# The Impact of World War II on the Canadian Tax System

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# OUTLINE OF PRESENTATION

- Background information on the history of Canada, the federal/provincial structure, the constitutional framework and the allocation of taxing powers between the federal and provincial governments
- The changes in the tax system during WW II
- The post-WW II tax system – funding reconstruction
- Lessons learned
- Lessons for Ukraine?

# SETTING THE STAGE: HISTORY

- Canada was originally a French colony, and then, after the Seven Years War, it became a British colony in 1763
- Canada became an independent country in 1867 with Upper and Lower Canada, New Brunswick and Nova Scotia forming the Dominion of Canada
- 3 additional provinces – Manitoba, British Columbia and Prince Edward Island – joined in the next 6 years; Alberta and Saskatchewan joined in 1905 and Newfoundland in 1949
- Canada was formed in response to the threat of U.S. invasion after the U.S. civil war

# SETTING THE STAGE: THE CONSTITUTIONAL FRAMEWORK

- The original constitution gave unlimited taxing power to the federal government and only the power to levy “direct taxation within the province for provincial purposes” to the provinces
- The drafters wanted a strong central government to avoid the disaster that had occurred in the U.S.
- Central government had broad powers to make laws for “peace, order and good government”
- Provinces were given power over property and civil rights, which included health and welfare, transportation and education

# SETTING THE STAGE: THE TAX SYSTEM

- The first federal income tax system was introduced in 1917 as a result of WW I; it was called the Income War Tax Act
- Previously, some provinces and some municipalities had adopted income taxes
- The Great Depression in the 1930s led to increased need for government services and increased revenue, which led to competition between the federal and provincial governments over taxing rights, especially with respect to income taxes
- This struggle was temporarily resolved by Canada’s involvement in WW II

# FUNDING CANADA'S ROLE IN WW II

- Canada joined the war in September 1939, one week after the U.K. declared war
- Measures included drastic increases in personal and corporate tax rates and the scope of both taxes, plus the adoption of an inheritance tax
- From 1941-47 the provinces suspended their income taxes in exchange for transfers from the federal government
- Federal government agreed to reduce its tax rates after the war by at least 10 percent

# PERSONAL TAX RATES

- Personal income tax (PIT) before WW II:
  - Marginal rate 13.7% on income of between 10,000 and 15,000
  - Because of high personal exemptions, only 2.3% of individuals paid tax
- During WW II:
  - Marginal rate 69% on income of between 10,000 and 15,000
  - Top marginal rate was 98%
  - Approximately 50% of individuals paid tax
- PIT rates remained high after the war until reductions during the 1980s and 1990s

# CORPORATE TAX RATES

- Corporate income tax (CIT) before WW II:
  - 12.5 to 16% on first 25,000, 19% on the excess
- During WW II:
  - 14.85 to 53%
  - Corporations were also subject to an excess profits tax
- Corporate tax rates remained high (about 50% after the war) but gradually declined starting in 1970s

# RECONSTRUCTION AFTER WW II

- Took 15-20 years; hampered by the ongoing Cold War and the Korean War in the 1950s
- Enormous population growth after the war (almost doubled from 10 million to over 18 million from 1940 to 1960)
- Demobilization of armed forces of 1 million was a large concern
- High tax rates maintained after the war to fund social security and other increased government services

# RECONSTRUCTION AFTER WW II

- Several federal studies and federal/provincial meetings on the allocation of tax revenues among 3 levels of government, funding of social security and health insurance, and avoiding inflation and another depression
- Failure to reach agreement; instead, patchwork of bilateral deals based on pre-war tax-rental agreements followed by tax-sharing agreements; Ontario and Quebec refused to agree
- Abatement of federal PIT of 10%, 9% for CIT and 50% for inheritance taxes

# RECONSTRUCTION AFTER WW II

- In 1962, Tax Collection Agreements: federal government collects provincial income taxes on behalf of provinces if provinces agree to the federal tax base
  - Quebec (both PIT and CIT), Ontario and Alberta (only CIT) did not agree
- Ongoing tension between provinces and federal government
- 1966 Royal Commission on Taxation (the Carter Commission) recommended a comprehensive tax base with equity as the primary policy ("a buck is a buck")

# CURRENT SITUATION

- Federal government and all the provinces (and territories) impose PIT and CIT
- Canada Revenue Agency collects all PITs and CITs (except Quebec); the tax base is harmonized but tax rates and credits vary
- Canada Revenue Agency collects both federal VAT (GST at 5%) and provincial VATs that agree to harmonized base (Alberta has no VAT)
- Federal estate tax and provincial succession duties have been eliminated and replaced by deemed disposition on death of capital gains

# LESSONS

- Canada's post-war problems related to federal/provincial tensions
- The post-war economic boom reduced the risks of inflation and another depression
- The lack of any imminent threat to national security led to gradual over-reduction in defence spending; large increases in the past year to meet NATO target
- Our biggest threat currently is the U.S. – invasion is probably unlikely but economic pressure is causing serious pain