The Origins of the *Income Tax Act*

Craig Burley

In the mid-1860s prior to Confederation, people living in the British North America colonies paid the government's revenue in three ways: customs duties on goods entering the colony; excise duties on alcohol and tobacco sold in the colony; and property taxes, which sometimes included a component of the owner's income. The United Kingdom had an income tax at the time, deeply controversial between Liberals who claimed to oppose it (but always maintained it) and Conservatives who were more ambivalent, but British North America had never had one.

This was the existing tax mix; the decision of the framers of the British North America Act, then, were tasked with dividing these taxing powers between federal and provincial spheres. The provinces received property taxation and the federal government customs and excise (and indeed, "any Mode or System of Taxation"). This was, as many commentators over the previous century have noted, an odd choice: because as many provinces had already incorporated municipalities for their largest cities, property taxes were even then being downloaded to the local level. This left no principal means of financial support for provincial governments beyond the sale, lease or licensing—especially resource royalties—of public lands.

Yet in Nova Scotia and New Brunswick, over 70% of government revenue in 1866 came from customs duties. The loss of these was predictably devastating to their fiscal position; one of the great public controversies of the late 1860s was over the size of federal transfers that had to be made to the Maritime provinces. (Plus ça change...)

Provincial governments moved into income tax early, although hesitantly, as a result. British Columbia had a small income tax established in the 1870s. However, they moved more quickly and extensively into two other types of direct taxation: succession duties, and corporation taxes. The field of personal income tax was therefore still relatively clear as Canada approached the Great War. In 1913, provincial governments raised about 60 times as much revenue from corporation taxes and estate taxes as they did from income taxes. Canadians as a whole, across the country, paid a total of $119,000 in income taxes to provincial governments in 1913. This represented approximately 0.06% of all government revenue in Canada.

And then the War came.

The immediate result of war was a sharp economic boom the likes of which Canada had not seen in 50 years of confederation. The economy had expanded over 15 years due to the "wheat boom" until about 1912, when interest rates skyrocketed and the prices of Canada's agricultural exports began to decline. This had produced a sharp retrenchment that suddenly expanded as the very early (and unprofitable) days of the war in 1914 receded and the global need for armaments and especially food (60% of Canada's exports in 1914 and 1915) exploded. It was agricultural prices that created (by 1915) an explosion in profits, an explosion in cultivation, of lumbering, and of export activity and shipping.

What also came with war, of course, was exploding public expenditures. The call for increased federal expenditure to pay soldiers and build weapons and tools of war in the 1915-16 federal budget was a total of $166 million, which matched exactly the total government revenue of all levels of government in 1913. War alone, even in this early and less capital-intensive stage, had doubled the fiscal needs of the federation almost overnight. By the following year, it had nearly tripled it. Skyrocketing prices for all necessities were then further increased by significant raises to excise duties.

It was organized labour and agriculture's opposition to three developments in the wartime economy (indifferent wage rises, rising prices and the export boom) that created the fertile ground for a federal income tax. Industrial and agricultural workers saw booming profits in both sectors going into the pockets of owners of capital and felt that they should be responsible for giving back to the country. In two years between 1915 and 1917, Canadian exports to the rest of the world tripled.

This, allied to the growing government influence over the use of labour (including the establishment of a National Service Board seen correctly by many as a precursor to conscription) raised calls by organized labour, including the influential Trades and Labor Congress, for the "Conscription of Wealth" to match the conscription of labour. In this, the national Congress was replicating calls from local labour councils from across the country. A groundswell was emerging, unhelpfully allied to entrenched public opposition to Conscription (on broadly nationalist grounds) in Quebec.

In the meantime, the Conscription Crisis dragged on as the national Union government tried unsuccessfully to meet the demands of Canadian industry, Canadian agriculture, and the charnel house of the European trenches, all calling inexorably for Canadian bodies.

It was therefore against the backdrop of the mass demonstrations of the height of the Conscription Crisis that the Union government introduced the Income War Tax Act legislation in the House of Commons in August of 1917. It was specifically aimed at high incomes; the $1,500 base personal exemption was above the average wage even for manufacturing workers, while agricultural labourers earned less. This was the Conscription of Wealth that the workers had demanded, in order to help them endorse (as the Trades and Labor Congress eventually did, reluctantly) the conscription program.

Because of the high exemption and (to our modern eyes) low rates (4%, with surtaxes on incomes over $6,000) the income tax in its first full fiscal year of implementation earned "only" $56 million for the fisc. However, this represented nearly 18% of federal government revenue for that 1918-19 fiscal year. The income tax was on its way to its current role as the deep bedrock from which Canadian government revenue springs. Canada transitioned easily by global standards to a post-war economy, but the necessity to finance the large federal debts (war loans and war bonds) that had been incurred meant that income taxation would remain along with industrialization, urbanization, financialization and other deep social effects of the Great War. Total Canadian public debt grew seven times over in seven years between 1914 and 1921. The coming demand for social services would ensure that this djinn would never return to its original form. ■