ASK A BRITISH COLUMBIAN ABOUT TAXES, and you’ll likely hear some variation on the idea that everyone should pay their fair share. Most people assume that the wealthy pay more, not only in straight dollars, but also a higher tax rate as a share of their income. So they would be shocked to learn that, in reality, that is not how our provincial tax system works.

This report examines changes to the provincial tax system over the last decade. We look at the total provincial tax rate for households at different income levels (the actual tax bill as a share of household income for all personal provincial taxes combined—income, sales, carbon and property taxes, and MSP premiums).

We find that together these changes have created a tax system where the rich now pay a lower total provincial tax rate than the rest of us.

- In 2000, most BC households paid about the same total tax rate, with households in the top 10% and top 1% paying a little more.
- By 2010, however, the tax system had become regressive, with the richest 20% of households paying a lower total tax rate than the rest of us.

This regressive tax shift was driven by the following:

- Large income tax cuts primarily benefited upper-income earners, both in dollar terms and as a share of income.
- Combined, tax cuts delivered an average of over $9,200 per year to the richest 10% of BC households, and more than $41,000 to the top 1%. In contrast, lower income households received an average tax cut of $200 per year, and those in middle got just over $1,200.
As a share of income, this translates into a 3.6% savings for the richest 10%, and a 5.1% savings for the top 1%. For the bottom half of households, in contrast, the tax cut benefit was about 1% of income.

BC now relies more heavily on regressive taxes: MSP premiums, the carbon tax, and sales taxes. These taxes hit lower- and middle-income households harder.

Changes in tax policy have shifted the provincial revenue mix:

- Between 2000 and 2010, the share of provincial government revenues coming from personal income taxes dropped by nearly one third.
- The province now collects more revenues from sales taxes (28% of revenues) than from personal income taxes (27% of revenues).
- BC families now contribute more in MSP premiums than businesses contribute in corporate income taxes.

British Columbians pay for tax cuts in reduced public services:

- Between 2000 and 2010, BC’s tax revenues fell by 1.7% of GDP (the size of the province’s economy). That may sound like a small change, but it’s equivalent to $3.4 billion. Meaning, if we’d kept our tax system the same, we’d have $3.4 billion more to spend on needed public services today.

This report recommends that the provincial government create a Fair Tax Commission to look at how we pay for the services and infrastructure we need, and make sure everyone contributes their fair share.

**INTRODUCTION**

“It is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenues, but something more than in proportion.”

— Adam Smith in *The Wealth of Nations* (1776)

Adam Smith, the father of modern economics, is often taken to be the patron saint of free market economics. But Smith was, in fact, more moderate than modern-day free marketeers and argued that key functions of the economy should be the domain of the public sector. He was also one of the first advocates for what is known as progressive taxation: the fundamental principle that those with higher incomes pay more tax, not only in dollar terms but also as a share of their income, than those with lower incomes. Most British Columbians would agree with Adam Smith that it is fair for those among us who are better off to shoulder a higher share of the public expense than those with smaller incomes.

Most British Columbians already believe this is how our provincial tax system works. This is likely because one of the most prominent taxes we pay, the income tax, is progressive; with our provincial income tax system’s five income brackets, higher tax rates kick in as people earn higher amounts of income. The problem, however, is that personal income tax is only one of several provincial taxes we pay.

Other taxes operate differently and end up costing lower income people a higher proportion of their incomes than higher income people pay (called regressive taxes). Provincial sales tax is an example of a regressive tax. Sales taxes charge everyone the same tax rate per dollar of consumer spending, but it eats up a higher share of the total income of lower income families because they tend to consume almost all
of their income. Higher income families, in contrast, consume a smaller share of their total income as they have the luxury of saving some of their incomes.

MSP premiums are another example of a regressive tax in BC, as the same per-person amount is charged regardless of household income (above a low income threshold). The lower the family income, the higher the share taken up by the fixed MSP premium.

In this short paper, we review changes to BC’s tax system over the last decade, with an emphasis on how these changes have affected households at different income levels. Our analysis reveals that after a decade of extensive change, BC’s provincial tax system fails Adam Smith’s test of fairness: British Columbians with lower incomes are paying a higher share of their income in taxes than their neighbours with higher incomes.

**TAX CHANGES OVER THE LAST DECADE**

Beginning with an across-the-board 25% reduction in personal income tax rates and a three percentage point reduction in the corporate income tax rate in 2001, through to the controversial decision to introduce a Harmonized Sales Tax (HST), the BC government has reshaped BC’s tax system over the last decade.

The changing mix of BC government revenue sources is illustrated in Figure 1. Between 2000/01 and 2010/11, personal income tax revenues dropped by almost one third, from 39% of all taxes to 27%, while sales tax revenues climbed from 24% to 28%. The province’s reliance on regressive MSP premiums has increased substantially, and we have also seen the introduction of the carbon tax.

Notably, our provincial government now collects more revenues from sales taxes than from personal income tax. Even more surprising is that in 2010/11, British Columbians paid more in MSP premiums than businesses paid in corporate income tax.

![Figure 1: Share of BC tax revenues by source, 2000/01 and 2010/11](image)

Source: Authors’ calculations based on *BC Financial and Economic Review – July 2010*, Table A2.5 and BC Budget 2011, Table A10.
THE EROSION OF TAX FAIRNESS IN BC

What do these changes mean for BC households? Figure 2 compares the total provincial taxes that households paid as a share of their total income in 2000 and 2010. We focus on personal provincial taxes, which are taxes that households pay directly, including income taxes, sales or commodity taxes, property taxes, carbon taxes and MSP premiums. Using a database produced by Statistics Canada, we examine what households actually paid in total provincial taxes. Note that business taxes are not included in this analysis, even though corporate tax cuts have been substantial over the past decade.

We rank BC households according to their total income (including employment income, other market income and government transfers), and divide them into 10 deciles – groups of equal size – from the poorest 10% of households (D1) to the richest 10% of households (D10). This allows us to see how taxes have changed for households at different points on the income spectrum. We further break down the top 10% (the richest BC households) into the top 1% (percentile 99-100), the next 4% (P95-99), and the next 5% (P90-95). More details on data and methods are provided in the Technical Appendix.

Our analysis reveals that the BC tax system was neither progressive nor regressive in 2000 for the vast majority of households, as families in different income groups paid roughly the same share of their incomes in provincial tax. BC’s tax system in 2000 was modestly progressive at the very top, with the richest 1% of BC households paying on average 16% of their incomes in tax, while the next richest 4% paid 14% of their incomes in tax.

At the bottom of the distribution, the total tax rate is higher, although some caution is urged in how this is interpreted. First, there is a greater tendency of families in this group to borrow in order to finance their consumption, thus having expenditures higher than their actual incomes. In addition, some families in the lowest deciles can have low declared incomes for the year, but higher levels of consumption – such as those who are self-
employed and declare a capital loss for the year. The bottom decile is difficult to analyze in more detail because it is composed of a mix of families who are truly poor and those who appear to have low incomes because they are able to avail themselves of the tax code’s capital loss provisions.

In addition, low-income tax credits for sales and carbon tax amounts are counted as income, as accounting convention treats them as income transfers (the government, after all, cuts cheques to people who qualify for these credits, based on their previous year’s income, rather than deducting an amount from their taxes). In recognition that these sales taxes (the HST and carbon tax) are inherently regressive, the government introduced the low-income credits in an effort to mitigate this reality. That said, this impact is small and does not fundamentally change the conclusions about how the tax system has changed over time.⁶

By 2010, BC’s tax system as a whole had become regressive. This is the direct result of sharp reductions in the progressive income tax that disproportionately benefited households with higher incomes, combined with increased reliance on regressive sources of taxation, notably sales taxes, the carbon tax and MSP premiums.

Figure 3 breaks down households’ 2010 tax bill by type of tax. Note that the composition of a household’s tax bill as a share of its income is very different for households along the income spectrum. Households in the lower half of the income ladder pay a larger share of their income in commodity taxes, property taxes and carbon taxes than those in the middle or top of the distribution. It’s easy to see that provincial income tax is progressive, with higher income families paying a higher share of their income in the tax, while commodity taxes, property taxes and carbon taxes are regressive. MSP premiums are progressive in the bottom half of the distribution, due to the recent improvements in premium assistance, but they are regressive in the top half of the distribution.

Currently, our tax system fails the test of fairness across income groups, as BC’s wealthiest contribute less to the provincial treasury, in proportion to their means, than lower-and middle-income families.

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Currently, our tax system fails the test of fairness across income groups, as BC’s wealthiest contribute less to the provincial treasury, in proportion to their means, than lower-and middle-income families. Figure 4 shows that BC taxes declined for every income group, though the gains were larger as income increased. The average tax cut was 2.3% of income, but the vast majority of British Columbian families got less.

For the bottom half of households the average tax cut was only about 1% of income. The value of the tax cuts increased to 1.8% of income for the upper-middle households (D6-D8), rose again to 2.2% for households in the second-highest decile, and amounted to 3.6% for those in the top decile. The richest 1% of BC households gained the most, saving an equivalent of 5.1% of their income on average. The outcome of this shift is that the wealthy are now contributing a smaller share of total taxes paid. For example, the richest 1% of households saw their share of total BC personal taxes paid drop from 14.7% in 2000 to 12.8% in 2010.

In dollar terms, lower income households received an average tax cut of a couple hundred dollars per year, those in the middle (decile 6) benefitted just over $1,200, and those in the top decile pocketed on average over $9,200 more per year in combined tax savings. For the top 1%, the tax cut is worth more than $41,000 per year – their tax cut is larger than the average incomes of any household in the bottom third of the distribution.

Note that the average tax cut is skewed by the large tax savings at the top of the income distribution and does not accurately characterize the experience of a representative BC household. This highlights the danger of focusing on averages when the underlying distribution is highly unequal, and reminds us of the importance of examining the entire distribution when talking about tax changes.
A CLOSER LOOK AT THE CHANGING TAX MIX FOR HOUSEHOLDS

Income tax cuts were the main driver of lower overall tax rates in BC. The 2001/02 income tax cuts reduced income tax rates in all brackets, with slightly higher reductions for the top three brackets. It was these very large tax cuts early in the decade that drive much of the erosion in progressivity, and account for almost the entire share of tax savings at the higher end of the income spectrum.

Figure 5 shows that the provincial income tax system continues to be progressive, but it has flattened out somewhat over the course of the last decade. The value of income tax cuts over the last decade averaged 2.8% of household income in British Columbia. However, low-income households do not pay much income tax to begin with, so they receive little from income tax cuts. The bottom 10% got an average income tax cut amounting to only 0.2% of their income. In contrast, at the top of the ladder, the richest 1% of households received income tax cuts equivalent to 5.2% of their incomes.

Figure 5 also shows that the actual provincial income tax rates paid by BC households bear little resemblance to the statutory provincial income tax rates that are listed on our income tax forms (in 2010 these ranged from 5.06% on income between $11,000 and $35,859 to 14.7% on income above $99,987). Yet even families at the very top—the richest 1% of British Columbians—paid only 8.5% of their total income in provincial income tax. In other words, after tax deductions and tax credits are taken into account, the effective income tax rate in BC is much lower than most people realize. The vast majority of British Columbians (the bottom 90%) are now paying less than 4% of their income in provincial income taxes.

Even families at the very top—the richest 1% of British Columbians—paid only 8.5% of their total income in provincial income tax. In other words, after tax deductions and tax credits are taken into account, the effective income tax rate in BC is much lower than most people realize. The vast majority of British Columbians (the bottom 90%) are now paying less than 4% of their income in provincial income taxes.
For middle-income families (those in deciles 4 to 9), gains from income tax cuts were somewhat offset by increases in MSP premiums, which rose by as much as half of a percent of income for deciles 4 and 5. Because MSP premiums are a fixed dollar amount based on family size, they inevitably shrink as a share of income as income rises. In fact, for the top 1% the difference between 2000 and 2010 is negligible (and rounds to zero). Note that many British Columbians who work full-time for large employers have their MSP premiums paid by their employer, which is not necessarily captured by the model. To the extent that households with higher incomes are more likely to have this benefit than lower-earning households, the distribution of MSP premiums is more regressive than our analysis shows.

For the bottom decile, exemptions based on income mean that the MSP premium rate they paid was effectively zero in both years. The BC government made its MSP premium assistance program slightly more generous in 2009, which virtually eliminated MSP payments for families in the second decile (they only received a partial subsidy in 2000).

Property taxes were virtually unchanged as a share of income for all groups. Low-income households may pay property taxes through higher rents passed on to them by landlords. All households are affected by property taxes whether they are homeowners or not.

Commodity taxes, including PST/HST, fuel and tobacco taxes, fell somewhat as a share of income for most groups. While tax rates were virtually unchanged in 2010 and some, like sales taxes, were even higher as more services became taxable under the HST, household incomes grew at a faster rate than tax revenues. This resulted in commodity taxes falling slightly as a share of income for most households. Households in the bottom half of the income distribution paid 0.6% to 0.8% less of their income in commodity taxes, while those at the top saw smaller declines, approaching zero at the top 5%. Commodity taxes are regressive, with the share of income paid to these taxes considerably larger for families in the bottom two deciles than for any other group.

CONCLUSION

After a decade of tax cuts, BC finds itself with a considerably different and much less fair provincial tax system. While we do not capture the full implementation of the HST, this context of regressive changes to BC’s tax system is important to the HST debate. While some important redistribution occurs through public spending (meaning, our public services and programs help to mitigate income inequality, and disproportionately benefit lower-income people), we should rightly be concerned about how the money for public spending is raised. And as this paper highlights, the province raises its revenues less fairly than it did 10 years ago.

These findings are consistent with previous CCPA reports, which have documented that provincial tax changes have not benefitted all British Columbians equally: personal income tax cuts have delivered the greatest share of the tax cut pie to upper income earners, while increases in user fees and head taxes like the Medical Services Plan premium have fallen more heavily on people with modest incomes.

BC now boasts the lowest personal income taxes for people earning up to $111,000 and one of the lowest corporate income tax rates in the country, but the savings have been small for most families and have largely gone unnoticed as user fees have risen, and a
number of public services have been scaled back or suffered from declines in quality due to underfunding. This shows clearly that the flip side of lower taxes is reduced fiscal capacity, as foregone revenue is no longer available to meet our collective needs.

In 2000/01, BC’s taxation revenues were 11.6% of GDP (the broadest measure of provincial income), but that figure had fallen to 9.9% of GDP by 2010/11. This may seem like a small change, but 1.7 percentage points out of a provincial GDP of about $200 billion amounts to $3.4 billion. In other words, if we had collected in 2010 the same share of our provincial economy in taxes as we did in 2000, we would have had $3.4 billion more in the public treasury. This could easily balance the BC budget and help pay for needed programs.

To the extent that regressive taxes are used in BC, compensating mechanisms must be enhanced to ensure that low- to middle-income earners are not made worse off. While regressive taxes such as the HST and the carbon tax have refundable low-income tax credits associated with them, the qualifying income thresholds for these credits are set too low and phase out too quickly (at relatively modest incomes). In practice, this results in most credits phasing out very steeply at incomes of around $30,000 for families, creating a large tax barrier for the working poor. This is a well-documented problem, which should be addressed by phasing out the credits more gradually as income rises.

Regressive changes to the provincial tax system exacerbate growing income inequality in BC. As the CCPA has noted elsewhere, the gap between the wealthiest and the majority of BC families has grown dramatically over the past 30 years. The share of income going to the richest 10% of families has grown fast, while the share going to the bottom half of families has declined substantially. This is true for both earnings and after-tax incomes. This trend needs to be reversed. After a decade of numerous changes to the tax system, it’s time for the provincial government to restore fairness by changing the level and mix of provincial taxes to ensure that the system is progressive overall.

A good way to ensure that the concerns of economic efficiency are balanced with concerns of fairness and equity in the distribution of total taxes is to convene a Fair Tax Commission. Such a commission could be tasked to examine the provincial tax system in its entirety and make recommendations for changes. The full range of how we raise taxes should be on the table—from resource royalties and business taxes, to personal income and sales taxes. Ideally, a Fair Tax Commission would ask: how much money do we need to raise to collectively pay for the services and infrastructure we wish to fund publicly? And second, what mix of taxes and other forms of revenue tools would allow us to raise these funds in a fair and efficient manner? Such an exercise should allow for public dialogue and deliberation, so that we can consider trade-offs together, and emerge with an overall tax system we understand to be fair.

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This paper examines changes in the BC provincial tax system between 2000 and 2010. 2000 is chosen as a starting point to provide a baseline reference point before extensive tax cuts were introduced by the BC government under Premier Gordon Campbell, the first wave of which came into force in 2001.

We use Statistics Canada’s Social Planning and Simulation Database and Model (SPSD/M). The SPSD/M contains a detailed database of 100,000 representative individuals in 40,000 families, drawn from tax, census and survey data sources. This is the same database used by governments in Canada when they analyze the impact of proposed tax changes. SPSD/M version 18.0 is used for this paper.

We examine income and tax distribution on the household level, to take account of the fact that individuals living together pool their resources. SPSD/M was run for each of 2000 and 2010 to allocate income and total provincial taxes across deciles for each of the two years. The top decile was broken into top 1% (P99-100), next 4% (P95-99) and next 5% (P90-95). Key subcategories of personal taxes (income tax, commodity tax, property tax, carbon tax and MSP premiums) were also allocated across income deciles in the two years of interest.

The definition of income used for the analysis is “total income,” which includes employment income, investment income, other market income, and government transfers. In analysis at the national level, Marc Lee (2007) uses a broader definition of income (called “broad income”) that includes items such as inheritances and gifts, employer-provided benefits, and accrued capital gains. However, data on those income sources are not available at the provincial level so we are not able to use this broader income definition in this report. In a “full incidence” analysis, imputed values for the benefits received from public services would also be included as income, but this would substantially complicate the analysis presented here.

There are data discrepancies between the SPSD/M and BC Budgets (the total amounts of provincial taxes paid by households in SPSD/M do not match exactly the total provincial tax revenues reported in the BC Budget). To be more accurate, we take the aggregate provincial tax amounts from the BC Budget, and allocate them across income deciles using the tax allocation shares across deciles derived from the SPSD/M.

We use income deciles because they provide a more appropriate comparison over time. For periods of five years or more, it becomes meaningless to compare fixed income groups (e.g. those with income under $10,000, $10,000–$20,000, etc.) because inflation and real wage growth will gradually move families upward in the income distribution, changing the composition of families in each fixed income bracket. Using deciles allows us to compare families in the bottom, middle and top of the income distribution in both years.

The SPSD/M does not easily consider the transition from PST to HST (in particular, shifts in taxes from business to households). The 2010 numbers include the first six months of HST as estimated by the SPSD/M.
NOTES

1 For an indicative list see a post by Gavin Kennedy, “How Laissez Faire was Adam Smith?” in Adam Smith’s Lost Legacy blog, http://adamsmithslostlegacy.com/2007/12/how-laissez-faire-was-adam-smith.html

2 Note that MSP premiums are not considered part of taxation revenues in BC government accounting practices. They are instead accounted for as “other revenue,” along with fees from post-secondary education and health care, motor vehicle licenses, and permits and other government fees and licenses. We include them in taxation revenues here because MSP premiums are mandatory for all British Columbians, which makes them much more similar to taxes than other government fees and licenses. The BC government appears to agree that MSP premiums should be considered taxes, as demonstrated by the fact that MSP premiums are regularly included in provincial tax comparisons in annual BC Budgets.

3 Sales tax revenues grew during the economic boom of the mid-2000s as incomes and consumer spending rose, stalled during the recession, and only picked up again in 2010/11. The 2010/11 increase in sales tax revenues is due both to increased consumer spending as the economy recovered and to the introduction of the HST, which is projected to collect more revenues than the PST.

4 Corporate income tax rates have fallen from 16.5% to 10% over the decade. Small business income tax rates have also been reduced. However, as the government’s reliance on personal income taxes has shrunk, corporate income tax revenues as a share of total government revenues have increased. (Note that if the HST survives the upcoming referendum, the corporate income tax is scheduled to increase back to 12%.)

5 The MSP amount used for the calculation is net of any premium assistance received. Commodity taxes include sales tax (PST/HST), fuel and tobacco taxes. The sales tax amount captures the introduction of the HST, which replaced the PST in July 2010.

6 For the bottom decile, when we calculate the HST and carbon tax low-income credits, and deduct these amounts from their income and their tax bill, the effective tax rate in 2010 drops from 17.6% (seen in the charts) to 14.8%; meaning, the effective tax rate falls, but at 14.8% it is still higher than for any of the other deciles. So the core finding of a regressive system does not change.

7 Note that Figure 4 plots only the difference between the two lines in Figure 2, which allows us to examine the data more easily.

8 This fact has been pointed out in PolicyNote.ca blog posts by Seth Klein, who reported paying provincial income tax equal to 3.46% of his gross income for tax year 2009. http://www.policynote.ca/income-taxes-are-a-steal-seths-tax-confessions/

9 Most economists argue that such benefits are passed along to workers in the form of lower wages.

10 It should be noted again that at the bottom of the income distribution, the regressive impact of PST/HST is partially offset by PST/HST low-income credits. This is particularly important after the introduction of the HST because the HST credit is considerably more generous than the PST credit that existed before.


12 These calculations are based on 2000/01 data from the BC Financial and Economic Update and 2010/11 estimates from the BC 2011 budget. Tax revenues include MSP.


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BC’s Regressive Tax Shift: A Decade of Diminishing Tax Fairness, 2000 to 2010

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A portion of this analysis is based on Statistics Canada’s Social Policy Simulation Database and Model. The assumptions and calculations underlying the simulation results are prepared by the authors; responsibility for the use and interpretation of these data is entirely theirs.