

Reforming the Income Tax Act to Drive Inclusive Prosperity and Support the Caring Economy

PRIORITIES FOR THE 2018 FEDERAL BUDGET

AUGUST 4, 2017
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The Income Tax Act is the government's most important economic policy lever. Revisions to the Act to nurture the "caring economy" would spur economic growth, create jobs and if done through an inclusive and innovative process help shift Canadians' mindsets and align their expectations with the realities of the 21st century information economy. Without revisions to the Act, the government's most important economic policy lever remains pointed to the industrial age of the 19th century, not to the future.

More productive people and more productive and competitive businesses can lead to enhanced growth and prosperity. But as our underlying economic model shifts, from the production and distribution of goods to the provision of services, our definition of productivity and competitiveness must also shift. In June 2016, the OECD committed itself "to redefine the growth narrative to put people's well-being at the centre of governments' efforts. Increasingly, "happiness" is considered to be the proper measure of social progress and the goal of public policy. The main factors found to support happiness – caring, freedom, generosity, honesty, health, income and good governance – could be nurtured through changes to the Income Tax Act.

Disruptive Forces Are Changing Everything

Disruptive forces – accelerating computing and communications technology, urbanisation, ageing demographics, globalisation and climate change – are transforming our economy, our jobs and our lives. More than three-quarters of Canadians are connected to the mobile internet via smartphone. Over 80% of Canadians live in urban centres versus 20% a century ago when income taxes were introduced. There are more Canadians over the age of 65 than there are under the age of 15 and life expectancy has increased from 65 to 85 in the past 20 years.

These forces are redefining the economic model; "jobs" (working for a company that gives you a T4 slip at the end of the year) are disappearing. According to The Economist, "in 1990, the three largest companies in the world (the three auto makers) had a market capitalisation of \$36 billion and employed 1.2 million people. In 2016, the three largest companies (Apple, Google and Microsoft) were worth more than \$1 trillion and employed 137,000 people." Closer to home, a recent speech by Brian Porter, CEO of Scotiabank to a group of students at Western University pointed out that "Tangerine (formerly ING Direct Bank) has 2 million customers and 1,000 staff; the rest of Scotiabank has 21 million customers and 90,000 staff." Clearly, it is possible to deliver financial services much more efficiently than the big six banks currently do.

As services including transportation, communications, banking, education, health care, become automated millions of jobs will disappear. Ontario is currently testing driverless automobiles, even though driving is the number one occupation for Canadian men. Thousands of clerical jobs will disappear as artificial intelligence and distributed processing technology streamline record-keeping activities. Manufacturing plants, like the Tesla assembly line have no workers; cars are being built by robots. And if robots can build high-end cars, then they can build anything.

But jobs are growing in the "caring economy." Projections from the U.S. Bureau of Labour Statistics show that four of the five fastest-growing occupations in the country involve personal care. With an ageing population, the need for health care workers will grow. With more women entering the work force, demand for quality child care services will also increase. Life-long learning will increase demand for education. There is a need for more mental health workers as

evidenced by the fact that suicide was the third highest cause of death in 2016. Many people will need mental and emotional support to cope with the new economic reality.

The massive socio-technological change has another effect. People feel isolated; they feel that their voice is not being heard. This suggests the need for a different approach to developing public policy – one that engages citizens in meaningful dialogue to envision and enact a different future, one in which they see themselves.

Growing the “Caring Economy” and Transitioning to the Information Economy

As machines take over more of the routine work, the need for “meaningful work” will increase. Although meaning is ultimately subjective, “a defining feature is a connection to something bigger than the self. People who lead meaningful lives feel connected to others, to work, to a life purpose, and the world itself.” Nourishing human connection is the essence of the “caring economy.”

Our current Income Tax Act penalises this “caring work.” Money paid for child care or to keep an elderly parent in their home is paid from after-tax dollars, essentially making it subject to double taxation. Many “care workers” are paid in cash to avoid this double taxation. Not only does this diminish their earnings and access to social benefits (such as CPP and UI), it reduces the perceived value of this important work.

According to McKinsey, the “caring economy,” including health care, education, protection, community development, etc., represents about 30% of Canada’s GDP. While the Economic Growth Council has made important recommendations for the rest of our economy, it neglected this important segment. Changes to the Income Tax Act to encourage growth in this sector (possibly to as much as 50% of the economy) could also improve the mental, physical and emotional health of Canadians. According to the World Happiness Report, 80% of the variance in happiness across the world occurs within countries, mainly due to differences in mental health, physical health and personal relationships, not due to income inequality.

The shift to the information economic model is creating many challenges for society, including the government’s ability to raise taxes. Our income tax act is structured around the industrial business model of T4 employment, not self-employment (if there are no jobs, we will have no choice but to create our own). And what if we create jobs for other people? To avoid double taxation, shouldn’t their wages be deductible? Would it not make sense to deduct the wages paid to care for children and elderly parents to encourage those with good ideas to nurture their businesses? One small change that the government could make immediately is to enable Canadians to carry forward caregiver tax credits. This small step could have a significant impact for entrepreneurs and small business owners who are unable to take full advantage of the credit in the first years of their company’s growth.

Shifting how the Income Tax act treats the caring jobs would relieve some of the burden on the government to provide care at taxpayers’ expense, and it may make everyone’s lives better and easier. At the same time, we need to ensure that self-employment rules do not create tax shelters for the rich, or reduce incentives for people to work. These are two small examples of the many

ways our income tax act needs to be revised to reflect the information economy, when fewer people have traditional “jobs.”

The changes should not stop with employment. Most T4 employees have health and dental plans. Could we not create registered health savings plans (like registered retirement savings plans) that an individual takes with them where-ever they work? Would these plans cover disability and critical illness? Co-insurance could be used to encourage Canadians to live healthier lifestyles, to the benefit of all.

With knowledge doubling daily, education will not be a one-time event. Continuous learning and job retraining will be essential, maybe registered life-long learning plans would allow people to plan for and take retraining when necessary. To protect people from the worst of this economic transition, we might consider a minimum annual income for every man, woman and child in Canada or at the least an earned-income-tax credit that improves the work incentives.

We will also need to tax the big platforms. In the early 1900s, the solution to income inequality was breaking-up of the big monopolies. In today's interconnected world consumers benefit from the interconnectedness created by big platforms such as Google, Facebook, Linked-in, etc. Breaking them up would defeat their purpose. But, regulation and taxation will be necessary to keep them in check. More important is the need for global tax treaties to ensure that the benefits of these platforms are shared equitably between citizens and companies. (The OECD is already working on this.) In addition, these tax dollars will be needed to provide the social safety net and job training necessary for citizens to transition from their dependence on T4 based employment to the caring, thinking, creative jobs of the future.

The Income Tax Act is one of the most powerful ways that government can implement public policy. Taxation and regulatory rules can create a large wind-assist for innovation, especially in knowledge-based industries. An overhaul of our income tax act to reflect the realities of the 21st century economy is necessary. If we get out in front of this socio-technological tsunami, before the major lay-offs begin, then Canada has a chance of making an orderly transition from the industrial age to the information age.

A Different Process is Needed

Overhauling the income tax act is truly a complex challenge, which has proven almost impossible using traditional approaches. It demands an inclusive, dialogue-based, forward looking and action-oriented solution. Effective action requires the support of multiple stakeholders with differing perspectives and priorities. It needs more work to be done by horizontal process, or it won't get done and more decisions must be made with wider and wider consultation – or they won't stick.

Catalytic governance is a horizontal process that is up to the challenge. It encourages and enables people from diverse backgrounds and perspectives to work through issues (particularly wicked problems); find common ground; construct shared mental maps, norms and expectations; and begin to act or experiment on that basis. The core role of government – in particular, the responsibility to define and protect the public interest including that of the voiceless – remains as

important as ever. What changes is how these responsibilities can be carried out effectively and legitimately in the information age.

Many of the things that matter to us are threatened by gale-force changes in the environment – technology, globalisation, mass migration to large cities, ageing demographics and climate change. None more so, than our jobs. Fear, not only of outsourcing and free trade, but much more significantly of “not just Uber but driverless Uber, and radiologists losing their jobs to A.I.” was an important factor in both Brexit and the U.S. election results. Canada can get out in front of the tsunami, create meaningful jobs and align our economic and social contracts with the realities of the 21st century information economy.

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From 2010 to 2012, Pat was the Chair of the Task Force for the Payments Review. The Task Force – which applied a catalytic governance process – delivered a community supported action plan that enabled government and industry to quickly act on all four of the recommendations. With her Catalytic Governance co-authors, Steven Rosell and Ged Davis, she is working to create a community of leaders developing better approaches to governing in the information age.

Dr. Meredith has a PhD in Business Strategy, an MBA in Management Information Systems and a Bachelor of Mathematics. She is a Fellow of the Institute of Chartered Professional Accountants of Ontario and of the Clarkson Institute for Board Effectiveness at the Rotman School of Management at the University of Toronto. She teaches Advanced Strategic Management and Competitive and Organizational Strategy to MBAs and executives. Patricia is Chair, of the Audit and Finance Committee of the Canadian Institute for Advanced Research (CIFAR).