Why a wealth tax will hurt Canadians

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Canadian Taxpayers Federation

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About the Canadian Taxpayers Federation

The Canadian Taxpayers Federation is a federally incorporated, not-for-profit citizens' group dedicated to lower taxes, less waste and accountable government.

The CTF was founded in Saskatchewan in 1990 when the Association of Saskatchewan Taxpayers and the Resolution One Association of Alberta joined forces to create a national organization. At the end of 2019, the CTF had 235,000 supporters nationwide.

The CTF maintains a federal office in Ottawa and regional offices in British Columbia, Alberta, Prairie (Saskatchewan and Manitoba), Ontario, Québec and Atlantic Canada. Regional offices conduct research and advocacy activities specific to their provinces in addition to acting as regional organizers of Canada-wide initiatives.

CTF offices field hundreds of media interviews each month, hold press conferences and issue regular news releases, commentaries, online postings and publications to advocate on behalf of CTF supporters. CTF representatives speak at functions, make presentations to government, meet with politicians and organize petition drives, events and campaigns to mobilize citizens to effect public policy change. Each week CTF offices send out Let's Talk Taxes commentaries to more than 800 media outlets and personalities across Canada.

Any Canadian taxpayer committed to the CTF's mission is welcome to join at no cost and receive emailed Action Updates. Financial supporters can additionally receive the CTF's flagship publication *The Taxpayer* magazine, published three times a year.

The CTF is independent of any institutional or partisan affiliations. All CTF staff, board members and representatives are prohibited from donating to or holding a membership in any political party. In 2018-19, the CTF raised $5.1 million on the strength of 30,517 donations. Donations to the CTF are not tax deductible as a charitable contribution.

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Introduction

A wealth tax is the governmental version of a get-rich-quick scheme.

When it comes to easy solutions, what could be easier than taking money from rich people to fix the federal government's financial problems?

The NDP and Green Party both called for a wealth tax of one per cent on households worth more than $20 million during the 2019 election. The organization Canadians for Tax Fairness issued a report calling for a one or two per cent wealth tax on households worth more than $10 million. In the United States, Senator Elizabeth Warren proposed a two per cent wealth tax starting at US$50 million. New Zealand's Green Party demanded a wealth tax starting at NZD$1 million.

But like diet pills promising quick results, wealth taxes overpromise, underdeliver, and often come with nasty side effects. Many other countries that have tried a wealth tax soon tossed the scheme.

Even wealth tax proponents acknowledge this.

"Today, only a handful of advanced economies levy an annual tax on wealth," states the Broadbent Institute's report advocating wealth taxes. It goes on to say: "Annual wealth taxes were generally eliminated in the 1980s."

The reality is, France, Austria, Denmark, Finland, Germany, Ireland, India, Netherlands and Sweden have all tried and abandoned a wealth tax. Britain pre-emptively rejected wealth taxes. New Zealand's governing Labour Party has flatly rejected a wealth tax despite demands from the Green Party for a wealth tax starting at NZD$1 million (including the family homes).

It's unlikely politicians from India to Ireland rejected wealth taxes out of benevolence to the rich. Administrative complexity is a more likely reason the simplistic scheme was abandoned.

The Canada Revenue Agency already employs an army of bureaucrats to assess personal and business income taxes. Comparatively, calculating income for tax purposes is fairly straightforward.

Taxing wealth is exponentially more complicated. How much is a farm worth, especially if it has been in the same family for a century? How much wealth tax should entrepreneurs pay when they're losing money? How will officials decide which forms of wealth should be exempt: insurance policies, personal homes, RRSPs, etc.? Bureaucrats will have to answer all of these questions in each instance with enough clarity to withstand inevitable challenges from the legal and accounting teams employed by wealthy individuals.

It's unclear whether it's even possible to administer a wealth tax in Canada, and if so, how much it would cost to administer.

Nonetheless, the prospect of a wealth tax at the federal level in Canada has the potential for broad political appeal; 99 per cent of Canadians are by definition outside the top percentile of wealth in this country, and politicians may be rewarded if they succeed in convincing these voters that the debt burden can be lifted off their shoulders and paid for by someone much richer.

But taxpayers ought to be wary, regardless of net-worth. The government implemented income taxes in 1917 as a temporary charge that only applied to the top two per cent of wage earners to help pay for the First World War. Now, the vast majority of Canadians who have an income are subject to income taxes.

A tax on assets will likely follow a similar course. Farmers who see the larger farm next door get hit with a wealth tax will logically recognize that they're next. Further, many Canadians who aren't subject to a wealth tax would have to pay an accountant for complicated assessments of their holdings annually to prove they're below the threshold.

We've already witnessed changing goal posts when it comes to wealth taxes. Warren's proposal starting at a threshold of USD$50 million would hit about 0.05 per cent of American households. New Zealand's Green Party estimates its wealth tax proposal starting at NZD$1 million would hit more than one in twenty New Zealanders.

Here in Canada, the original proposal during the 2019 election was for a wealth tax to be imposed on household net worth over $20 million. Less than a year later, the Broadbent Institute suggested the threshold be lowered to $10 million.

This report argues against the implementation of a wealth tax in Canada because it would be costly and complex to administer, and it would have negative economic consequences.

PART I
Inefficient, Impractical and Impossible

There's only one sure way to find out how much something is worth: sell it. Until the deal is done, the price the seller's willing to take is entirely unconnected to the price the buyer is willing to pay. That's a big problem for a wealth tax.

Income taxes are comparatively simple. Individuals total up the amounts they made from salaries, investments and other sources. Then they subtract expenses and deductions. Finally, they apply the required tax rate and either collect a refund or send a cheque.

A wealth tax would require households to total up their assets, subtract their liabilities and pay a wealth tax on any amount above the specified threshold.

That means step one is to value assets.

For some assets, that's relatively easy. For cash in the bank, it's just the balance on the bottom line. Stocks and bonds are revalued every nanosecond by the markets.

Real estate adds a level of complexity. Appraisers routinely estimate real estate values based on comparable properties that have been sold recently. However, despite best efforts by appraisers, there's both art and science in assessing values. Every homebuyer sees that artistry when a home sells for more or less than the listed price. Valuations are exponentially harder to determine with unique properties that don't have ready comparables in volatile markets.

Then there's the really tricky part: valuing businesses. Many wealthy individuals hold much of their wealth in businesses. Unless a business is publicly traded, its value is difficult to determine and constantly changing.

The difficulty of valuing businesses

Consider an example from the television show, Dragon's Den.

In season nine, an entrepreneur named Morgan Carey pitched his company Real Estate Web Masters to the dragon investors. Carey originally set his price at $2 million to sell four per cent of his company. That meant he valued his company at $50 million.

Arlene Dickinson immediately dropped out of the negotiations and rejected the deal outright because she thought that asking price valued the company at more than it was worth.

Jim Treliving viewed the company differently. He offered $2 million for 10 per cent of the company. That meant he valued the company at $20 million.

Michael Wekerle joined the bidding and offered $2 million for 6.67 per cent at a valuation of $30 million.

Carey ultimately made a deal with Treliving and Wekerle jointly for $2 million for five per cent at a valuation of $40 million.

Based on this real-life case study, what should Carey's wealth tax be if the rate is two per cent and the threshold is $10 million?

On one extreme, according to Dickinson's valuation, Carey might not be subject to any wealth tax as she didn't offer a bid even when Treliving initially devalued the company down to $20 million.

On the other extreme, by initially valuing the company at $50 million himself, Carey could be hit with a wealth tax of $800,000.

In the middle, the agreed upon valuation was $40 million, so perhaps the right wealth tax bill would be $600,000.

In this case, there's a relatively common wrinkle: the deal ultimately fell through. So where does that leave the value of the company?

Consider the implications of case study. The CRA will need evaluators to determine the value of businesses. It will be no easy task for bureaucrats with little to no business experience, to complete business valuations with greater accuracy than Dragon's Den investors who are making deals with their own money.

Further, the bureaucrats' valuations will have to withstand the scrutiny and legal challenges of individuals who view their wealth tax bill as unfair. Consider Carey's position: if the bureaucrats hand him a wealth tax bill for $800,000, he may well be willing to spend thousands of dollars employing accountants and lawyers to show the bureaucrats are using a valuation that's too high. Accounting and legal expenses on the CRA's side would likely be similar.

As a result, at most, the government will net a fraction of the amount it hopes to collect. And that's in a relatively straightforward case where the negotiations were televised.

Wealth tax proponents may argue there are standard metrics bureaucrats can use to value businesses.

Perhaps the CRA will use multiples of future earnings. But, again, there's as much art as science in that prognostication. What are the projected future earnings of a clothing company if Drake happens to wear one of its T-shirts courtside at a Raptor's game? What happens if a restaurant chain has to throw out its ingredients because of a recall from a supplier? What happens in the case of a pandemic?

Perhaps it's better to focus on the present rather than trying to predict the future. Balance sheets show the assets and liabilities for a business. If the total on the bottom line exceeds the threshold, the CRA could send a wealth tax bill.

There's a basic issue of unfairness that would come with applying a wealth tax to the equity on a business's balance sheet: double taxation. Businesses already pay corporate income taxes on the revenues they keep after subtracting expenses. Essentially, businesses would pay income taxes when they make money and wealth taxes when they save it.

Bureaucratic bloat at the CRA

The complexity doesn't end there: a wealth tax could mean bureaucrats have to value everything from fine art to classic cars.

Consider this example: Haley Wickenheiser's hockey sticks. For her son, they might be old sticks for firing tennis balls around the basement. For collectors, they might be valuable pieces of memorabilia that would draw numerous bids at auction. For Wickenheiser herself, they might be priceless mementoes of gold-medal games at the Olympics.

The compliance costs of a wealth tax would be considerable. Taxpayers above or anywhere near the threshold would have to hire accountants and lawyers to assess their wealth. That will be expensive.

The CRA will, of course, have to assess the wealth tax returns that these families file each year. The CRA will almost certainly have to create an entirely new department. This new department will need to hire highly paid expert valuators. These experts would be responsible for ensuring that families are not understating the value of their assets on their self-reported wealth tax returns.

What if the CRA valuators disagree with the self-reported value in the wealth tax return? The CRA will audit the wealth tax returns, causing re-assessments, adjustments, appeals, objections and inevitable court cases.

The CRA already employs 40,000 Canadians and has an annual budget of $4.3 billion. The Internal Revenue Service of the United States has 73,000 employees and a budget of $12 billion. The U.S. has 10 times the population of Canada's population, yet its tax authority has less than double the number of employees and only three times the budget of the CRA. Clearly, the CRA is already bloated. In fact, the CRA is already the tenth largest employer in Canada and can barely cope with the 53 million phone calls it receives each year. The new wealth tax department will add potentially hundreds of millions of dollars to the CRA's budget and countless more employees to an already inefficient organization.

PART II
Unrealized, Unfair, Unheard Of

There are two questions to ask when considering a wealth tax in Canada: *should* the government tax assets, and if so, *can* the government tax assets?

To answer the first question, there's a strong argument to be made that the government should not tax business assets. It's one thing for governments to tax business profits, but taking a chunk out of working assets every year depletes the resources used to generate those profits in the first place. It would be unwise for the government to diminish the capacity of its tax base year over year in pursuit of more taxes. It's sort of like the fable about killing the golden goose.

Putting that argument aside, implementing a wealth tax could also prove to be a costly administrative nightmare.

There's a reason why governments focus on taxing incomes: if individual taxpayers have income, then they'll have the cash to pay taxes. That makes collection a reasonably straight forward process.

There's also a reason governments avoid wealth taxes: there's no guarantee the taxpayer will have the cash on hand. That makes collecting complicated.

Consider farm families. Tractors, combines and other pieces of farm machinery routinely sell for hundreds of thousands of dollars and agricultural land is a valuable asset. Depending on the threshold, a significant number of farmers would be hit by a wealth tax.

Further, other factors outside of farmers' control can affect the value of their farming operations and make them liable for a wealth tax. Consider land prices. In 2013, farmland prices shot up 22 per cent, according to Farm Credit Canada. The land itself may not be producing better crops or increased income, but a proposed subdivision could increase the land value and force farm families to pay wealth taxes.

Once again, the CRA will face a daunting challenge to value Canadian farms. Are bureaucrats going to assess the grade of the grain in each bin? Do they want to guess how much 100 bred heifers will sell for at a cattle auction?

Agricultural businesses highlight the problem of cash flows for wealth taxes: farm families would be required to pay wealth taxes every year whether the harvest is a bumper crop or a complete failure. In the case of crop failure, farm families lose money, so they don't have surplus cash to pay wealth taxes.

The New Zealand Green Party, provides a specific example dealing with this issue:

> *"Dan and Lesley own a farm worth $5 million, but only have equity of $2 million as they have $3 million in liabilities (debt). They also have a $600,000 home with no mortgage. They have $1.3 million net wealth each and will be liable for a $3,000 wealth tax each. If one year their income is low because the commodity price for the products their farm produces is low, they can defer their tax payment and pay it later when the commodity price is higher."*

While these problems are particularly obvious for farmers, they're certainly not the only ones vulnerable to cash-flow issues.

This same problem exists for landlords who own real estate. Should a family that owns real estate be obligated to hire a professional real estate appraisal firm to complete a full proper valuation report of each of their properties every year? This could potentially cost thousands of dollars. Would past sales of similar properties in similar locations be sufficient for wealth tax valuation purposes? If there are no past sales of similar properties, would the assessed value as per their municipal property tax assessment be sufficient?

Consider a scenario where a family's real estate holdings are breaking even. The rental income they earn is used to pay for insurance, repairs and maintenance, improvements, management, cleaning, landscaping, snow removal, mortgage payments, property taxes, etc. Some of the buildings might even be cash-flow negative due to major improvements and repairs. A wealth tax could siphon away money that would be otherwise reinvested to repair or upgrade properties.

What if the real estate market drops? This has happened in Canada in the past. For example, in Toronto, real estate prices came crashing down after 1989, and continued to decrease for seven years.

The values of assets and liabilities fluctuate, so what happens to a family's wealth tax bill? Will families receive wealth tax refunds in years in which the market value of their property decreases compared to prior years, if it puts them under the wealth-tax threshold?

If the real estate market picks up and prices of properties increase in value, is it really fair that a family should have to pay increased taxes on the value of their real estate holdings that they have not yet sold? Just because a family's real estate holdings could be sold for an amount above an arbitrary threshold does not mean they've actually sold anything or have any of that cash available.

Interestingly, the Broadbent Institute briefly addresses the possibility that some people may not have the liquidity to pay a wealth tax. It dismisses the issues as "unlikely to be a major problem." It then suggests the government could "allow delayed payment of tax at a specified rate of interest."

Farmers dealing with crop failure will no doubt be comforted with the reassurance that they can make payments on their wealth tax debts for years to come.

PART III
Double and Triple Tax

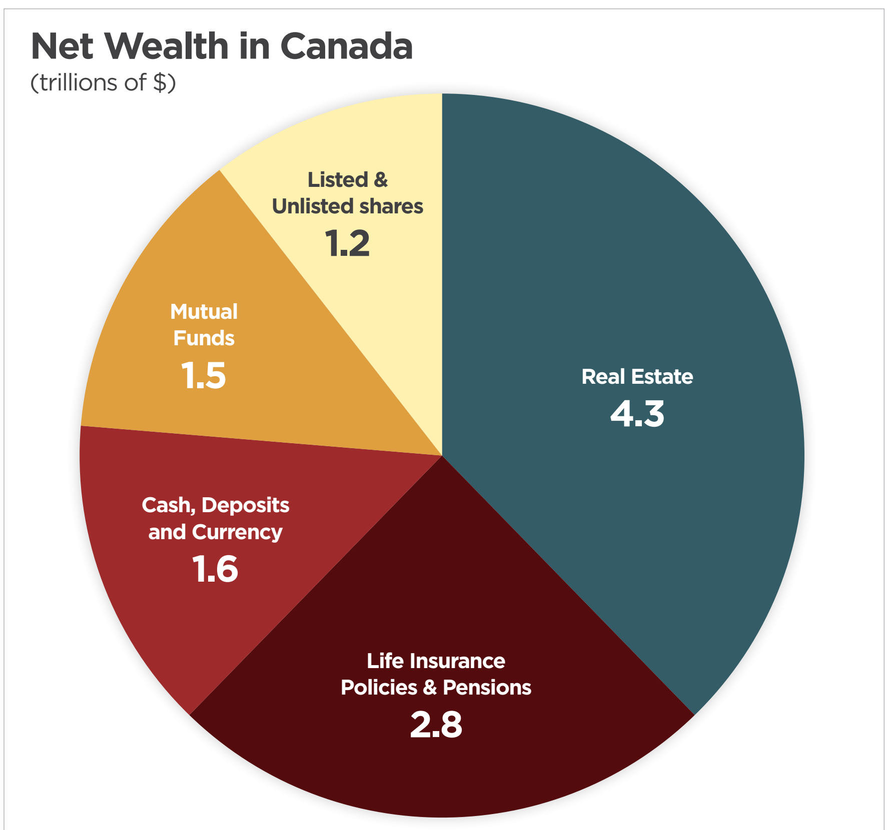
It's important to note that proposed wealth taxes would actually duplicate existing taxes on assets.

For example, anyone who owns real estate is already paying property taxes which are assessed based on the value of each property. If real estate were to subject to wealth taxes, it would be a clear example of a double tax. In fact, 42.7 per cent of all net wealth in Canada is real estate which is worth, on a net basis, [$4.3 trillion], according to the Parliamentary Budget Officer.

Homeowners are already subject to a myriad of taxes. In addition to buying their homes with after-tax dollars and paying annual property taxes, they've likely also paid land transfer tax(es), development fees, and sales taxes on most if not all of the materials used to build the home.

There is an estimated [$2.8 trillion]-worth of life insurance policies and pension assets in Canada. Would the wealth tax apply to the value of a family's life insurance policy? Life insurance premiums are already paid from after-tax funds. Further, taxes are often charged on premiums. This would force people to pay income tax on their incomes, then purchases life insurance policies and then pay a wealth tax on the value of the life insurance policy every year.

About $1.6 trillion of net wealth in Canada consists of currency and deposits, meaning cash and GICs and other term deposits. Cash deposits are already taxed since any funds in hand are after-tax funds. These wealth taxes would clearly represent a double tax because the wealth that's been accumulated has resulted from income that was already taxed.



Perhaps the government would provide exemptions for certain assets. Maybe the government would exempt personal residences, RRSPs, life insurance policies and even farmland. If it does, that would dramatically undermine its wealth tax revenue projections.

PART IV

Been There, Done That

A wealth tax is not a novel idea. It's been tried and abandoned numerous times over the years and around the globe.

From 1988 to 2017, France had a wealth tax of 1.3 to 1.8 per cent on wealth of more than US$14.3 million. The results were abysmal. It caused thousands of wealthy people to leave the country.

At the beginning, the exemption levels of the wealth tax were linked to inflation, but in 1997, they were set permanently and more families began to be caught by the wealth tax due to rising property values. One estimate determined that 42,000 millionaires said au revoir and left France between 2000 and 2014.

The exodus of high-net worth families from France due to its wealth tax caused two major problems: a shortfall in tax revenues, and the flight of investment capital which helped to create jobs and economic growth in France.

It's estimated that the government actually lost money by implementing a wealth tax because of all the value-added (sales) taxes, income taxes, and other taxes that evaporated when the wealthy left the country.

"The wealth tax costs twice as much in VAT gone missing as it actually yields," said Patrick Artus, a research director at the IXIS-CIB investment bank in a 2007 interview.

It's estimated that the flight of the wealthiest people from France, along with all their savings, investments, and capital has caused tens of thousands of jobs to have been lost due to these assets being put to use in other countries. The slower economic growth in France compared to Germany and England is partially explained by this factor.

An estimated total of €200 billion ($311 billion Canadian) worth of assets have left the country or €7 billion ($11 billion Canadian) per year, which is twice the total amount of revenue generated by the wealth tax. That does not include the lost jobs, investment, consumption and economic growth lost due to the wealthiest people leaving the country, which finally led France to completely eliminate its wealth tax in 2017.

France is not the only example of wealth taxes having gone awry.

In 1990, 12 European countries had a wealth tax, but today only three still do.

Austria abolished its wealth tax in 1994 citing high administrative costs and the economic burden on Austrian enterprises. Denmark abolished its wealth tax in 1997. Finland abolished the wealth tax in 2006 because it "had an unfair impact on enterprises and provided many possibilities to evade." Germany abolished its wealth tax in 1997. The Netherlands did the same in 2001. Sweden abolished its wealth tax in 2007 "as it became clear that it was driving business people, such as the founder of Ikea, Ingvar Kamprad, out of the country."

The only European countries that still have a wealth tax are Norway, Switzerland, and Spain. Switzerland only imposes wealth taxes at local canton levels. The burden of its wealth tax is offset by very low property taxes, very low corporate income taxes, and the absence of individual capital gains taxes. Spain's wealth tax is also applied at the regional level with rates going down since 2011.

In the 1970s, the British Labour Party nearly implemented a wealth tax, but decided not to forge ahead when it realized how complicated the administration would be. The Chancellor of the exchequer at the time, Denis Healey, said: "We had committed ourselves to a wealth tax; but in five years I found it impossible to draft one which would yield enough revenue to be worth the administrative cost and political hassle."

The Indian Minister of Finance, Arun Jaitely, described his reasons for abolishing the wealth tax in 2015: "The practical experience has been it's a high cost and a low yield tax."

Ireland imposed a wealth tax in 1975 and abolished it very soon after in 1978 because it raised little revenue and influential lobby groups pressured the government to include many exemptions.

New Zealand's Green Party is currently demanding a wealth tax starting at a million dollars (about $881,000 in Canadian dollars) and it includes the net value of personal family homes. Prime Minister Jacinda Ardern's left-leaning Labour Party rejected the wealth tax and won a decisive and rare majority government.

"As the revenue minister, I have had a look at a wealth tax and I think it is very, very difficult to implement," said New Zealand Finance Minister Grant Robertson. "It's on unrealized gains, which makes it very difficult for people to pay who are asset rich, cashflow poor."

In Canada, it's likely that the government will be lobbied to exclude many assets from the wealth tax such as principal residences, RRSPs, RESPs, RDSPs, TFSAs, family farms, insurance policies, real estate and many other assets that are extremely difficult to value, such as jewelry, art, collectibles, etc. All of these exemptions will limit the estimates of potential revenue and cause the wealth tax to become extremely complicated and inefficient.

Canadians can learn from the experiences of all the above mentioned countries and recognize that wealth taxes are inefficient and costly to administer, will cause some of the wealthiest people to leave the country, and actually undermine other government revenue sources.

PART V
Insufficient Funds

It's tempting to dream about ways to spend a big windfall. Canada certainly has financial problems with a deficit of nearly $400 billion and a national debt which recently surpassed $1 trillion. Wealth tax advocates herald this as a policy to address these economic ills and fuel even more spending.

Here's the problem: a wealth tax won't bring in enough money – not even close.

The Parliamentary Budget Officer analyzed the NDP's proposal for a one per cent tax on household wealth totaling more than $20 million. It estimated the tax would bring in about $5.6 billion.

That means a wealth tax would cover less than 1.5 per cent of the current deficit.

Even before the pandemic plunged Canada deep into deficit, the wealth tax would have barely covered a quarter of the pre-COVID deficit of nearly $20 billion. The wealth tax falls woefully short of solving Canada's financial problems and that's based on a rather optimistic assessment.

The Parliamentary Budget Officer assumes administration costs will only be two per cent of revenues generated by the wealth tax. As outlined previously, there's a significant risk the CRA will get mired in costly disputes over valuing assets and determining wealth tax bills

The report also assumes the wealth tax will be universally applied, but this sets aside political realities. Powerful agricultural organizations would push hard to ensure assets such as farmland and dairy quotas would be exempt. Insurance providers would almost certainly ensure their products would be exempt. The real estate sector will push for similar exemptions. And it's hard to believe politicians will tell their constituents that retirement savings and family homes should be subject to a wealth tax. When all of the exemptions are subtracted from the equation, the overall revenues from a wealth tax are likely to shrink dramatically.

To its credit, the Parliamentary Budget Officer is upfront about the uncertainty of predicting how wealthy families will react to a tax on their assets. However, that risk is significant. The report estimates that 13,800 families would pay the wealth tax. Those families already pay massive tax bills such as the 53.4 per cent marginal income tax rate on earnings above $220,000 in Ontario. Further, those families likely have the means to move anywhere in the world. If even a fraction of those families left, Canada would not realize the estimated revenue gains from a wealth tax and could stand to lose revenue from other streams as well.

The bottom line is bleak for the wealth tax. There's a real risk that the disadvantages could outweigh the benefits. Even if it was administratively possible and could generate net positive revenues, it's clear that it could not make a significant improvement on the country's finances.

Conclusion

Like all get-rich-quick schemes, wealth tax proposals are too good to be true.

A wealth tax is virtually doomed to collapse under the overwhelming weight of administrative complexity. Bureaucrats are fundamentally ill equipped to value businesses and assets. They're also poorly positioned for legal battles against teams of accountants and lawyers employed by taxpayers targeted by wealth taxes.

A wealth tax is fraught with issues of unfairness such as double taxation and cash flow uncertainties.

Most importantly, Canadian taxpayers aren't gullible. When politicians say they're raising taxes on someone else, Canadians know those tax bills are destined for their own mailboxes. The NDP and Green Party originally proposed a wealth tax starting at $20 million. The Broadbent Institute cut that in half to $10 million. Would any of those groups oppose the New Zealand Green Party's proposal starting at NZD$1 million? Does anyone think wealth tax proponents would stop lowering the threshold there? That's certainly not what happened with income taxes.

A wealth tax is not a serious solution to fix the federal government's financial problems. It's a fundamentally flawed proposal that would create more problems than it would address. That's why governments around the world have rejected wealth taxes and Canada should too.

About the Author

Neal Winokur is a CPA who feels a moral obligation to speak out against the inherent flaws, unfairness and needless complexities that taxation is in Canada. His new book, *The Grumpy Accountant*, is now available for sale on Amazon.ca.