



FISCAL AND TAX COMPETITIVENESS

What's My METR? Marginal Effective Tax Rates Are Down – But Not for Everyone: The Ontario Case

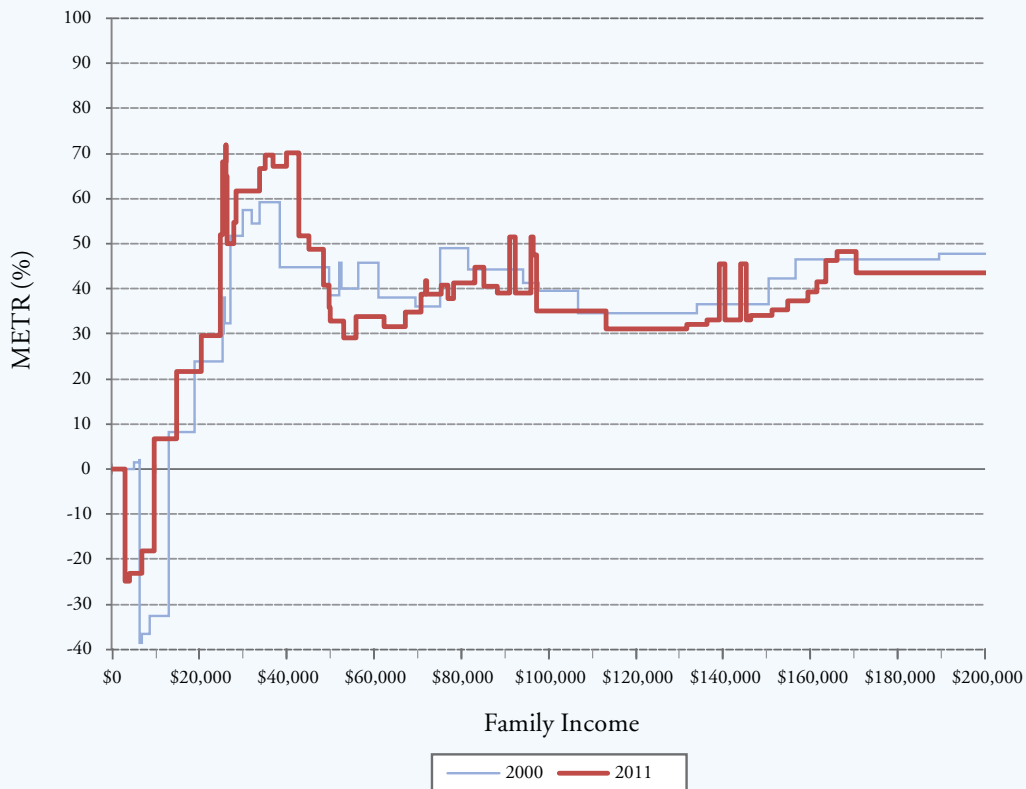
By

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- The marginal effective tax rate (METR) on personal income measures the impact, on take-home pay, of federal and provincial income taxes combined with the impact of reductions and clawbacks of income-tested tax credits and benefits as individual or family income rises.
- Income-tested credits and benefits mostly target financial support to low- and middle-income families with children, or to low-income seniors. As these families' incomes rise past prescribed thresholds, clawbacks and reductions begin, raising the METR on each dollar of incremental income above the threshold.
- A decade after the federal government implemented a significant personal income tax relief program, what has happened to METRs? Overall, METRs are lower, but for many families with children, they are higher – almost five percentage points higher for families with income under \$45,000 in Ontario, for example – mostly because of increases in targeted benefits and credits that have income tests attached.
- Policymakers interested in keeping down METRs overall should consider reinvigorating the personal income tax relief imperative, rather than implementing or expanding targeted benefits that make general tax relief more difficult to achieve.

Measuring the impact of taxes on take-home pay is a common concern for Canadians. One key determinant is the schedule of federal and provincial personal income tax rates, which are set by legislation as percentages of individual taxable income above set thresholds. These statutory tax rates, however, do not reflect the tax system's full impact on take-home pay, which is affected by reductions and clawbacks of the benefits and credits that are intended to target support to low- and middle-income households, particularly families with young children, or seniors. The combined impact of statutory personal income tax rates and benefit reductions and clawbacks is the marginal effective tax rate, or METR, on incremental personal income. High METRs matter: they reduce the gains for individuals from working or adding to their incomes.

Figure 1: Marginal Effective Tax Rates (METR) for a Typical Dual-Earner Family of Four (Two Parents, Two Children), Ontario, 2000 and 2011



Assumptions: Each parent earns 50 percent of the family’s income and children are both under five years old. The family’s income source is employment. For calculating tax credits for shelter costs, \$1,000 per month rent is assumed. Child care expenses are not modeled.
 Source: Authors’ calculations using Statistics Canada’s SPSPD/M, v. 18.1. Responsibility for the results and their interpretation lies with the authors.

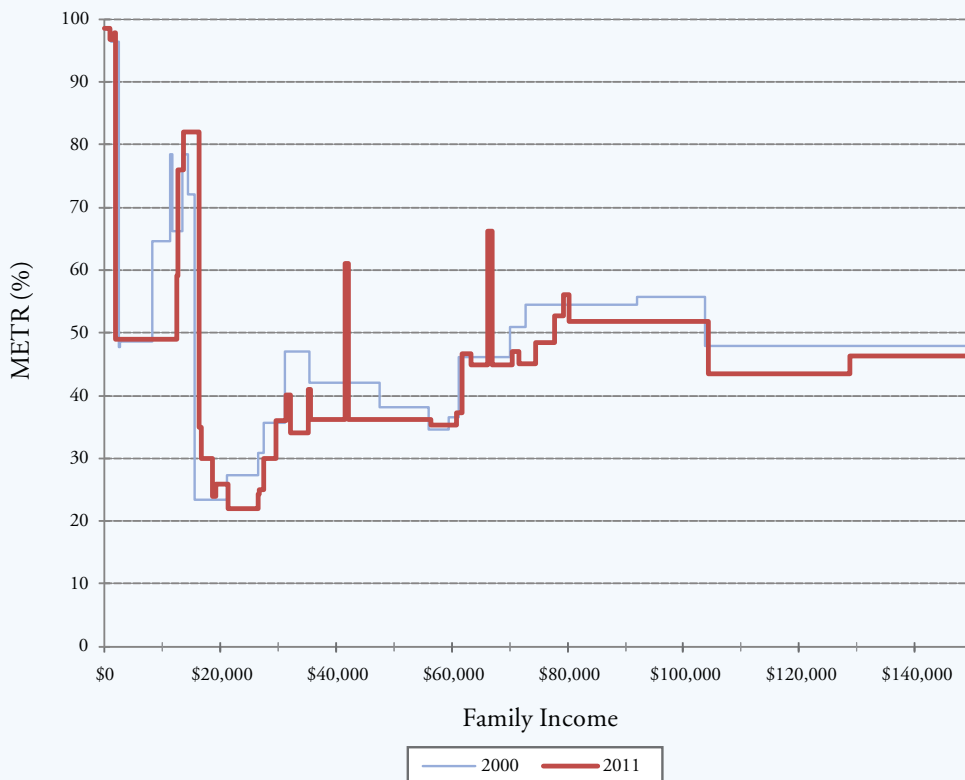
This *e-Brief* examines the current METRs faced by Canadians, with a focus on Ontario, and how they compare with those of a decade ago because, during a time when many federal and provincial statutory tax rates were falling, many targeted federal and provincial benefits and credits have been rising. The jumping off point for this review is the personal tax rate changes announced in the 2000 federal budget, which launched a process taking basic federal tax rates from 17, 26 and 29 percent that year, with the highest rate kicking in at individual taxable income of \$59,180, to rates of 15, 22, 26 and 29 percent in 2011, with the top rate kicking in at \$128,800.

Falling personal tax rates federally and in some provinces, and the reduction or elimination of surtaxes on personal income tax, have resulted in the national average for all family types being almost five percentage points lower today than it was in 2000. However, for many families – mostly for low-to-middle-income families with young children, rates are higher, which reduces their gains from taking on paid work or working longer hours. Ontario is a case in point, with METRs over 50 percent for many low-to-middle-income families with children, and the share has risen in 2011 compared to 2000.

Background: The Impact of Benefits Geared to Income

Most jurisdictions use graduated income tax rate schedules aimed at delivering tax burdens that rise as a percentage of income as taxpayers’ incomes rise. In the Canadian system, over the past generation, this geared-to-income approach

Figure 2: Marginal Effective Tax Rates (METR) for a Typical Single Senior Individual, Ontario, 2000 and 2011



Assumptions: METRs calculated for a single senior individual, incremental income is from taxable pension sources, with no employment income. For calculating tax credits for shelter costs, \$1,000 per month rent is assumed.

Source: Authors' calculations using Statistics Canada's SPSPD/M, v. 18.1.

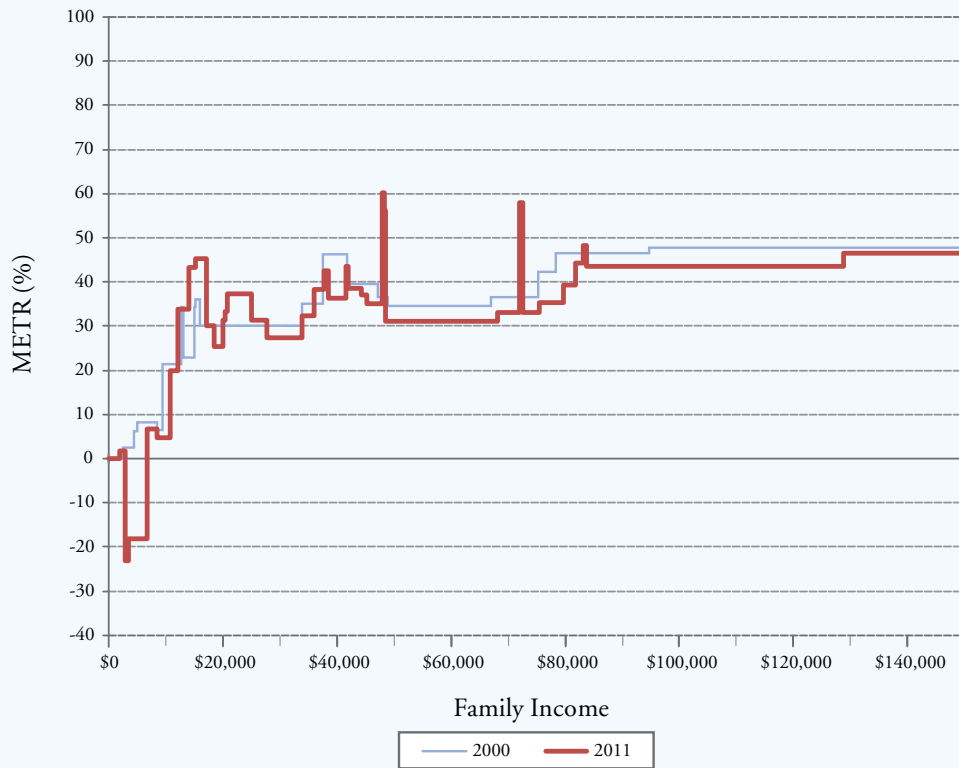
has spread to more of the tax and benefit system, in particular with the introduction of the Child Tax Credit in 1978, paid to families with young children. When introduced, the value of the credit declined as family income rose above \$18,000 and disappeared entirely at a family income above \$26,000. In 1992, the federal government rolled together several family-related deductions, credits and benefits into a larger, income-tested Child Tax Benefit, which became the basis for the larger-yet National Child Benefit System which, beginning in 1998, sought to provide, through the tax and transfer system, a minimum income for families with children.

The program has changed over the years: the federal benefit for a first child grew from less than \$2,000 in 2000 to over \$3,400 in 2011. The effective tax rates that are needed to limit their cost have also grown either in magnitude, meaning higher clawback or reduction rates, or in breadth of application, meaning that higher than otherwise METRs apply to families farther up the income scale.¹ This burgeoning issue had emerged by the late 1990s; some authors warned rising benefits and their clawbacks would for many earners sharply reduce the gains from working (Davies 1998, Poschmann 1999, Poschmann and Richards 2000).

Meanwhile, the child benefit system has been successful at providing transfer income to families with young children that have little or no market income, and the amount is now substantial – the federal benefit for a family with three young children in 2011 is almost \$10,000. But targeting benefits to families on the low end of the income scale,

¹ For families with three young children, the federal child benefit clawback on the basic benefit applies to family incomes up to about \$150,000.

Figure 3: Marginal Effective Tax Rates (METR) for a Typical Single Individual Without Children, Ontario, 2000 and 2011



Assumptions: METR calculated for a single individual aged under 65 on his/her income from employment, with no other sources of income. For calculating tax credits for shelter costs, \$1,000 per month rent is assumed.

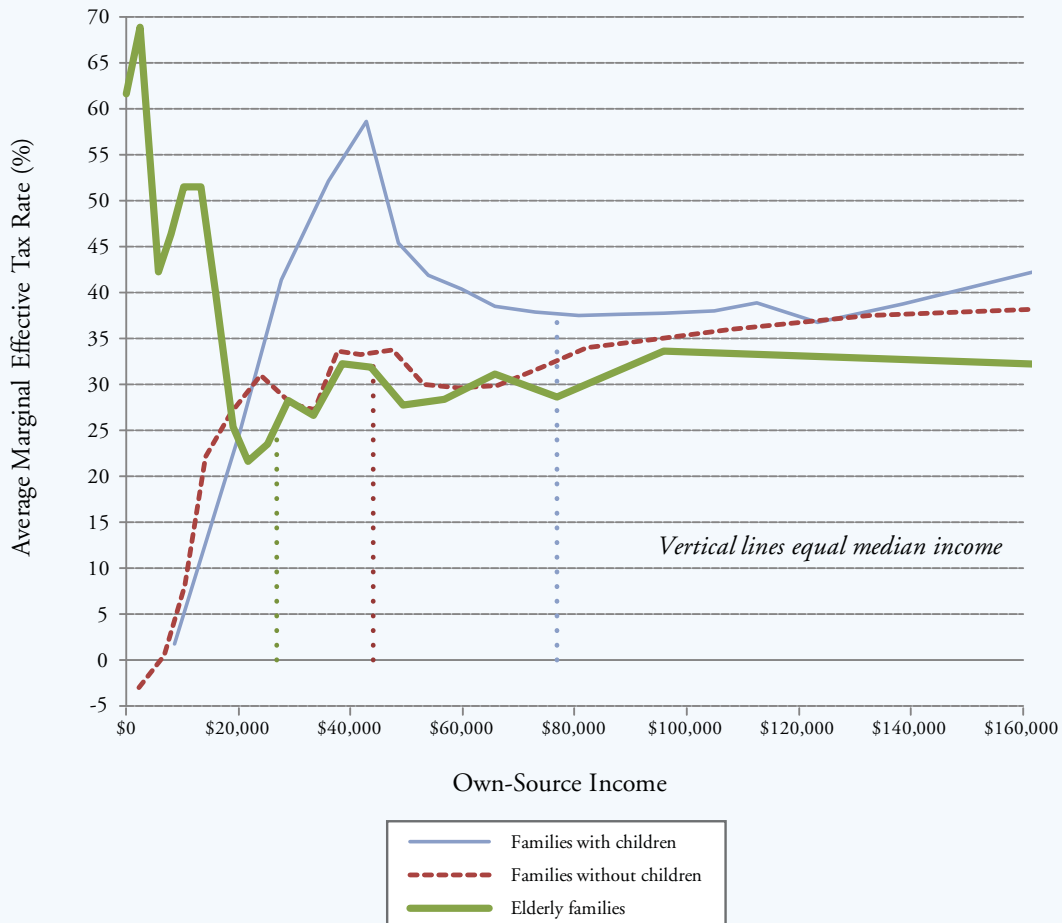
Source: Authors' calculations using Statistics Canada's SPSPD/M, v. 18.1.

which is necessary to keep the program's cost down, has a big impact on METRs, especially when the benefits and their reductions are substantial. In the case of the low-income supplement for families with three young children, the benefit reduction rate now adds 33.3 percent to the METRs.

The impact of these taxes, benefits and clawbacks is substantial, and it exposes families at low-to-mid-income levels to METRs higher than those faced by higher income families. For families in Ontario, for example, the rates are especially high in the \$25,000-to-\$45,000 range, where they are persistently over 60 percent for wage earners with two young children (Figure 1). For all families with minor children in Ontario, the METR in that income range now averages 52.1 percent, whereas it was 47.4 percent in 2000, in part owing to the Ontario component of child benefit and its supplement for families with child care expenses.

The impacts are similar for seniors in Ontario and elsewhere in that METRs are high at the low end of the income scale, but the causes are different. The main influence on seniors' METRs is the sharply pitched phase-out of the Guaranteed Income Supplement, a federal cash transfer that has been successful in reducing the incidence of poverty among Canada's seniors over the past two generations. The benefit comes at a price, however, which includes METRs of 50 to 100 percent for some of the lowest-income families. The phase-out of provincial top-ups, as well as the nonrefundable age tax credit – which has grown from about \$3,500 in 2000 to almost double that now – leaves low-income seniors facing among the highest possible METRs in Canada (Figure 2).

Figure 4: Average Family Marginal Effective Tax Rates (METRs) in Ontario, by Family Types 2011



Note: This chart shows average METRs calculated for each income vintile. Vintiles divide the income range into 20 equal parts, so that the bottom vintile, for example, represents the 5 percent of families whose incomes are lower than the next 95 percent. Families with children are single- or dual-parent families with minor children. Families without children are non-elderly single individuals and married or common-law couples without children. Rates are computed on the incremental income earned by the higher earning spouse. Recipients of social assistance are excluded from the sample. Elderly families are single individuals at least 65 years old and married or common-law couples with at least one spouse 65 years old or older, without children. Rates for elderly individuals are computed on income from taxable pension sources.

Source: Authors' calculations using Statistics Canada's SPSD/M, v. 18.1.

The METR profile and the impact of changes in the past decade are much simpler for households without children or seniors in Ontario.² They have benefited less from transfers aimed at families, of course, but neither does their incremental income typically expose them to extraordinarily high METRs (Figure 3).

Illustrating METR impacts for a given family type requires specific assumptions, such as those underpinning Figures 1 through 3. Family characteristics differ, and average METRs within a family type and income group have higher lows and lower highs than any particular family will experience. Nonetheless, we can aggregate families within an income

² With the exception of low-income working people affected by the Working Income Tax Benefit. Introduced in 2007, it has been helpful in combating the “welfare wall” by reducing METRs to negative levels for very low earnings, but also raised them in the phase-out range starting at earnings of about \$10,500 to \$16,500.

class and type, as in Figure 4, to illustrate common experience. The averages for families tell a slightly moderated story: low-to-middle income families with children face very high METRs, but generally not so high as do seniors. For families without children, the average METR profile is more in line with expectations of a simple graduated tax rate system, except that in practice the METR rises quickly and, after incomes exceed about \$20,000, shows a profile of the sort a flat rate tax might be expected to deliver. On the other hand, for both seniors and families with children, the half of families whose income is below the median generally face higher METRs than do the half of families above the median.

The Big Picture Assessment

Averaged across all family types and income levels, and across provinces, the personal income tax relief program introduced in 2000 has been a success in lowering METRs: the all-in average was 37.4 percent in 2000, whereas it is 32.7 today (Table 1).

For policymakers who focus on the questions that surround targeted benefits, however, the results bear a mixed message. That transfers and targeted credits deliver financial benefits is clear, but these benefits come at the expense of extraordinarily high METRs, harming work incentives for many of their beneficiaries. This cautions against further expansion of the targeted transfer system – by expanding low-income supplements or creating new, targeted benefits, for example – absent a broader rethinking of the system’s potential impacts on wage earners.

Policymakers interested in keeping down METRs overall should reinvigorate the personal income tax relief imperative, rather than implementing or expanding targeted benefits that make general tax relief more difficult to achieve.

Table 1: Average Marginal Effective Tax Rates (METRs), all Family Types, by Income Group and Province

2011						
Family Market Income	Up to \$15,000	\$15,001 to \$35,000	\$35,001 to \$60,000	\$60,001 to \$100,000	\$100,001 and over	All Families
Province	Percent					
Newfoundland	26.7	32.2	33.5	35.7	37.1	33.1
P.E.I.	38.5	32.0	35.8	36.5	39.5	36.1
Nova Scotia	27.3	32.5	36.5	38.1	41.1	34.9
New Brunswick	31.5	30.5	34.7	34.7	35.7	33.3
Quebec	25.0	35.0	42.1	40.8	42.4	36.6
Ontario	19.5	29.2	35.5	33.9	38.5	31.6
Manitoba	24.9	32.1	36.0	37.0	40.3	34.1
Saskatchewan	30.1	27.6	34.4	34.4	36.5	32.8
Alberta	28.9	24.9	34.1	32.9	34.8	31.7
B.C.	19.8	28.2	31.7	30.2	35.0	28.8
Canada	22.9	30.4	36.5	35.1	38.2	32.7

2000						
Family Market Income	Up to \$15,000	\$15,001 to \$35,000	\$35,001 to \$60,000	\$60,001 to \$100,000	\$100,001 and over	All Families
Province	Percent					
Newfoundland	30.4	35.7	41.5	44.3	47.9	38.5
P.E.I.	39.2	32.9	40.4	42.0	45.1	39.1
Nova Scotia	28.6	34.1	41.9	42.6	44.5	37.8
New Brunswick	27.4	34.3	41.6	42.3	44.3	37.2
Quebec	29.3	38.9	48.9	48.2	48.5	42.0
Ontario	24.5	29.5	39.4	38.7	43.0	35.5
Manitoba	29.4	33.9	42.2	44.0	45.7	38.6
Saskatchewan	27.4	35.9	41.7	42.5	45.3	37.8
Alberta	26.6	31.0	39.9	39.4	40.8	35.8
B.C.	20.5	33.0	39.2	39.9	44.7	34.6
Canada	26.0	33.4	42.2	41.6	44.3	37.4

Note: Each income group contains approximately one-fifth of families. Rates are computed on the incremental income earned in employment for non-elderly families, and on income from taxable pension sources for elderly families. Incremental income is earned by the higher earning spouse for married or common-law couples. Recipients of social assistance are excluded from the sample.

Source: Authors' calculations using Statistics Canada's SPSP/M, v. 18.1.

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