, are collected in the Fraser Institute's biennial publication *Tax Facts*. This monograph purports "to provide a basic tool kit of knowledge about taxation in Canada in order to enhance the opportunity for rational debate about these issues [relating to implementing an efficient and sensibly designed tax system]."

Nothing could be further from the truth. The information the Institute presents about the tax system is flawed, misleading, pernicious, seriously distorts public knowledge, and hinders rational debate about the tax system.

## 2 The Origins of Tax Freedom Day

Appropriately enough, the idea of celebrating a tax freedom day appears to have originated with Milton Friedman, the well-known American right-wing economist. In one of his *Newsweek* columns in 1974, he suggested that the United States should have a national holiday, called Personal Independence Day, on the day of the year “when we stop working to pay the expenses of government...and start working to pay for the items we severally and individually choose in light of our own needs and desires.”

In a clever propaganda coup, market-oriented think-tanks seized upon Friedman’s suggestion and began heralding that day as “tax freedom day.” The concept was apparently initially copyrighted by a U.S. businessperson, but the copyright has been transferred to the Tax Foundation, a right-wing, non-profit research and educational organization based in Washington, D.C., which claims to have done more than any other group to promote a sense of “tax consciousness” in the public.

The Tax Foundation usually announces tax freedom day on April 15 — the deadline for filing tax returns in the United States — reportedly to “give some context to help people understand the cost of their government when they feel it most.” In its most recent report, the Tax Foundation has calculated that in 2005 Americans will work until April 17 before earning enough to pay their taxes.

Not to be outdone by the Tax Foundation in competing to distort people’s thinking about taxes and government, Grover G. Norquist, the president of another U.S. right-wing tax group, Americans for Tax Reform, began publicizing another theoretical date to measure not only the cost of government taxes and spending, but also the indirect cost that government regulations impose on the marketplace through higher prices for goods and services. He labelled the day “the cost of government day.” In his annual press release, he usually pegs that day around the second week in July. Until that day, he claims that Americans could not say that they were truly working for themselves. He also asserts that his annual cost of government day report “has become a true measure of whether the conservative movement is achieving its goal of shrinking the size of government.”

In Canada, the Fraser Institute undertook its first study of the incidence of the Canadian tax system in 1976, only a couple of years after the Institute was formed. In its first tax publication, it produced an index that it labeled the “Canadian Consumer Tax Index” in order to measure the taxes paid by the average Canadian family and changes in those taxes over time. Michael Walker, the Institute’s Director, said that he initially became interested in the concept because in the mid-1970s Canadians seemed solely concerned with rising prices, or the rising Consumer

Price Index, and he felt that they should be equally concerned with rising taxes, hence the Consumer Tax Index.

Beginning in 1976, the Institute has published a biennial monograph on the Canadian tax system. The most recent edition, published in 2004, is *Tax Facts 13*. The major purpose of each edition is to calculate the percentage of income that the average Canadian family pays in tax. Although the notion of tax freedom day was not mentioned in the monograph until the ninth edition, published in 1994, the Institute began issuing annual tax freedom day press releases in the early 1980s.

The concept captured the imagination of the business press. A search of Factiva, a business news database, finds that since 1982 over a total of 230 newspaper articles and news releases from Canadian Newswire have referred to tax freedom day.

Given the success of the idea in the U.S. and Canada, right-wing think-tanks around the world have taken to flogging the idea every year in an effort to shape the public's thinking about taxes and government in their own countries. They include the United Kingdom's Adam Smith Institute, the Lithuanian Free Market Institute, the New Zealand Business Roundtable, the Jerusalem Institute for Market Studies, and the Australian Centre for Independent Studies.

Indeed, Michael Howard, the new Conservative leader in the UK, in the lead-up to this year's election in that country, promised a bank holiday called "Tax Freedom" if he were elected in order to help voters "decide whether you get genuine value for money, in return for the tax you pay." UK voters apparently decided they could do without an official tax freedom day holiday and re-elected Tony Blair.

### 3 Calculating Tax Freedom Day

In many countries, including the United States, right-wing think-tanks calculate tax freedom day in a straightforward manner. They take the ratio of the total taxes paid in the country to some measure of total national income and multiply the result by 365. They then add one to the calculated number and count that number of days from January 1 to determine tax freedom day.

Although simple, this method is flawed; but, if it were used in Canada, tax freedom day would have fallen on June 7 in 2003. According to the national income accounts, in that year total taxes (\$409,123) were 43% of net national income at basic prices (\$942,826).

Reporters routinely compare tax freedom day in Canada with tax freedom day in the United States, without realizing that the calculations are very different. For example, this past year Jonathan Chevreau, in his column on tax freedom day in the *National Post*, noted that “we now spend all winter and spring paying taxes, and work for ourselves in summer and fall. Compare our June 28 liberation day to April 11 in the United States.” Our financial reporters don’t even go to the trouble to see if the figures are comparable and, of course, the Fraser Institute never corrects them.

To its credit, the Fraser Institute in fact uses a more accurate (but still misleading in some respects) method of calculating tax freedom day than does the Tax Foundation in the U.S., which indeed suggests that tax freedom day fell on April

**TABLE 1 Total income before tax, 2003**

Wages and salaries	\$ 41,134
Income from farm operations	150
Unincorporated non-farm income	2,677
Interest	1,703
Dividends	661
Private and government pension payments	3,657
Old age pension payments	1,715
Other transfers from government	7,085
<b>Cash income</b>	<b>58,782</b>
	<i>Plus</i>
Fringe benefits from employment	7,637
Investment income from insurance companies	883
Investment income from pension plans	2,461
Imputed interest	351
Value of food from farms	11
Corporate retained earnings	2,623
<b>Total income</b>	<b>72,748</b>
	<i>Plus</i>
Property taxes	2,375
Profit taxes	2,556
Indirect taxes	12,779
<b>Total income before taxes</b>	<b>90,458</b>

SOURCE Fraser Institute, *Tax Facts 13*, Table 3.3, p.36.

24 in Canada in 2003. However, in its press release the Institute announced that it fell on June 28. The following description of how the Institute calculates tax freedom day explains its miscalculations and misreporting.

The Institute first calculates the income of the average family. To do that it takes the total of the various sources of income in Canada. It then determines the total number of family units in the country and divides the number of families into each source of income. **Table 1** shows the results for 2003.

As the table shows, the Institute arrives at three different concepts of income for the average family.

First is the family’s “cash income,” which includes the common sources of income that most families receive in cash in the year, such as wages and interest on bank accounts. As shown in the table, the Institute estimates the average family’s cash income to be \$58,782 in 2003.

Second, in addition to cash income, most families also benefit from various sources of non-cash income that clearly increases their ability to pay and that should be included in any comprehensive measure of their income. This includes such things as income-in-kind that they might receive from their employer, such as pension contributions, premiums paid for private health insurance, and so on. It also includes amounts that the family clearly benefits from but that they might be unaware of, such as investment income accumulating in insurance policies. It also includes profits in corporations that are not distributed but that are clearly accruing for the benefit of some families. The Fraser Institute adds in these amounts to arrive at an average family’s “total income” for 2003 of \$72,748.

Finally, the Institute has a category that includes property, profit, and indirect taxes. It might seem confusing to add these taxes in as part of

**TABLE 2 Tax bill of the average Canadian family, 2003**

Income taxes	\$ 8,887
Sales taxes	4,507
Liquor, tobacco, amusement & other excise taxes	1,772
Automobile, fuel & motor-vehicle license taxes	733
Social security, medical & hospital taxes	5,659
Property taxes	2,375
Import duties	241
Profits tax	2,556
Natural resource taxes	333
Other taxes	578
<b>Total taxes</b>	<b>27,640</b>

**SOURCE** Fraser Institute, *Tax Facts 13*, Table 3.4, p. 37.

the family’s income; but some of the income from the items mentioned above — whether wage or investment income — would have been larger except that taxes were paid on it by an employer or corporation. Since all of these taxes are treated as taxes paid by the average family in the Institute’s calculation, it is necessary to add them to family income.

When these three categories of income are added together, the Institute shows that the average family’s “total income before taxes” amounted to \$90,458 in 2003.

In calculating the taxes paid by the average Canadian family, the Fraser Institute simply takes the total amount of various taxes collected by Canadian governments and divides this amount by the number of Canadian families. **Table 2** shows the resulting taxes they claim are paid by the average Canadian family.

Once the average Canadian family's income and taxes paid are determined, calculating tax freedom day is simple. First the percentage of its income that the family pays in taxes is calculated. The Fraser Institute notes that the average family's taxes — \$27,640 — are 47% of its cash income, which they calculate as \$58,782. Second, that percentage of the number of days in the year is cal-

culated. Forty-seven percent of 365 is 172; June 21 was the 171<sup>st</sup> day in the year in 2003, hence the next day, June 22, should have been designated tax freedom day according to the Fraser Institute's calculations in *Tax Facts 13*. However, as explained below, since in its press release it fails to count unattached individuals, it proclaimed that tax freedom day was June 28 that year.

## 4 What Is Wrong and Misleading about the Fraser Institute’s Calculation of Tax Freedom Day?

### 4.1 The Institute seriously understates the income of Canadian families by calculating their effective tax rates based only on their cash income

One of the most misleading aspects of the Institute’s calculation of tax freedom day is that it dramatically understates the income of taxpayers, and therefore significantly overstates their effective tax rates. Instead of using “total income before taxes” as a measure of the average family’s income, in calculating its tax freedom day it uses the family’s “cash income” — a much more limited definition of income. As a result, the average family’s taxes — \$27,640 — seem huge in comparison to its cash income of \$58,782.

This means that amounts that clearly increased the family’s economic well-being, such as contributions to their pension plans and employer-paid health premiums, were not counted as part of their income for the year. Moreover, the family was treated as having paid certain taxes, such as the employer’s share of payroll taxes and taxes paid by corporations on their profits, even though the income out of which those taxes were paid was not included in the family’s income.

Using cash income to calculate tax freedom day results in the average family paying 47% of its income in taxes in 2003. Thus, tax freedom day fell on June 22. If tax freedom day had been calculated based upon an average family’s total in-

come, it would have been treated as having paid only 31% of its income in tax — and tax freedom day would have fallen on April 24, 58 days earlier than the date cited by the Institute.

This misuse of statistics is so egregious that naturally the Institute is aware of it. However, in its press release on tax freedom day, it makes no mention of this dubious use of statistics. It simply reports the average family’s cash income as implicitly being its sole income. In *Tax Facts 13*, the Institute gives this feeble explanation for using the average family’s cash income instead of its total income: “If we told people that taxes are 31% of their total income before tax, they would have a large task ahead of them to estimate all the types of income that must be included to arrive at this measure of income...Cash income is a useful tool in describing the tax burden because it does not force people to go through arithmetic gymnastics to arrive at their total income before tax to get an idea of how large the total tax burden is.” (pp. 37-38)

This is ridiculous. The Institute implies that it is sparing people from complicated calculations, but it has already done the calculations for them. It has already arrived at a figure for “total income before taxes” — an amount clearly identified in its table as \$90,458 — so no arithmetic gymnastics are required.

Even if taxpayers might find the concept of cash income easier to understand than some no-

tion of total income, does that justify misleading them? If Canadian families are under a misapprehension about what their true income is, then the Institute should assist in promoting rational debate by informing them of this concept. More likely, however, the average family would find it hard to understand the justification for treating amounts such as contributions to their pension plan or private health insurance as not contributing to their well-being, or for treating them as having paid taxes out of income they didn't receive.

The question is: why did the Institute choose a less meaningful measure of income for its calculations? And the answer seems obvious: in order to make the taxes paid by the average family appear much greater than they are.

#### **4.2 Even the Institute's concept of total income understates the economic income of taxpayers**

The purpose of measuring total income in the national income accounts is to provide a measure of the value of the economic activity in the country. The purpose of measuring economic income for tax purposes is to provide a measure of taxpayers' ability to pay. Thus, there is no reason why these two income concepts should be the same. Numerous amounts received by taxpayers increase their ability to pay, but are not recorded in the national income accounts. These include, for example, gifts and bequests. Thus, when tax policy analysts measure effective tax rates paid by individual taxpayers, they invariably attempt to include these amounts in their income, thus resulting in lower effective tax rates.

As another example, a prominent source of individual income that is realized primarily by high-income individuals and not included in the national accounts is capital gains. Yet the tax that

individuals pay on capital gains is included in the national accounts as a tax that has been paid. Thus, even if the Fraser Institute were to use its measure of total income as a basis for calculating the taxes paid by the average family, it should add to it the capital gains realized by taxpayers in that year. If it didn't, it would in effect be counting the taxes paid on such income as part of the taxes paid by the average family, but not counting the income on which the taxes were paid. The tax freedom day calculations of the Tax Foundation in the United States are frequently criticized on these grounds.

#### **4.3 The Institute overstates the taxes paid by Canadians by treating certain non-tax sources of government revenue as taxes**

Taxes are normally defined as compulsory payments to the government for which the payer receives no specific benefit. In addition to taxes, governments also raise revenues through the sale of goods and services, licenses and permits, royalties, rentals, investment income, and fines and penalties. In Canada, these non-tax sources of revenue constitute about 18% of government revenues.

In calculating the taxes that Canadians pay, the Fraser Institute has included items that are more properly considered non-tax revenues. It claims to have derived its definition of taxes from the revenue sources used in determining equalization payments. (p. 6) However, not all of the sources of revenue that are considered for purposes of calculating equalization payments are appropriately treated as taxes paid by Canadian families. For example, the Institute includes the royalty payments made by oil and gas and mining companies as taxes paid by Canadians even though these royalty payments are more



properly regarded as non-tax revenues. They are equivalent to rental or royalty payments the government receives for the use of its lands and resources. Adding these to the calculation of the average family's taxes seems odd, to say the least. It does, however, produce the desired result of bumping up the amount of taxes paid by the average family.

In *Tax Facts 13*, the Institute acknowledges this misclassification, to some extent, by providing a separate calculation for the ratio of taxes to income for those provinces with large natural resources revenues. Only if such royalties are not counted as taxes does Alberta become the lowest taxed province. (72)

#### **4.4 The Institute overstates the taxes paid by the typical family by calculating the income paid by the average family instead of the median family**

Another distortion is the Institute's use of the concept of the "average" family as opposed to the "median" family. In order to provide Canadians with a sense of how much tax they pay, the Fraser Institute claims that the average Canadian family did not start working for itself until June 28 in 2003. Presumably, since most families think they are about average, this was meant to suggest that most families paid about one-half of their income in taxes. But no family receives the average amount of income, and the average income of Canadians is certainly much more than that received by the typical family.

The average of anything is simply a statistical construct, in this case derived by dividing total income by the total number of families. Since a relatively small number of Canadian families are very wealthy, the income of the average Canadian family is considerably above that of the typical family. (The income of an average family

with two or more members in 2003 was \$73,400 in 2002 constant dollars, but the median income for families with two or more persons in 2003 was only \$60,900 in 2002 constant dollars.)

If the typical Canadian family is assumed to be the median family—the family at the midpoint in the income scale, where 50% of the families are richer and 50% poorer—obviously tax freedom day would come much sooner than the day suggested by the Institute.

To provide a sense of how silly the Fraser Institute's idea of the average family is in this context, imagine that the tax system were changed so that all taxes were paid by only the richest 10% of Canadian families. The other 90% of Canadian families were relieved from any obligation to pay tax. Yet tax freedom day for the average family would not change because the amount of taxes collected remains the same and total income and the total number of families has not changed.

The misleading method of using the income received by the average family can also be seen from **Table 1** where the Institute has the average family receiving \$1,703 of interest income, \$661 of dividends, and benefiting from \$2,623 of corporate retained earnings. Members of a typical Canadian family, which almost invariably has net interest expenses instead of net interest income, would no doubt be surprised to learn they had benefited from these amounts during the year.

In its press release announcing tax freedom day, the Institute does not explain that the great majority of Canadian families do not pay as much tax as suggested by its concept of the average family. However, in *Tax Facts 13*, it does attempt to calculate the effective tax rates of families in different income deciles (p. 65). Based upon the Institute's concept of cash income, this is what it found: The effective tax rate of the 10% of Canadian families with the lowest incomes is only 15.3% (which would put their tax freedom

day on February 27, 2003); the effective tax rate of the families in the fifth decile (their income placed them in the 40% to 50% of families) is 44.8% (which would put their tax freedom day on June 14, 2003); and the richest 10% of Canadian families have an effective tax rate of 59.1% (which would put their tax freedom day on August 5, 2003).

On the basis of the more realistic total income of these families, the poorest 10% of families had an effective tax rate of 12% in 2003, which meant their tax freedom day would be on February 15; those families in the fifth decile had an effective tax rate of 28.8%, which meant their tax freedom day would be on April 16; and the richest 10% of families had an effective tax rate of 39%, which meant their tax freedom day would be on May 24, 2003.

Not everyone agrees that the tax system is as progressive as the Fraser Institute finds it to be. Indeed, some analysts suggest it is almost flat for most families when all taxes are considered. But it is blatantly deceptive for the Institute to calculate average tax burdens that blur distinctions in the rates paid by families in different income groups, and at the same time to denounce the increasing proportion of taxes paid by upper-income taxpayers.

#### **4.5 The Institute's calculations are misleading because the Institute is inconsistent in its use of the family unit**

All of the figures given above are from *Tax Facts 13* and show how the Institute calculates effective tax rates. They are based upon all families with one or more members; that is to say, the Canadian population is divided into families and unattached individuals. These were the family units that the Institute previously used in calculating tax freedom day. However, beginning with *Tax Facts 10*, and in its press release announcing the celebration of tax freedom day, the Institute based its calculations only on families with two or more individuals. Since such families are on average richer than unattached individuals, this means that the so-called average family has a higher income and thus a higher effective tax rate than families that include unattached individuals.

The Institute's calculations show that it estimated that in 2004 families with two or more individuals had an average effective tax rate of 48.2% (once again, based upon the weird notion of only cash income), while families and unattached individuals had an effective tax rate of slightly less than 46.9%. It appears that the Institute changed its use of family units because ignoring unattached individuals suggests that the taxes paid by its "average" family were even greater.

## 5 How much have the taxes of average families increased over the past 42 years?

Along with tax freedom day, another disingenuous conceptual innovation the Fraser Institute uses to demonstrate how much tax the average Canadian family pays is the “consumer tax index.” This term was used so that it would appear to correspond with the Consumer Price Index. The CPI measures the change in prices for private goods and services; the consumer tax index was designed to answer the question: “How has the tax burden of the average family changed since 1961...?” (p. 40) Or, in other words, the index was

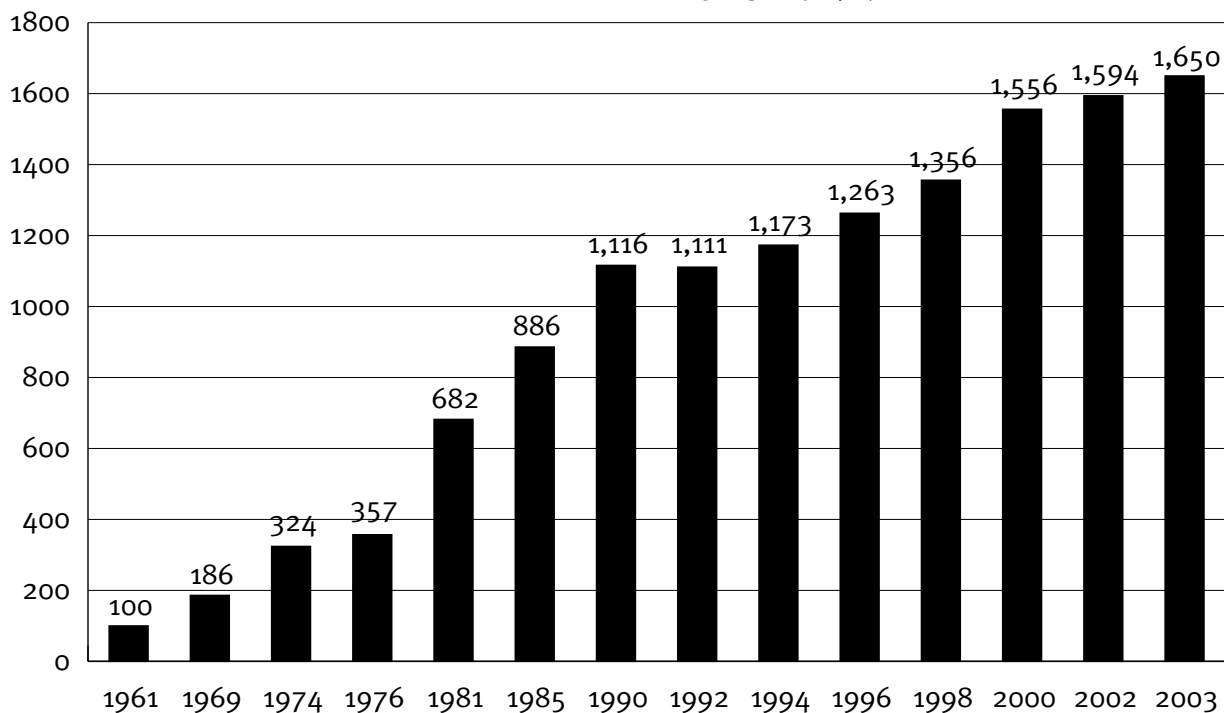
designed to measure “changes in the price that Canadians pay for government.” (p. xv)

The consumer tax index was set at 100 in 1961, and measures the increase in taxes since then, as calculated using the method outlined above for total family units. The index is illustrated in **Figure 1**, which some business columnists have simply reproduced without critical comment.

The index suggests that taxes have soared in Canada over the past 42 years — that they have increased 1,550%. *Tax Facts 13* notes that this

**FIGURE 1 The Canadian Consumer Tax Index, 1961-2003**

SOURCE Fraser Institute, *Tax Facts 13*, Figure 4.1, p. 41.



index “has been widely used by financial and consumer affairs columnists across the country to describe how the Canadian tax system has evolved.” (p. 40)

The most obvious problem with this index of increasing tax payments is that it takes no account of inflation — that is, of the declining value of the dollar. Yet, comparing the \$1,675 of taxes that the average Canadian family paid in 1961 with the \$27,640 they paid in 2003 is meaningless without taking inflation into account. It is like comparing a fixed number of dollars with a fixed number of yuan without taking into account the exchange rate.

Of course, the authors of the Canadian consumer tax index are aware of this, but why would they let such an absurd statistic stand? Perhaps they thought that, since the Canadian consumer tax index was supposed to be the counterpart of

the CPI, it should not be adjusted to take the CPI into account. But that makes no sense. What is bought with tax dollars each year has to be purchased with dollars valued in that year.

As *Tax Facts 13* itself notes, when inflation is taken into account, taxes only increased by 152.6% over this period. (p. 41)

This is still a substantial increase. Almost 70% of this increase, however, can be attributed to the significant real increase in the incomes of Canadians over this period. Only about 30% of the increase is because effective tax rates increased.

The Institute itself calculates in *Tax Facts 13* that effective tax rates for the average family increased by 40.4% over this period. Is rational public discussion of the tax system likely to be furthered if Canadians are told that their taxes have increased by 1,550% since 1961, when in fact their taxes have increased by only 40.4%?

## 6 How much does the average family spend on taxes compared to necessities such as food, clothing, and shelter?

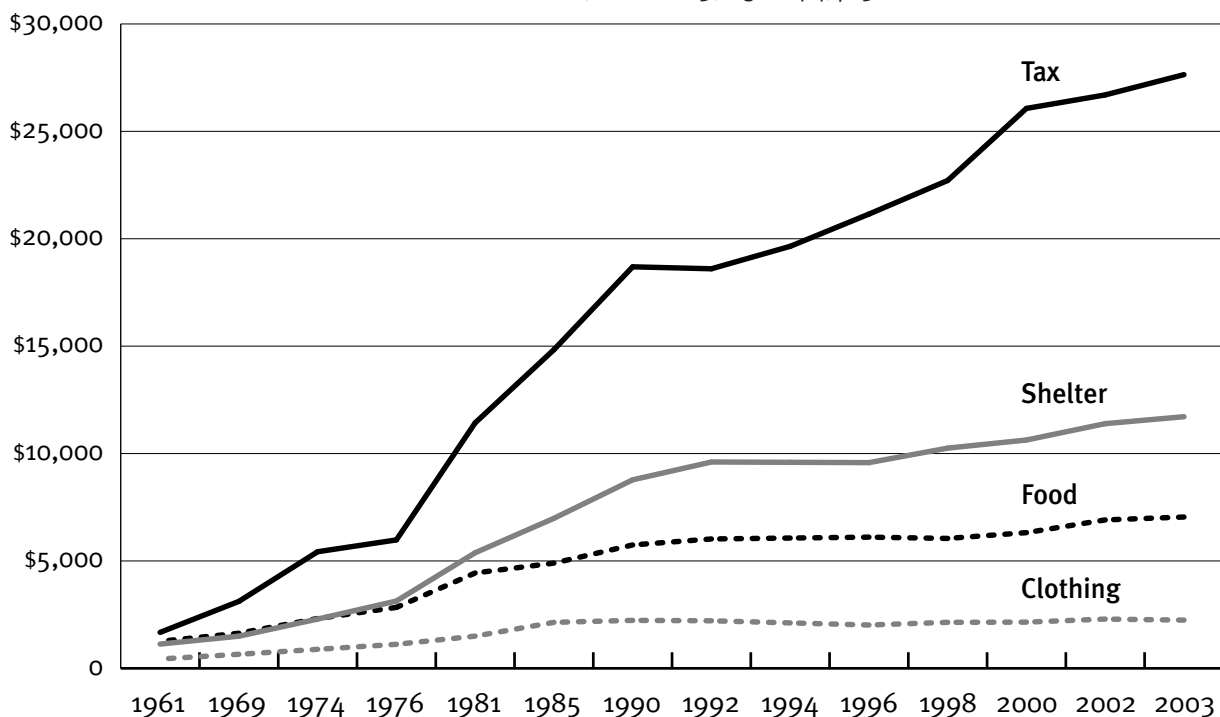
As another way of making the taxes that Canadians pay sound onerous, the Institute compares how much the average family spends on taxes with how much the family spends on necessities such as food, clothing, and shelter. **Figure 2** is sometimes reproduced in the press.

*Tax Facts 13* makes the point that “expenditures on shelter rose by 936%, food by 460%, and clothing by 416%. Meanwhile, the tax bill of the average family is alleged to have grown by 1,550%.” (p. 45)

Again, quite inexplicably, in presenting these numbers the Institute does not control for inflation. Nevertheless, the direction of change is apparent. Families *are* spending more on taxes and less on necessities. In another table, the Institute converts these numbers to a percentage of the average family’s income. It shows that in 1961 the average Canadian family spent 22.1% of its income on taxes and 37.3% on necessities. By 2003, it was shown to be spending 30.6% of its income on taxes and only 23.2% on necessities. (p. 48)

**FIGURE 2 Taxes and Basic Expenditures of the Basic Canadian Family, 1961-2003**

SOURCE Fraser Institute, *Tax Facts 13*, Figure 4.4, p. 36.



In this section of its monograph, when calculating the percentages of income the average Canadian family spent on taxes and necessities, the Institute uses the family's total income instead of its cash income. Presumably they did this since, if cash income were used instead of total income, the average family would seem to have spent over 82% of their income on taxes and necessities, instead of only 53.9%. The Institute must have felt that to indicate that the average family had spent such a high a percentage of its income on taxes and necessities would have confused people, exposing, of course, the silliness of the concept of cash income in the first place.

This comparison between amounts spent on taxes as compared to necessities over the past 43 years is misleading in many ways.

**First**, it is misleading to compare the taxes that a family pays to amounts spent on specific private goods such as shelter, food, and clothing. Taxes do not represent the purchase of one undifferentiated type of good or service. Taxpayers buy a hugely diverse bundle of goods and services with their taxes. One could say, for instance, that in 2003 the average Canadian family spent 2.5% of its income on clothing, 7.8% on food, and 13% on shelter, while through its taxes it spent the following percentages on public goods and services from which its members benefited (using the Institute's assumption that the average family earned \$90,458 and paid \$27,649 or 30.6% of their total income in taxes in 2003): 1.4% supporting the elderly through the old age security program; 0.5% supporting children through the federal child tax benefit program; 0.9% on employment insurance benefits; 2.3% on medical care; 2% on hospital care; 1.1% on other health services; 2.5% on elementary and secondary education; 1.6% on universities and community colleges; 0.9% on national defence; 0.2% on federal government policing; 1.3% on highways and

other public transportation and communication; 1.3% on resource conservation and industrial development; 1.1% supporting government institutions and general government services; 0.8% on recreational and cultural activities; 0.4% on foreign affairs and international assistance; 0.1% on research institutes; and so on.

**Second**, while the quality of the food, clothing, and shelter that families consumed improved over this period, the basic function of these purchases remained the same. However, the basic functions served by the goods and services that families purchased with their taxes changed enormously over this period. Among the many additional government programs available to Canadians since 1961 are a universal system of health insurance, the Canadian Pension Plan, and an enriched employment insurance program. That is to say, since 1961 Canadians have demanded a good deal more from their governments in order to enrich the quality of their lives.

**Third**, the use of averages is particularly misleading in these comparisons. High-income families pay a small percentage of their income on necessities and much more on taxes, while lower-income families pay a much larger percentage of their income on necessities; indeed, most of their income is consumed by these expenditures.

**Fourth**, a simple comparison of the relative amounts families spent 43 years ago on taxes and necessities with what they spend today is misleading since it fails to account for the growth in the income of families. As the Institute's data show, the average Canadian family has become considerably wealthier in real terms over the past four decades. As families become wealthier, they spend a smaller percentage of their income on necessities and a larger percentage of their income on goods that increase the quality of their lives and their children's lives, such as education, health, insurance against economic risks,

and expenditures that increase the vibrancy of their communities. Canadians have democratically decided to deliver these goods and services primarily through the public sector. Thus, as Canadians become wealthier, it would be natural to expect that the amount they spent on these goods through their taxes would increase relatively more than the increase in the amount they spent on necessities.

Furthermore, there have been enormous productivity gains in the production of food and manufactured goods such as clothing and shelter, but significantly fewer productivity gains for

the delivery of personal services such as education and health care. Back in 1961, it took 60 minutes for a teacher to give a one-hour class, and 60 minutes for a nurse to monitor a patient for one hour; and in 2005 it still takes 60 minutes. This means that the production of food, clothing and shelter have become relatively less expensive than the production of many labour-intensive, government-provided services. Consequently, just to maintain the same level of government services that Canadian families have always received, they must be prepared to pay relatively more for them than they pay for food and manufactured goods.

## 7 Conclusion

In *Tax Facts 13*, the Fraser Institute claims that the sole purpose of its analysis is to inform Canadians about how much tax they pay and promote rational public debate. In its annual press release, it claims that “Tax Freedom Day is not a reflection of the quality of the product, how much of it each of us receives, or whether we get our money’s worth. It’s up to individual Canadians to decide how much value they receive in return for their tax dollars.”

Yet the Institute has presented us with information that seriously distorts the picture of how much tax Canadians pay. Far from promoting rational discussion, the Institute is clearly trying to incite Canadians to anger, to encourage them to join with members of the financial elite in a kind of collective “tax rage.” The ultimate result of its campaign will be even lower taxes, particularly for high-income Canadians—and a continued decline in the capacity of our governments to deliver programs that most Canadians value.

If the Fraser Institute had truly wanted to inform Canadians about the general amount of taxes they pay, they could have simply referred Canadians to the annual Organisation for Economic Co-operation and Development (OECD) publication, *Revenue Statistics*. The most recent edition shows that in Canada taxes were 33.9% of gross domestic product (GDP) in 2002. Thus, taxes in Canada were indeed higher than in the United States, where they were only 26.4% of

GDP. But the United States has one of the lowest levels of taxes among industrialized countries, whose average tax level is considerably higher than Canada’s at 36.3% of GDP. The average level of taxes among the European countries of the OECD is even higher at 38.9% GDP.

Or, if Fraser Institute had truly wanted to promote rational public debate about taxes in Canada, it might have simply informed Canadians about the results of the most thorough and comprehensive study of tax incidence in Canada, which was authored by Frank Vermaeten, W. Irwin Gillespie, and Arndt Vermaeten, and published in the *Canadian Tax Journal* in 1994, “Tax Incidence in Canada.” Although the results are based upon data from 1988, the tax system has not changed substantially. These authors found that, based upon the most reasonable assumptions about the incidence of Canadian taxes, the Canadian tax system was about flat. **Figure 3** illustrates their findings. The incidence of each individual tax is given on the left-hand axis of the graph. It shows that the personal income tax and the corporate income tax (at least at the very high-income level) are the only progressive taxes in the Canadian tax system. All other taxes are regressive. Low-income families pay a higher percentage of their income in these taxes than do high-income families.

The overall effective tax rate for Canadian families is given on the right-hand axis of the

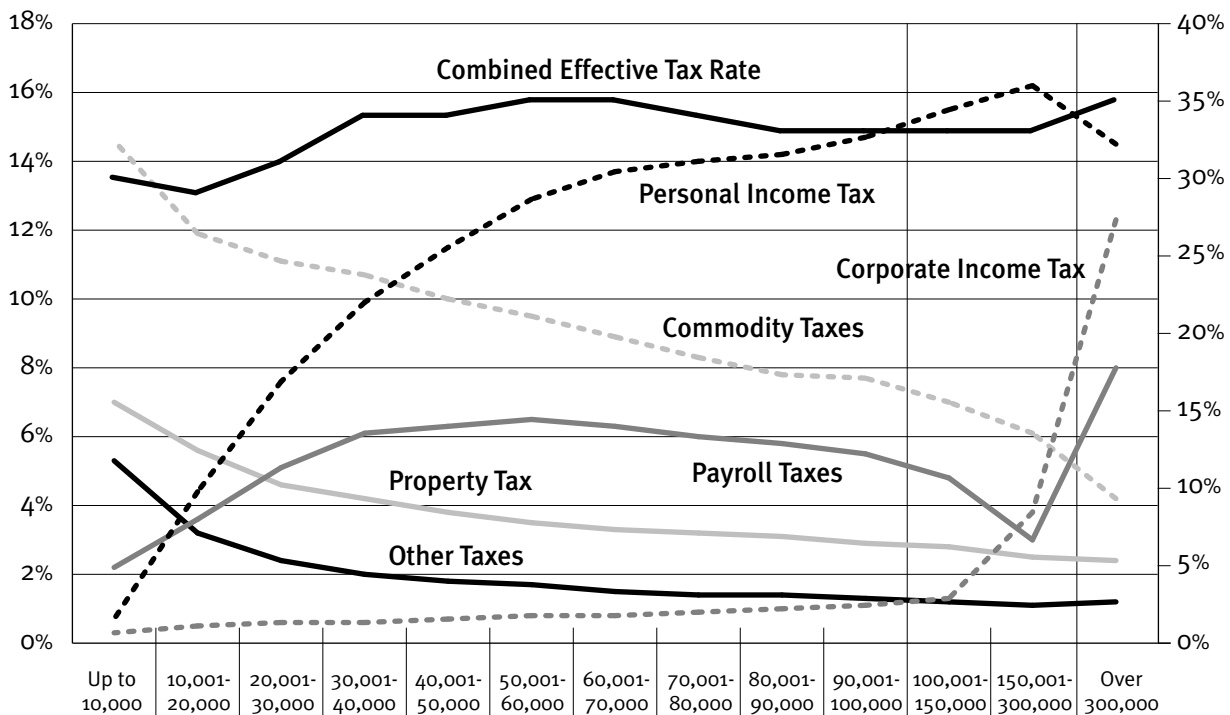


graph. All families, whether their income was \$30,000 or \$300,000, paid from about 30% to 35% of their income in taxes.

Public opinion surveys suggest that most Canadians favour a progressive tax system — one in which high-income individuals pay a greater percentage of their income in tax than do low-income individuals. Canadians would undoubt-

edly be surprised to learn that the Canadian tax system is essentially flat. If the Fraser Institute presented this information to the public, it would no doubt have provoked rational debate — but debate that would probably lead to a public outcry, not for tax reductions, but for tax increases on the rich.

**FIGURE 3 Effective Tax Rates in Canada, 1988**  
 SOURCE Frank Bermaeten, W. Irwin Gillespie and Arndt Vermaeten, "Tax Incidence in Canada" (1994), vol. 42, no. 2, Canadian Tax Journal 348-416.



## 8 References

Information about Tax Freedom Day is available on the Fraser Institute's web site at <http://www.fraserinstitute.ca/>. A week before the date, it issues a press release that usually contains a description of it with appropriate quotes from Institute employees. It also usually publishes an article in the July issue of the *Fraser Forum* that contains more details. The issue of the *Fraser Forum* about tax freedom day in 2004 is available at <http://www.fraserinstitute.ca/shared/readmore.asp?sNav=pb&id=677>, while the 2004 news release is at [www.fraserinstitute.ca/shared/readmore.asp?sNav=nr&id=613](http://www.fraserinstitute.ca/shared/readmore.asp?sNav=nr&id=613). Most details are found in their biennial publication, *Tax Facts*. Niels Veldhuis, Joel Emes and Michael Walker, *Tax Facts 13* (Vancouver: The Fraser Institute, 2003) (released on February 4, 2004).

In the U.S., the Tax Foundation annually publicizes "Tax Freedom Day" — see Tax Foundation, Special Report, April 2005, No. 134, "America Celebrates Tax Freedom Day" at <http://www.taxfoundation.org/files/8aeoffb685f381da2b2fc6d035513ac7.pdf>. Citizens for Tax Justice debunked the tax freedom day concept almost a decade ago in a February 17, 1997 article by Robert S. McIntyre and Michael P. Ettlinger entitled "A (Belated) Happy Income Tax Freedom Day!" The Center on Budget and Policy Priorities now responds to the Tax Foundation report annually, with a good summary explaining why the "Tax Freedom Day" concept is

silly and inaccurate when it is used to estimate middle-class tax burdens. See Joel Friedman, David Kamin, and Robert Greenstein, "Tax Foundation Figures Do Not Represent Middle-Income Tax Burdens: Figures May Mislead Policymakers, Journalists and the Public," (April 7, 2005) at <http://www.cbpp.org/4-7-04tax.pdf>.

For Milton Friedman's suggestion for a national holiday celebrating Personal Independence Day, see Milton Friedman and Rose Friedman, *Free to Choose: A Personal Statement* (New York: Harcourt Brace Jovanovich, 1980), at 56. For Grover Norquist's calculation of the cost of government day, see Americans for Tax Reform, Cost of Government Day at <http://www.atr.org/national/cogd/>. For a discussion, see Mark Q. Rhoads, "The Most Certain Thing in Washington," *The World and I*, May 1994, 90-93.

For a description of the early work of the Fraser Institute on the Canadian tax system, see Michael Walker, "Measuring and Coping with a Progressive Tax System or Robin Hoodery — A Canadian Tradition Past Its Prime" vol. 2, no. 1 *Canadian Taxation: A Journal of Tax Policy* (Spring, 1980), at 8-15. This past year Jonathan Chevreau's column on tax freedom day was at "Don't forget to vote on Tax Freedom Day: 'More than a little ironic' that June 28 plays dual roles" *National Post*, June 22, 2004, IN1.

The statistics on government spending were drawn from financial management system data from Statistics Canada, see CANSIM 3850001 and CANSIM 3850002. By far the best and most detailed annual description of government spending in Canada is Karin Treff and David B. Perry, *Finances of the Nation 2004* (Toronto: Canadian Tax Foundation, 2005), available at <http://www.ctf.ca/FN2004/finances2004.asp>.

For a detailed and scholarly analysis of tax incidence in Canada, see Frank Vermaeten, W. Irwin Gillespie, and Arndt Vermaeten, "Tax Incidence in Canada," vol. 42, no. 2, *Canadian Tax Journal* 348-416 (1994).

OECD, *Revenue Statistics 1965-2003* (Paris: OECD, 2004).