Financial Accountability Office of Ontario

TAX EXPENDITURES

OVERSIGHT, GROWTH AND DISTRIBUTION

2020

About this document

Established by the *Financial Accountability Officer Act, 2013,* the Financial Accountability Office (FAO) provides independent analysis on the state of the Province's finances, trends in the provincial economy and related matters important to the Legislative Assembly of Ontario.

The FAO produces independent analysis on the initiative of the Financial Accountability Officer. Upon request from a member or committee of the Assembly, the Officer may also direct the FAO to undertake research to estimate the financial costs or financial benefits to the Province of any bill or proposal under the jurisdiction of the legislature.

This report was prepared on the initiative of the Financial Accountability Officer. In keeping with the FAO's mandate to provide the Legislative Assembly of Ontario with independent economic and financial analysis, this report makes no policy recommendations.

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Table of Abbreviations

Abbreviation	Long Form
CARE	Childcare Access and Relief from Expenses
CIT	Corporate Income Tax
CPP	Canada Pension Plan
EHT	Employer Health Tax
FAO	Financial Accountability Office
GDP	Gross Domestic Product
HST	Harmonized Sales Tax
LIFT	Low-income Individuals and Families Tax
MPP	Member of Provincial Parliament
PIT	Personal Income Tax
RST	Retail Sales Tax
SPSDM	Statistics Canada's Social Policy Simulation Database and Model
TCA	Tax Collection Agreement
TTR	Taxation Transparency Report

1 | Executive Summary

What are tax expenditures and how much do they cost the Province?

- Tax expenditures are benefits delivered through the tax system, which include tax deductions, tax exemptions, non-refundable and refundable tax credits, and other tax provisions. Tax expenditures provide benefits to individuals, businesses and other organizations by either reducing the amount of taxes owed or directly transferring money to beneficiaries. All tax expenditures incur a cost to government, either in the form of a reduction in tax revenue or an increase in program spending.

- In 2019-20, there are 149 tax expenditures offered by the government of Ontario (the Province) at a projected cost of $44.4 billion. If tax expenditures were identified separately in the Ontario Budget and compared to the Province's program spending, tax expenditures would be the second highest spending sector for the Province, after the health sector.

Most tax expenditures are not regularly reviewed by MPPs

- In Ontario, all tax expenditures must be approved by the provincial legislature.[1] However, once a tax expenditure has been created through legislation there is limited ongoing oversight by Members of Provincial Parliament (MPPs). This is in stark contrast to the Province's program spending, most of which is reviewed and approved each year by MPPs through the *Supply Bill* process.[2]

- Similar to program spending, tax expenditures are an important policy instrument that have wide-ranging impacts on the government's finances and the provincial economy. The Province's 149 tax expenditures are intended to achieve many different policy objectives, including encouraging investment and savings, providing support to businesses and assisting low-income individuals and families.[3]

- In order to ensure the effectiveness and efficiency of tax expenditures, as with any other government spending program, it is important to regularly review and monitor each tax expenditure to ensure that the objective for the tax expenditure is being achieved.

The federal government controls one-third of the Province's tax expenditures

- The Province's 149 tax expenditures are delivered through 13 different tax systems. Three of these tax systems – personal income tax (PIT), corporate income tax (CIT), and the Harmonized Sales Tax (HST) – are administered by the federal government on behalf of the Province.[4]

- As part of the administration agreements, the Province gave the federal government unilateral control in determining taxable income, for PIT and CIT, and the sales tax base for the HST.[5] Since many of the Province's tax expenditures are deductions and exemptions that are part of the calculation of taxable

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[1] Includes Ontario tax expenditures that are controlled by the federal government. See chapter 3 for more information.
[2] Fifteen of the Province's tax expenditures (at a cost of $1.4 billion in 2019-20) are recorded as program spending and are subject to the annual *Supply Bill* review process. The remaining 134 tax expenditures (at a cost of $43.0 billion in 2019-20) are recorded as foregone revenue and are not subject to an annual review process by MPPs. For more information on the annual *Supply Bill* process, see FAO, "Expenditure Estimates: A Review of Ontario's Proposed Spending Requirements for the 2018-19 Supply Bill," 2019.
[3] See chapter 3 and appendix A for more details.
[4] This arrangement is enabled by provincial legislation and tax collection agreements between the federal and Ontario governments.
[5] Also called the "common tax base." See chapter 3 for more information.

income and the sales tax base, a number of the Province's tax expenditures are created and controlled exclusively by the federal government.[6]

- Overall, 49 of the Province's tax expenditures are controlled by the federal government, with the remaining 100 tax expenditures controlled by the Province.

Tax expenditure spending is growing faster than program spending

- For the past eight years, spending on tax expenditures has grown significantly faster than program spending. During this period, program spending growth averaged 2.6 per cent per year, a growth rate slower than the overall economy. On the other hand, tax expenditure spending grew 4.4 per cent on average each year, exceeding the growth rates of program spending and the economy.
- For 2019-20, the FAO forecasts an even larger gap in the growth rate of tax expenditure spending compared to program spending. Tax expenditure spending is projected to increase by 4.8 per cent, while program spending is projected to increase by 1.3 per cent. The larger than average gap in the growth rates between tax expenditure spending and program spending in 2019-20 partially reflects two new tax expenditures introduced by the Province in 2019: the Childcare Access and Relief from Expenses (CARE) tax credit and the Low-income Individuals and Families Tax (LIFT) credit.

How are tax expenditure benefits distributed to Ontario families?

- The FAO selected the 12 costliest tax expenditures offered through the personal income tax system, representing a total cost to the Province of $17 billion in 2019-20, and estimated how the $17 billion benefit is distributed to Ontario families.[7] The FAO made the following observations:
    - The 20 per cent of Ontario families with the highest incomes (earning over $123,400) will receive 43 per cent of the total benefit, or $5,660 per family on average.
    - Families in the second highest income quintile, earning between $78,100 and $123,400 per year, will receive 18 per cent of the total benefit, or $2,374 per family on average.
    - The remaining 60 per cent of Ontario families, earning $78,100 or less, will receive only 38 per cent of the benefit, or between $1,395 and $1,823 per family on average.
- The FAO separated the 12 tax expenditures into four tax deductions and eight tax credits, and found that the benefit from the tax deductions is heavily concentrated in the top income group, while the benefit from the tax credits is more evenly distributed.
- Seventy-five per cent of the total benefit from the four tax deductions will be provided to families with incomes greater than $123,400 in 2019-20.[8] High-income families receive most of the benefit because tax deductions typically target the income sources and activities (e.g., capital investment and savings) that are concentrated among high-income earners. In addition, high-income earners are subject to a higher marginal tax rate so the benefit from tax deductions is greater for these families than lower-income families.

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[6] Tax expenditures that are applied after the calculation of taxable income, such as refundable and non-refundable income tax credits, are created and controlled by the Province.

[7] For the list of selected tax expenditures, see chapter 5.

[8] The four tax deductions reviewed are the Registered Retirement Savings Plans (RRSPs) – Deductions for Contributions, the Registered Pension Plans (RPPs) – Deduction for Contributions, the Partial Inclusion of Capital Gains, and the Deduction of Carrying Charges Incurred to Earn Income.

- Although the combined benefit from the eight tax credits is distributed relatively evenly across family income quintiles, different tax credits target different income groups:
    - The Ontario Sales Tax Credit and the Ontario Energy and Property Tax Credit provide most benefit to families in the bottom 20^{th} percentile (earning $25,100 or less).
    - The Charitable Donations Credit, the CPP/QPP Contributions Credit and the Basic Personal Credit provide most benefit to families in the top 20^{th} percentile (earning $123,400 or more).
    - The CARE tax credit, LIFT credit and Age Credit provide most benefit to middle-income families (the middle 60 per cent of families by income).
- See chapter 5 for more information on how the benefit from each tax deduction and credit is distributed to Ontario families.

2 | Introduction and Background

What are tax expenditures?

Tax expenditures are benefits provided through the tax system to individuals, businesses and other organizations by reducing the amount of taxes owed or directly transferring money to beneficiaries. In 2019-20, there are 149 different tax expenditures offered by the government of Ontario (the Province).[9] These tax expenditures include:

- Income tax deductions, which allow tax filers to reduce the amount of income that is subject to tax;
- Exemptions to remove specific income or transactions from being subject to tax;
- Non-refundable income tax credits that reduce the amount of taxes owed; however, in the case where there are no taxes payable, these credits do not create a tax refund; and
- Refundable income tax credits, which can produce a tax refund even if there are no taxes payable, making these tax credits effectively provincial spending grants.

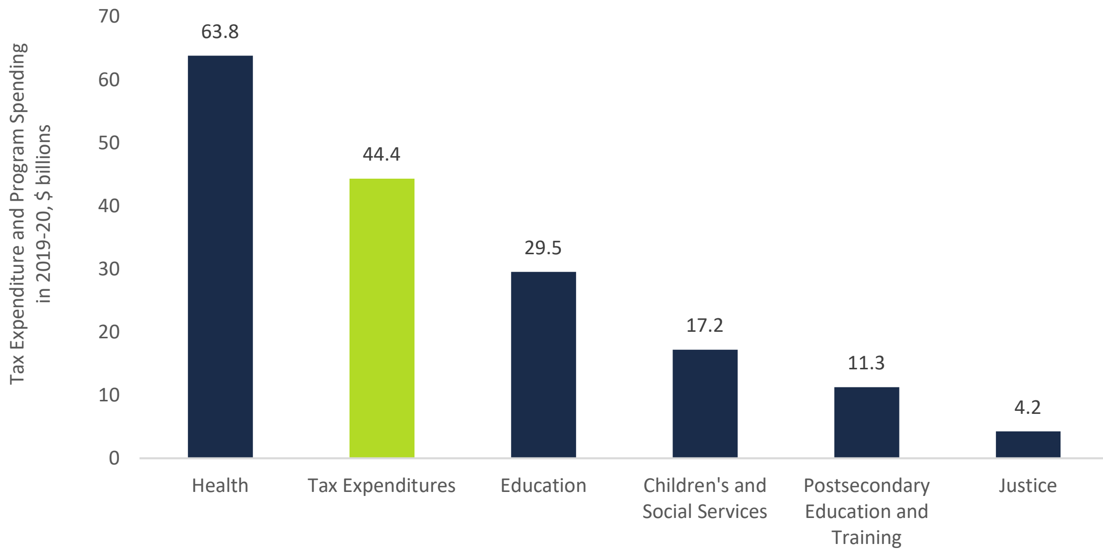
How much do tax expenditures cost the Province?

The FAO estimates that in 2019-20, the Province's 149 tax expenditures will cost $44.4 billion.[10] The cost of the Province's tax expenditures is recorded in the Ontario Budget and the Public Accounts of Ontario as either foregone revenue (i.e., as a reduction in taxation revenue) or program spending expense, depending on the nature of the tax expenditure.

In general, all tax expenditures incur a cost to government to achieve policy objectives and are comparable to program spending. If tax expenditures were identified separately in the Ontario Budget and compared to the Province's program spending, tax expenditures would be the second highest expense sector for the Province, after the health sector.

[9] Includes all tax expenditures reported in the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates. Tax expenditures for which there are no available estimates are not included in the Province's Taxation Transparency Reports and are excluded from the FAO's analysis.
[10] The FAO estimates the total cost of the Province's tax expenditures as the sum of individual estimates from the Taxation Transparency Reports, Public Accounts of Ontario, and the Expenditure Estimates. The total cost is an estimate only and may not reflect potential interactions among some tax expenditures. See appendix B for more information on the methodology used to estimate the cost of the Province's tax expenditures.

Figure 2-1: Tax expenditures compared to program spending, 2019-20, $ billions



Note: Program spending sectors exclude applicable tax expenditures.
Source: FAO analysis using the Taxation Transparency Report, 2019, the 2019 Ontario Economic Outlook and Fiscal Review and the 2019-20 Expenditure Estimates.

Purpose and structure of this report

The purpose of this report is to provide an overview of Ontario's tax expenditures, estimate the cost of tax expenditures to the Province and review how tax expenditure costs have evolved over time. The report also identifies how the largest personal tax expenditures are distributed across Ontario families.

This report is structured as follows:

- Chapter 3 discusses the administration and oversight of the Province's tax expenditures.
- Chapter 4 analyzes the historical growth rate of tax expenditure spending.
- Chapter 5 identifies the 12 costliest personal tax expenditures and shows how the benefit from these tax expenditures are distributed to Ontario families.

Appendix B provides more information on the development of this report.

3 | Administration and Oversight

How are tax expenditures administered and controlled?

The Province's 149 tax expenditures are provided through 13 different tax systems. A third of the Province's tax expenditures, at a cost of $21.1 billion in 2019-20, are provided through the personal income tax system. The sales and corporate income tax systems account for another 54 tax expenditures, combined, at a cost of $19.1 billion in 2019-20. Finally, the remaining 45 tax expenditures are provided through 10 additional tax systems, at a cost of $4.1 billion in 2019-20.

Table 3-1: Number of tax expenditures and total cost by tax system, 2019-20, $ millions

Tax System	Number of Tax Expenditures	Total Cost ($ millions)
Personal Income	50	21,107
Sales	33	13,036
Corporate Income	21	6,076
Education Property	13	174
Beer, Wine and Spirits	7	53
Gasoline	6	319
Land Transfer	5	296
Mining	5	50
Retail Sales	3	1,878
Fuel	3	412
Estate Administration	1	0
Employer Heath	1	958
Tobacco	1	0
Total	**149**	**44,359**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis of the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Ontario's personal income tax (PIT), corporate income tax (CIT), and sales tax (or Harmonized Sales Tax (HST)) systems are administered by the federal government on behalf of the Province. This arrangement has been in place since 1962 for PIT, 2009 for CIT and 2010 for HST, and is enabled by provincial legislation and tax collection agreements between the federal and Ontario governments.

Under the three federal-Ontario tax collection agreements,[11] the Province has agreed to use the federal definition of taxable income[12] for PIT and CIT, and the federal definition of the sales tax base for HST. This results in what is called the "common tax base" for Ontarians and organizations when paying federal and provincial PIT, CIT and

[11] For more information on the PIT tax collection agreement, see "Federal Administration of Provincial Taxes," 2000. For more information on the CIT tax collection agreement, see https://www.fin.gov.on.ca/en/tax/ct/singleadmin.html (accessed on December 12, 2019). For more information on the HST tax collection agreement, see "Comprehensive Integrated Tax Coordination Agreement," 2009.
[12] Taxable income is calculated as total income for tax purposes, less the value of tax deductions and other items.

HST.[13] Once the common tax base is determined, the Province sets its own provincial income tax brackets, rates and credits, and the HST rate and rebates.

Importantly, as part of the three tax collection agreements and enabling legislation, the Province has agreed to give the federal government unilateral control in determining the common tax base. Since many of the Province's tax expenditures are tax deductions[14] and exemptions[15] that are applied to the calculation of the common tax base, this means that a number of the Province's tax expenditures are created and controlled exclusively by the federal government. On the other hand, under the three tax collection agreements, the tax expenditures that are applied after the calculation of the common tax base, such as refundable and non-refundable income tax credits, are created and controlled by the Province.

Overall, 49 of the Province's tax expenditures are controlled by the federal government, at a projected cost to the Province of $21.7 billion in 2019-20, with the remaining 100 tax expenditures, at a projected cost of $22.7 billion in 2019-20, controlled by the Province.

How do MPPs approve and review tax expenditures?

In Ontario, all tax expenditures, including the 49 controlled by the federal government, must be approved by the provincial legislature. Tax expenditures are either approved explicitly, through legislation that creates the specific tax expenditure, or implicitly through the *Taxation Act, 2007* and the *Retail Sales Tax Act* which use the federal government's definition of the common tax base (and associated tax expenditures).

Once a tax expenditure has been created through legislation (either explicitly or implicitly), there is little ongoing oversight by Members of Provincial Parliament (MPPs) on the cost or effectiveness of the Province's tax expenditures. This is especially apparent when compared to MPPs' oversight of provincial program spending.

In Ontario, MPPs approve the majority of the Province's program spending each year through the passage of the *Supply Bill*.[16] As part of the *Supply Bill* process, the Province formally requests spending authority from the legislature through the Expenditure Estimates and each ministry provides an Estimates Briefing Book, which reviews planned spending, objectives and outcomes of the ministry's programs. The Standing Committee on Estimates (SCE), a committee of the legislature, then has the opportunity to select and meet with between six and 12 ministries in order to question ministers and staff about each ministry's programs and spending plans.

Of the Province's 149 tax expenditures, only 15 are recorded as program spending expense in the Expenditure Estimates and are consequently included in the annual *Supply Bill* review and spending approval process. The remaining 134 tax expenditures, representing a cost of $43.0 billion in 2019-20, are not subject to any formal ongoing oversight by the legislature.

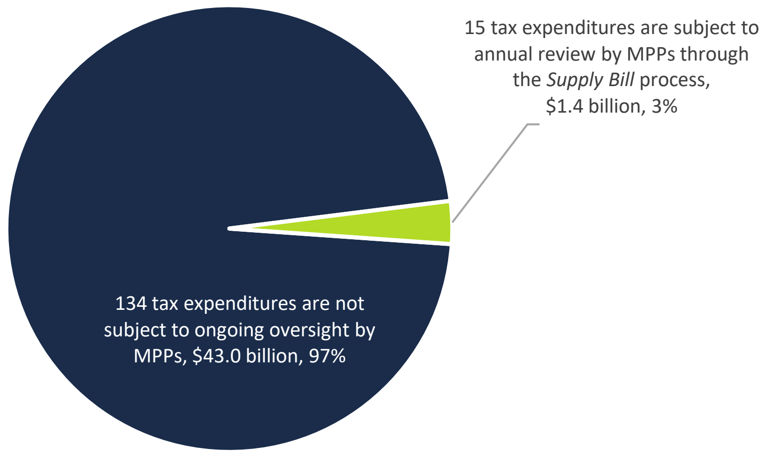
[13] A single administration of tax through a common tax base simplifies the tax filing process and lowers administrative costs.

[14] For example, the Child Care Expense Deduction allows individuals to deduct from their income all or part of child care expenses they incurred to earn income or study. This reduced income subject to tax lowers the common tax base and, in turn, lowers provincial income tax revenue and results in a provincial tax expenditure.

[15] For example, Tax-Free Savings Accounts (TFSAs) allow individuals to exempt from tax capital gains and investment income earned on funds within a TFSA. Exemptions also apply to the HST system. For example, basic groceries, which include most foodstuffs for preparation and consumption at home, are exempt from HST. These two measures impact the calculation of the common tax base for PIT and HST and result in provincial tax expenditures.

[16] For more information on the annual *Supply Bill* process, see FAO, "Expenditure Estimates: A Review of Ontario's Proposed Spending Requirements for the 2018-19 Supply Bill," 2019.

Figure 3-1: Most tax expenditures are not subject to any formal review process by MPPs, $ billions



Source: FAO's analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

The policy objectives of Ontario's tax expenditures

Similar to program spending, tax expenditures are an important policy instrument that have wide-ranging impacts on the government's finances and the provincial economy. The Province's 149 tax expenditures are intended to achieve many different policy objectives, which the FAO has divided into six major categories:[17]

- Encouraging investment and savings;
- General support to businesses;
- General personal income tax relief;
- Support for low-income individuals and families;
- Tax relief for public organizations; and
- Support to achieve other targeted policy objectives.

The following table shows the number of tax expenditures and total cost by major policy objective.

[17] See appendix A for the complete list of tax expenditures by major policy category.

Table 3-2: Tax expenditures categorized by major policy objective

Policy Objective	Total Cost in 2019-20 ($ billions)	Number of Tax Expenditures
Investment and Savings Mostly deductions and exemptions for retirement savings and investment activities.	10.6	14
Business Support Provide financial support to businesses. Includes reduced tax rates, deductions, exemptions and targeted tax credits.	6.1	52
General Tax Relief Reduce the overall personal income tax burden. The Basic Personal Credit accounts for most of this cost.	5.5	6
Support for Low-income Individuals and Families Provide financial support to low-income individuals and families. Most are provincially controlled tax expenditures.	4.3	10
Public Bodies Exempt public organizations from taxation, such as municipalities, hospitals and school authorities.	2.6	5
Targeted Supports Incentivize actions, support certain groups or promote other specific policy objectives.	15.2	62
Total	**44.4**	**149**

Note: See appendix A for a complete list of tax expenditures by policy objective.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Overall, the largest category, by both total cost ($15.2 billion) and number of tax expenditures (62), is for Targeted Supports. These tax expenditures incentivize actions, support certain groups or promote other specific policy objectives. Three tax expenditures in this category are projected to cost over $1 billion each in 2019-20.[18] However, most of the Targeted Supports tax expenditures are estimated to cost less than $100 million in 2019-20.[19]

Compared to Targeted Supports, which cover a broad range of policy objectives, the other five categories have specific policy objectives. Business Support has the largest number of tax expenditures (52) at a projected cost of $6.1 billion in 2019-20. Two tax expenditures account for over half of this cost: the Ontario Small Business Deduction and the Employer Health Tax Exemption for Private-Sector Employers. The remaining 50 tax expenditures in this category have an average estimated cost of about $55 million in 2019-20.

Investment and Savings includes 14 tax expenditures at a cost of $10.6 billion in 2019-20. Four tax expenditures account for nearly 80 per cent of the cost in this category: the Partial Inclusion of Capital Gains for PIT and CIT, deductions for Registered Retirement Savings Plans (RRSPs), and deductions for Registered Pension Plans (RPPs).[20]

Support for Low-income Individuals and Families and General Tax Relief include 10 and six tax expenditures, respectively. Support for Low-income Individuals and Families includes the Ontario Sales Tax Credit, Ontario Energy and Property Tax Credit, the Low-income Individuals and Families Tax (LIFT) Credit and the Age Credit. Over 80 per cent of the cost for the General Tax Relief category is through the Basic Personal Credit. Chapter 5 reviews how the benefit from these tax expenditures is distributed by family income.

[18] The Zero-Rating of Basic Groceries, the Exemption for Residential Rent and the Exemption for Automobile Insurance Premiums.
[19] See appendix A for the complete list.
[20] See chapter 5 for more information on the distribution of the benefit from these tax expenditures by family income (excluding the Partial Inclusion of Capital Gains for CIT).

Finally, the Public Bodies category includes five tax expenditures that exempt the Province's municipalities, hospitals, school boards, universities and colleges from paying HST.

Why is it important to review tax expenditures?

Tax expenditures deviate from the core function of the tax system, which is to raise the revenue required to fund government programs, and instead use general tax system revenues to provide benefits to select beneficiaries in order to achieve policy objectives. In many cases, a new tax expenditure will be introduced by government, rather than a new direct spending program, because the taxation system can easily and more efficiently administer the new spending program. In other words, introducing a new spending grant through the taxation system as a tax expenditure can often be less costly and less complex than creating a new system to administer a direct payment to people or organizations.

On the other hand, the introduction of new tax expenditures can increase the complexity of the tax system, which can add compliance costs for taxpayers and reduce the predictability of tax revenues due to complex interactions among tax expenditures.

In general, to ensure the effectiveness and efficiency of tax expenditures, as with any other government spending program, it is important to review and monitor each tax expenditure to ensure that the objective for the tax expenditure is being achieved. For most tax expenditures, the policy purpose of the measure is only scrutinized and debated by MPPs when first introduced by the government in proposed legislation.[21] Without periodic review and debate, it is unclear whether the purpose, effectiveness, impact and cost of Ontario's tax expenditures continue to be desirable.

[21] For tax expenditures controlled by the federal government, there is no opportunity for MPPs to debate the proposed tax expenditure even when the tax expenditure is first introduced.

4 | Tax Expenditure Spending Growth

This chapter explores how tax expenditure spending has evolved over time and compares the growth in tax expenditure spending relative to the growth in Ontario's economy and the Province's program spending. Overall, the cost of the Province's tax expenditures has grown faster than both provincial program spending and nominal GDP.

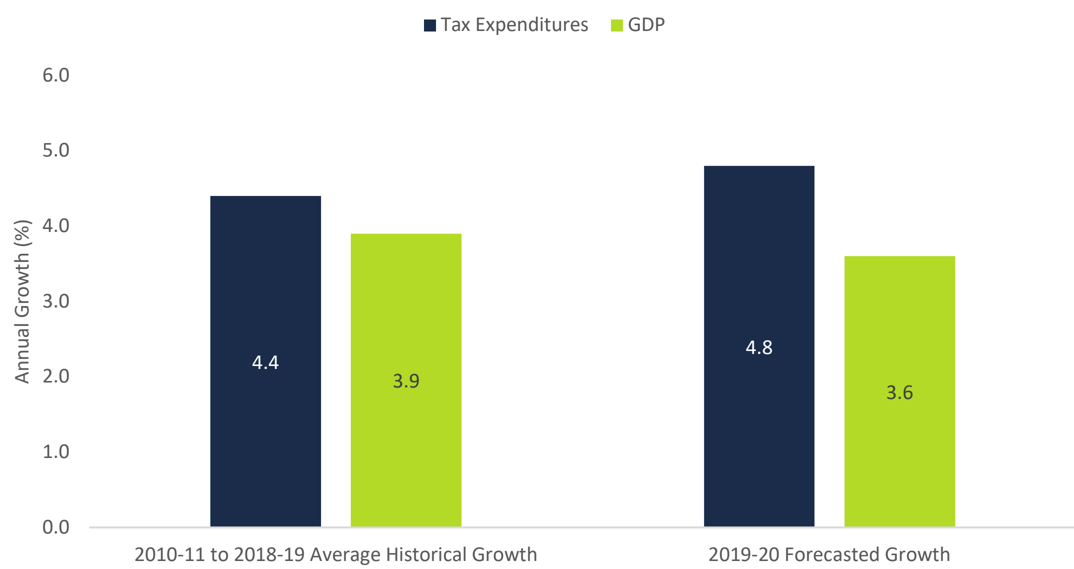
Tax expenditure spending growth higher than nominal GDP growth

Between 2010-11 and 2018-19, the average annual growth rate of the total cost of the Province's tax expenditures was 4.4 per cent, which is above the 3.9 per cent average annual growth rate for nominal GDP, the broadest measure of the tax base.

For 2019-20, the FAO estimates that nominal GDP growth, at 3.6 per cent,[22] will be below the 3.9 per cent average growth rate since 2010-11. In comparison, tax expenditure spending is expected to grow at 4.8 per cent in 2019-20, above the 4.4 per cent average growth rate from 2010-11 to 2018-19. The relatively higher growth rate in tax expenditure spending is largely due to the introduction of two new tax expenditures in 2019:

- Childcare Access and Relief from Expenses (CARE) tax credit;[23] and
- Low-income Individuals and Families Tax (LIFT) Credit.[24]

Figure 4-1: Tax expenditure spending growth higher than nominal GDP growth



Source: FAO analysis using the Taxation Transparency Reports, Public Accounts of Ontario and the Expenditure Estimates.

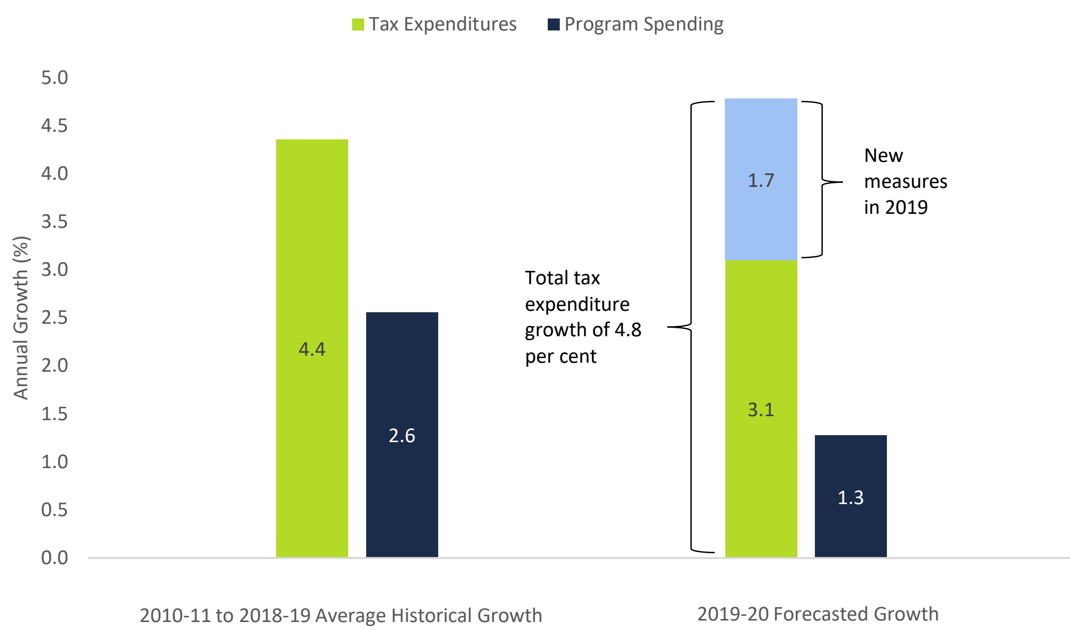
[22] For more information, see FAO, "Economic and Budget Outlook: Assessing Ontario's Medium-Term Budget Plan," Fall 2019.
[23] For more information on the CARE tax credit, see FAO, "Child Care in Ontario: A Review of Ontario's New Child Care Tax Credit and Implications for Ontario's Labour Force," 2019.
[24] For more information on the LIFT credit, see FAO, "Comparing the LIFT Credit to a Minimum Wage Increase," 2019.

Tax expenditure spending growth faster than program spending

For the past eight years, spending on tax expenditures has grown significantly faster than program spending, with an average growth rate of 4.4 per cent compared to 2.6 per cent for program spending.[25] As noted above, nominal GDP grew at an average annual rate of 3.9 per cent over the 2010-11 to 2018-19 period. This implies that program spending, at 2.6 per cent average growth, experienced a period of restraint, growing at a rate slower than the overall economy over the last eight years. On the other hand, tax expenditure spending, at 4.4 per cent average annual growth, exceeded the growth rate of the economy over the same eight-year period.

For 2019-20, the FAO forecasts an even larger gap in the growth rate of tax expenditure spending compared to program spending. In 2019-20, tax expenditure spending is projected to increase by 4.8 per cent, while program spending is forecast to increase by 1.3 per cent.

Figure 4-2: Tax expenditure spending growth to outpace program spending growth in 2019-20



Note: Program spending excludes tax expenditures that are reported as expense.
Source: FAO's analysis using the Taxation Transparency Reports, Public Accounts of Ontario and the Expenditure Estimates.

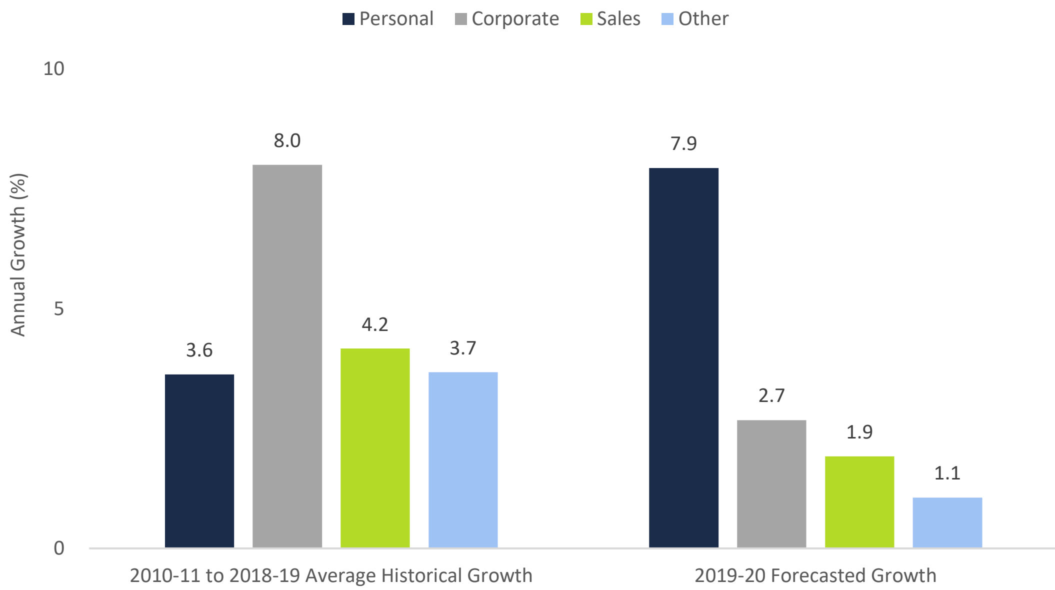
The larger than average gap in the growth rates between tax expenditure spending and program spending in 2019-20 reflects the two new tax expenditures introduced by the Province in 2019: the CARE tax credit and the LIFT credit. The FAO estimates that, when combined, these two new tax expenditures will cost the Province about $0.9 billion and be responsible for 1.7 percentage points of the 4.8 per cent growth in tax expenditure spending in 2019-20. Without these measures, the FAO estimates that tax expenditure spending growth would have been 3.1 per cent in 2019-20.

[25] Program spending excludes tax expenditures that are reported as expense.

Personal tax expenditures growing faster than historical average

Only tax expenditures delivered through the personal income tax system are projected to grow faster in 2019-20 than the historical average, while tax expenditures delivered through the corporate, sales and all other tax systems are projected to grow at below average rates in 2019-20.

Figure 4-3: Tax expenditure spending growth by tax system categories



Source: FAO's analysis using the Taxation Transparency Reports, Public Accounts of Ontario and the 2019-20 Expenditure Estimates.

PIT tax expenditures

The FAO estimates that spending on the 50 tax expenditures delivered through the PIT system will grow by 7.9 per cent in 2019-20, which is the highest growth rate over the past eight years. The higher 2019-20 growth, compared to the historical average annual growth rate of 3.6 per cent, is largely due to the introduction in 2019 of the CARE tax credit and the LIFT credit. The FAO estimates that in 2019-20 the CARE tax credit will cost the Province $434 million and the LIFT credit will cost $495 million.[26] Without these two new tax expenditures, the FAO estimates that 2019-20 PIT tax expenditure growth would have been 4.4 per cent, which is more comparable to the historical average.

CIT tax expenditures

Between 2010-11 and 2018-19, spending on tax expenditures delivered through the CIT system has recorded the highest average annual growth out of all four tax system categories at 8.0 per cent. In the eight-year period, spending on CIT tax expenditures has grown from $3.2 billion to over $5.9 billion. Behind the rapid growth in CIT tax expenditure spending are the Ontario Small Business Deduction (SBD) and the Partial Inclusion of Capital Gains (PICG). Combined, these two tax expenditures have grown at an average annual rate of 11 per cent between 2010-11 and 2018-19. By 2019, these two tax expenditures accounted for 74 per cent of all CIT tax expenditure spending.

[26] In the FAO's report "Comparing the LIFT Credit to a Minimum Wage Increase," 2019, the FAO estimated the cost of the LIFT credit at $413 million for 2019-20. This estimate was net of interaction effects with the Ontario Tax Reduction. The $495 million cost of the LIFT credit in this report is the gross cost of the LIFT credit, offset by a lower cost for the Ontario Tax Reduction, which is consistent with the Province's estimates as reported in the Taxation Transparency Report, 2019.

In 2019-20, spending on CIT tax expenditures is expected to grow by 2.7 per cent, which is below the historical average of 8.0 per cent over the past eight years. This is consistent with the FAO's projection of corporate profits, which are expected to grow by 1.7 per cent in 2019-20,[27] below the historical average of 5.2 per cent over the past eight years.

Sales tax expenditures

Spending on tax expenditures delivered through the sales tax system recorded an average annual growth of 4.2 per cent between 2010-11 and 2018-19.[28] This average growth rate is comparable to the average growth rate of 4.1 per cent over the last eight years for Ontario's household consumption. In 2019-20, the cost of sales tax expenditures is projected to increase by 1.9 per cent, significantly lower than the historical average. The low growth in 2019-20 is mainly due to the declining cost of housing-related tax expenditures, which include the HST Exemption for Certain Residential Rent and the Ontario New Housing Rebate. The costs of these two tax expenditures in 2019-20 are projected to decline by 19 per cent and 25 per cent, respectively.

Other tax expenditures

The cost of the 20 tax expenditures delivered through the remaining tax systems is projected to grow by 1.1 per cent in 2019-20, which is lower than the 3.7 per cent historical average. The largest tax expenditure in this category is the Employer Health Tax (EHT) Exemption for Private-Sector Employers, which accounts for 80 per cent of the total cost. Due to an inflation-related adjustment in 2019 that increased the EHT exemption from the first $450,000 of employee compensation to the first $490,000, the FAO projects the cost of the EHT Exemption for Private-Sector Employers tax expenditure will increase by 4.5 per cent in 2019-20. However, the higher cost of the EHT exemption is offset by sharply declining costs for the Vacant Commercial and Industrial Unit Rebate and the Vacant Land and Excess Land Sub-Class Tax Rate Reduction tax expenditures,[29] which are being phased out in many municipalities after they were made optional in 2017.[30]

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[27] For more information, see FAO, "Economic and Budget Outlook: Assessing Ontario's Medium-Term Budget Plan," Fall 2019.

[28] This growth rate includes tax expenditures delivered through the HST, RST and commodity (fuel, gasoline, land transfer, tobacco, and beer, wine and spirits) tax systems.

[29] The Vacant Commercial and Industrial Unit Rebate provides tax rebates on the municipal and education property taxes paid with respect to vacant commercial and industrial buildings or portions of the building. The Vacant Land and Excess Land Sub-Class Tax Rate Reduction reduces property tax rates on vacant and excess lands in the commercial and industrial property classes. Refer to the "Descriptions of the Tax Provisions Listed in the Taxation Transparency Report, 2019" for more details.

[30] See Ontario Regulation 360/18 and Ontario Regulation 582/17 for more details.

5 | Distribution of Tax Expenditure Benefits

This chapter explores how the largest tax expenditures delivered through the personal income tax (PIT) system are distributed among Ontario families.[31]

What are the costliest PIT tax expenditures?

The FAO identified the 12 costliest PIT tax expenditures with overall projected spending of $17 billion in 2019-20. Together, these 12 tax expenditures represent over 80 per cent of expected PIT tax expenditure spending in 2019-20. Of the 12 tax expenditures, four are tax deductions and eight are tax credits.[32]

Table 5-1: Largest PIT tax expenditures for 2019-20

Tax Expenditure	Cost ($ millions)	Share of Total (%)	Type
Basic Personal Credit	4,703	22.3	Credit
Registered Retirement Savings Plans (RRSPs) — Deduction for Contributions	2,714	12.9	Deduction
Partial Inclusion of Capital Gains	2,147	10.2	Deduction
Ontario Energy and Property Tax Credit	1,474	7.0	Credit
Ontario Sales Tax Credit	1,401	6.6	Credit
Registered Pension Plans (RPPs) — Deduction for Contributions	1,382	6.5	Deduction
Charitable Donations Credit	758	3.6	Credit
Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) Contributions Credit	652	3.1	Credit
Deduction of Carrying Charges Incurred to Earn Income	510	2.4	Deduction
Low-income Individuals and Families Tax (LIFT) Credit	495	2.3	Credit
Childcare Access and Relief from Expenses (CARE) Tax Credit	434	2.1	Credit
Age Credit	335	1.6	Credit
Total	**17,006**	**80.6**	

Note: "Share of Total" represents the share of the total cost of all PIT tax expenditures in 2019-20.
Source: FAO analysis using SPSDM, Taxation Transparency Report, 2019, and the 2019-20 Expenditure Estimates.

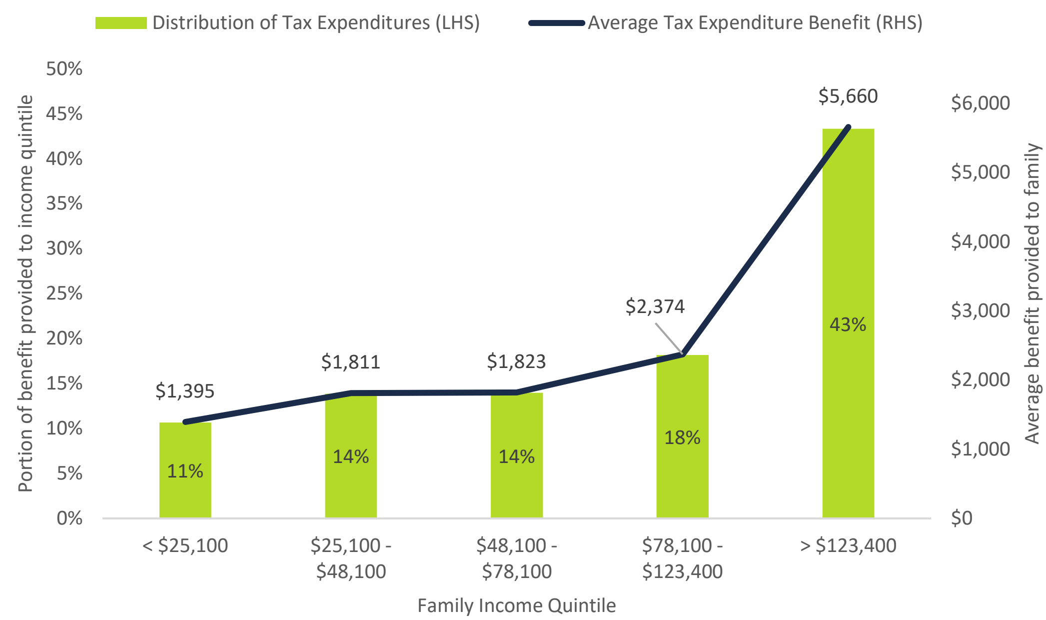
[31] The FAO uses census family as the unit of analysis. See appendix B for more information on the FAO's methodology.
[32] For the purpose of this analysis, the Partial Inclusion of Capital Gains is considered a deduction because it effectively allows tax filers to deduct half of their capital gains from their taxable income.

Tax expenditure benefits concentrated among higher-income families

The FAO estimated how the $17 billion benefit from the 12 selected tax expenditures is distributed among Ontarians by family incomes. Overall, the 20 per cent of Ontario families with the highest incomes (earning over $123,400) will receive 43 per cent of the total benefit from the 12 tax expenditures in 2019-20, or $5,660 per family on average. Families in the second highest income quintile, earning between $78,100 and $123,400 per year, are projected to receive 18 per cent of the benefit from the tax expenditures in 2019-20, or $2,374 per family on average.

The remaining 60 per cent of Ontario families, earning $78,100 or less, will receive only 38 per cent of the benefit from the 12 tax expenditures. In general, the lower the family's income, the lower the average benefit the family will receive. On average, in 2019-20, families earning $25,100 or less will receive $1,395, families earning between $25,100 and $48,100 will receive $1,811, and families earning between $48,100 and $78,100 will receive $1,823.

Figure 5-1: PIT tax expenditure benefits are concentrated at the top of the family income distribution

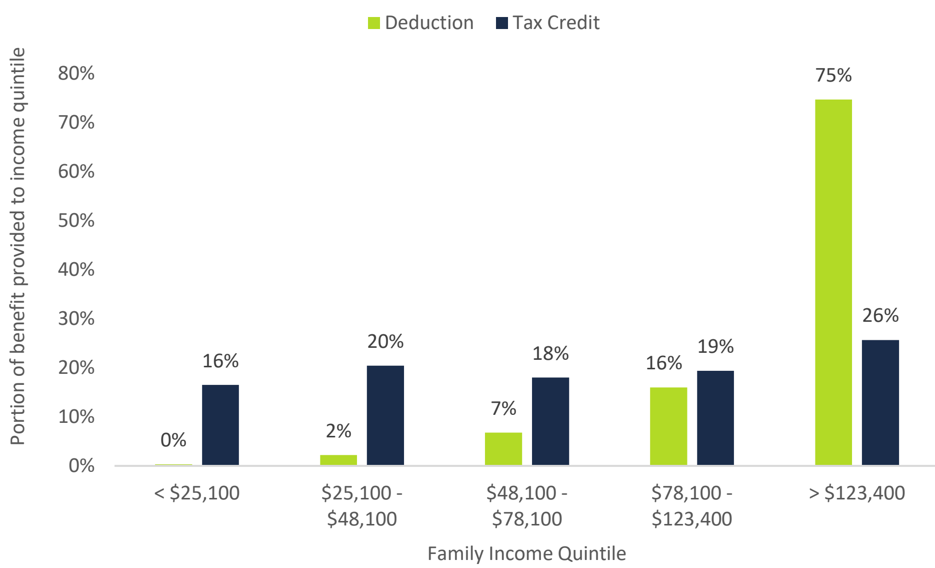


Note: Based on the 12 selected PIT tax expenditures from Table 5-1 that account for 81 per cent of the value of all PIT tax expenditures in 2019-20.
Source: FAO analysis using SPSDM.

Tax deductions are concentrated with the highest income earners while tax credits are more evenly distributed

Breaking down the distribution of the selected PIT tax expenditures between tax deductions and tax credits, the combined benefit from the four tax deductions is heavily concentrated among high-income families, with 75 per cent of the total benefit going to families earning over $123,400. The benefit from the eight tax credits is more evenly distributed. However, the 20 per cent of families earning over $123,400 are projected to receive 26 per cent of the benefit from the tax credits, while the 20 per cent of the families earning less than $25,100 are projected to receive 16 per cent of the benefit.

Figure 5-2: Distribution of tax expenditure benefits by deductions and credits, per cent of total



Note: Based on the 12 selected PIT tax expenditures from Table 5-1 that account for 81 per cent of the value of all PIT tax expenditures.
Source: FAO analysis using SPSDM.

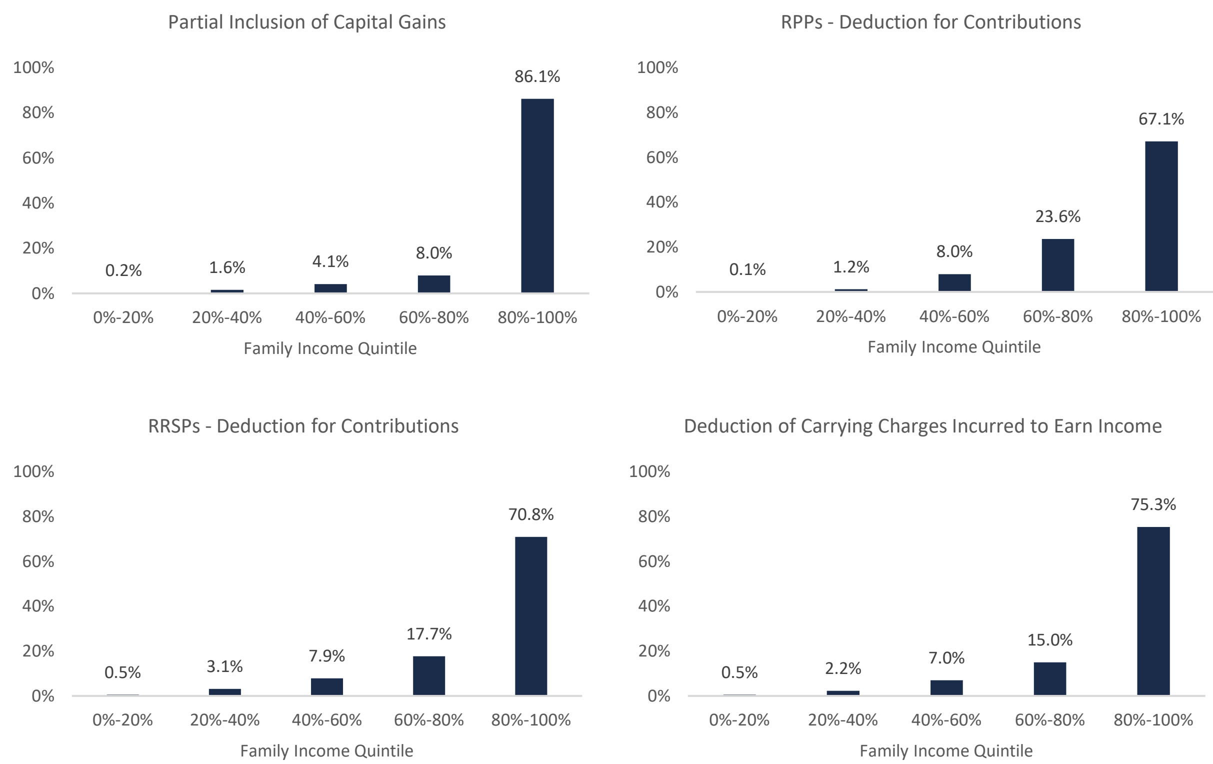
Tax deductions

Seventy-five per cent of the total benefit from the four selected tax deductions will be provided to families with incomes greater than $123,400 in 2019-20 (see Figure 5-2). In contrast, families earning less than $25,100 will receive less than one per cent of the benefit from the four tax deductions. Since tax deductions typically target the income sources and activities that are concentrated among high-income families, tax deductions generally provide more benefits to high-income families. In addition, high-income earners are subject to a higher marginal tax rate so the benefit from deductions is greater for these families than lower-income families.

In particular, the Partial Inclusion of Capital Gains (PICG) distributes the largest portion of its benefit to high-income earners. This tax expenditure allows tax filers to exclude half of their capital gains from taxable income. Since earnings from capital gains are most concentrated among high-income earners, the PICG provides 86 per cent of its $2.1 billion tax benefit to the top income quintile (see Figure 5-3).

Similarly, pension contributions and investment income are more concentrated among high-income families. As a result, the benefits from Registered Pension Plan contributions, Registered Retirement Savings Plan contributions, and the Deduction for Carrying Charges Incurred to Earn Income are heavily concentrated among high-income families, with 67 per cent, 71 per cent and 75 per cent of the benefit, respectively, provided to families earning more than $123,400.[33]

Figure 5-3: Distribution of tax deduction benefits by family net income quintiles, 2019-20



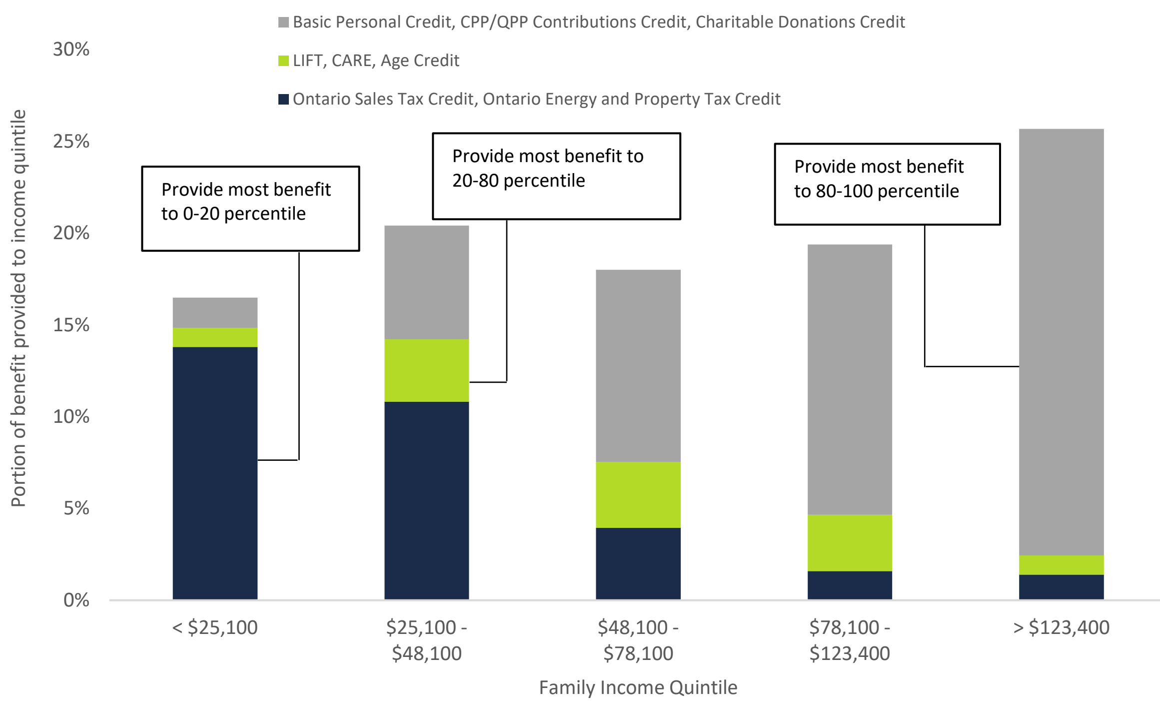
Note: 0%-20% represents families with incomes less than $25,100. 20%-40% represents families with incomes between $25,100 and $48,100. 40%-60% represents families with incomes between $48,100 and $78,100. 60%-80% represents families with incomes between $78,100 and $123,400. 80%-100% represents families with incomes above $123,400.
Source: FAO analysis using SPSDM.

[33] These tax deductions are also more valuable for higher-income individuals as a result of marginal tax rates. Tax deductions reduce taxable income, so the higher the individual's marginal tax rate, the more valuable the tax deduction.

Tax credits

The overall benefit from the eight selected tax credits is distributed relatively evenly across the family income quintiles (see Figure 5-2). However, since tax credits target different income groups, the benefit from individual tax credits is unevenly distributed (see Figure 5-4).

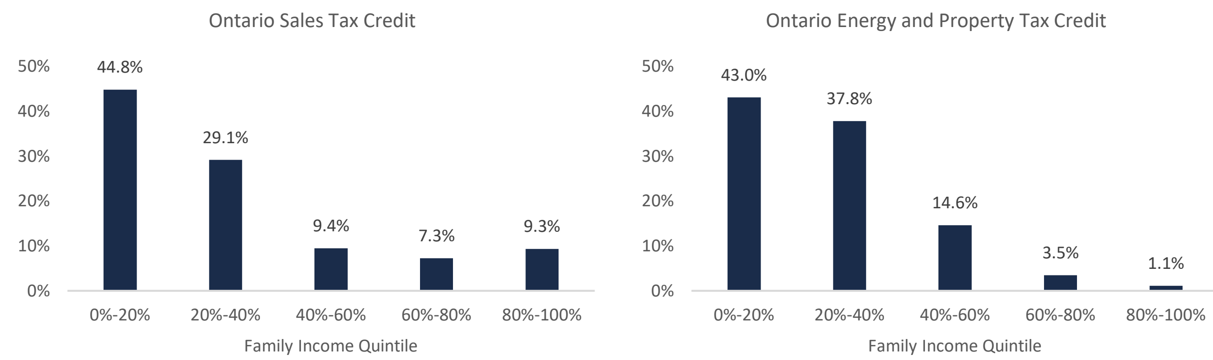
Figure 5-4: Distribution of tax credit benefits by different income groups, 2019-20



Source: FAO analysis using SPSDM.

The largest share of the combined benefit from the Ontario Sales Tax Credit and the Ontario Energy and Property Tax Credit is provided to families earning less than $25,100. These two credits are designed so that benefits are reduced as family income increases and are phased out completely for those earning above the respective thresholds. In addition, these two tax credits provide benefits irrespective of the taxpayer's income tax payable. In other words, low-income individuals who do not owe any income tax and individuals without income may still receive the benefit from these tax credits.

Figure 5-5: Distribution of tax credits that provide most benefit to the bottom 20 per cent of family incomes, 2019-20



Note: 0%-20% represents families with incomes less than $25,100. 20%-40% represents families with incomes between $25,100 and $48,100. 40%-60% represents families with incomes between $48,100 and $78,100. 60%-80% represents families with incomes between $78,100 and $123,400. 80%-100% represents families with incomes above $123,400. Distribution represents the incremental benefit from each tax credit.
Source: FAO analysis using SPSDM.

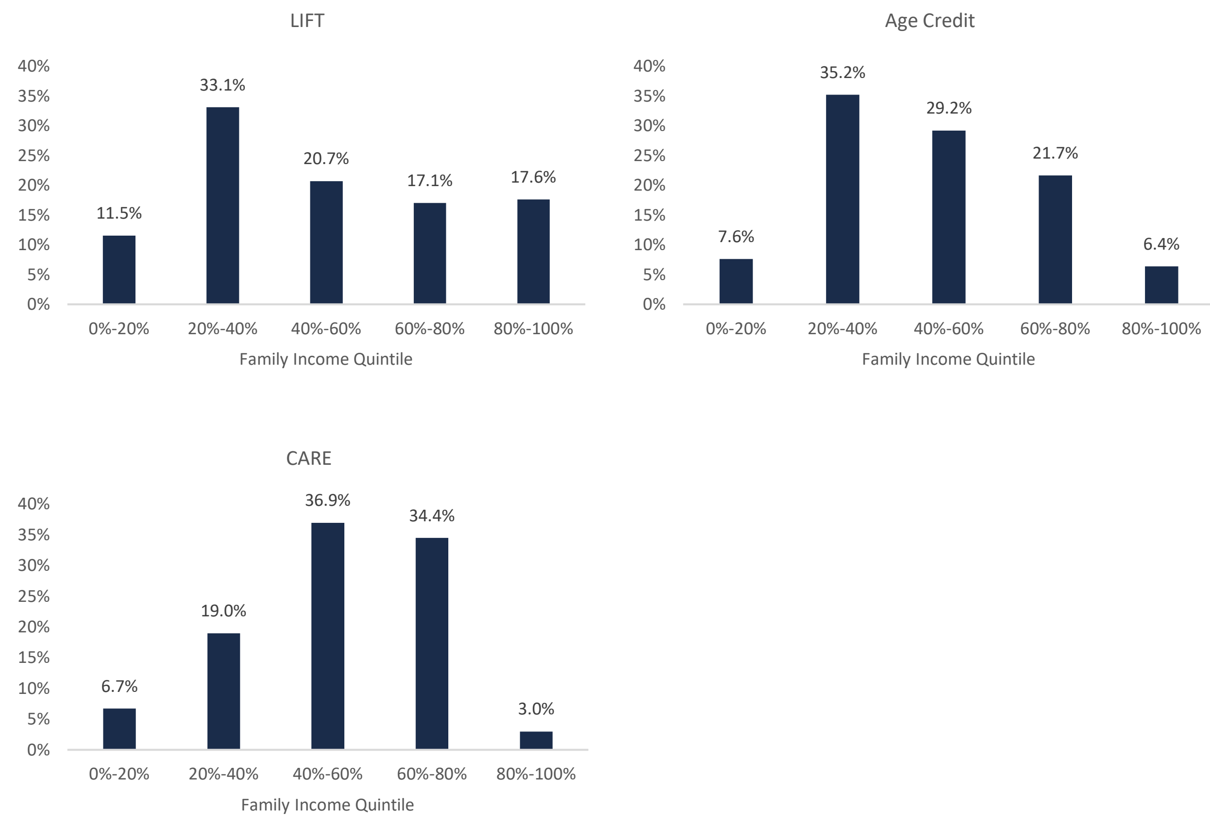
There are three income-tested tax credits that provide most benefit to middle-income families (the middle 60 per cent of families by income). The Low-income Individuals and Families Tax (LIFT) credit, a non-refundable tax credit aimed to reduce or eliminate Ontario personal income tax for low-income taxpayers, provides most benefit to families in the second income quintile ($25,100 to $48,100). Although the LIFT credit targets low-income taxpayers, it excludes many families in the bottom 20 per cent (earning less than $25,100) because they already do not pay any Ontario personal income tax.[34]

Similarly, the Age Credit is also a non-refundable tax credit that does not provide any benefit to individuals who do not owe any income tax. While designed to provide tax relief for low-income seniors, the Age Credit provides most benefit to families in the second income quintile ($25,100 to $48,100).

The Childcare Access and Relief from Expenses (CARE) tax credit distributes the biggest share of its benefit to families in the third income quintile ($48,100 to $78,100). The CARE tax credit is a refundable tax credit aimed to reduce child care costs for low to middle-income families. While the CARE tax credit is reduced as family income increases, higher-income families typically incur more child care expenses than lower-income families, leading to families earning between $48,100 and $123,400 receiving the most benefit.

[34] Of the 2.9 million individuals in Ontario who are eligible for the LIFT credit, 1.5 million are excluded because they already do not pay any Ontario personal income tax. See FAO, "Comparing the LIFT Credit to a Minimum Wage Increase," 2019 for more information.

Figure 5-6: Distribution of tax credits that provide most benefit to the middle 60 per cent of family incomes, 2019-20



Note: 0%-20% represents families with incomes less than $25,100. 20%-40% represents families with incomes between $25,100 and $48,100. 40%-60% represents families with incomes between $48,100 and $78,100. 60%-80% represents families with incomes between $78,100 and $123,400. 80%-100% represents families with incomes above $123,400. Distribution represents the incremental benefit from each tax credit.
Source: FAO analysis using SPSDM.

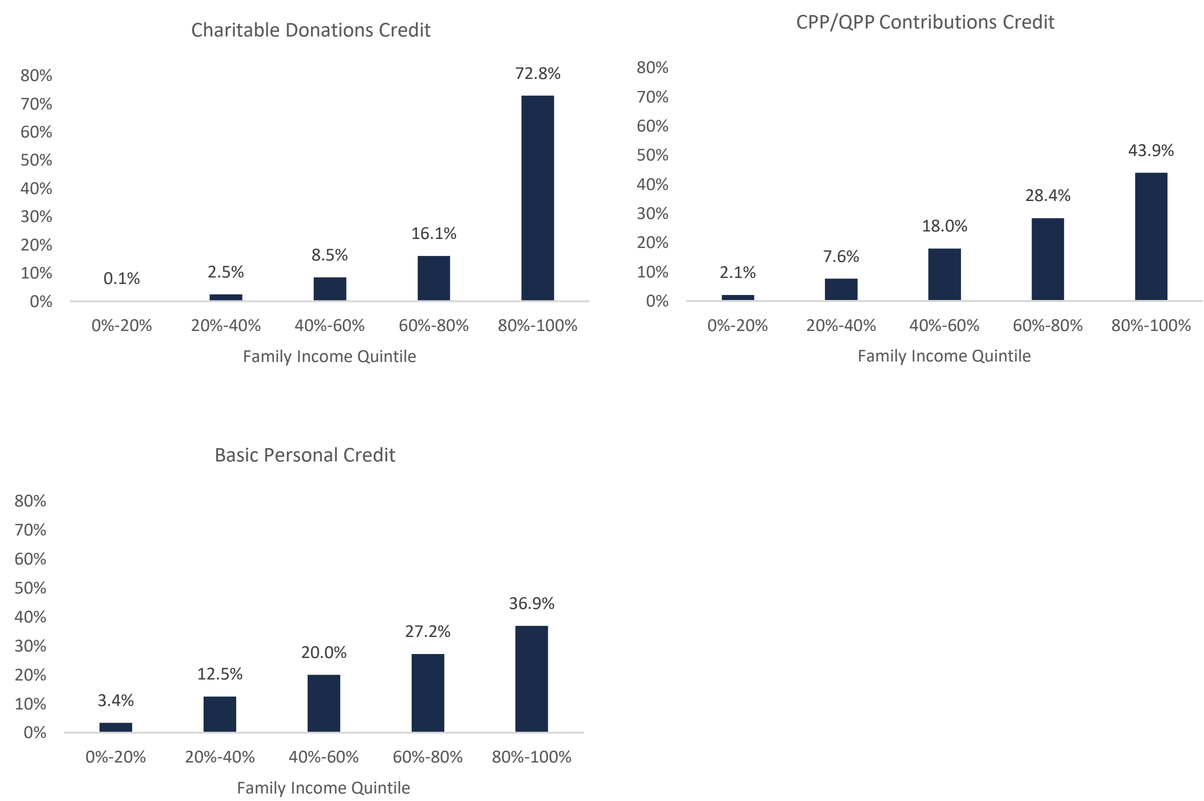
The three tax credits without income-testing conditions provide most benefit to the top income quintile (families earning more than $123,400). The Charitable Donations Credit provides a credit on eligible charitable donations and gifts, which typically increases with family income.[35] As a result, almost 73 per cent of the benefit from this tax expenditure goes to families earning more than $123,400.

The CPP/QPP Contributions Credit provides a credit on CPP/QPP contributions, and the Basic Personal Credit provides a universal benefit to individuals with tax payable. The benefits of these two non-refundable tax credits increase with family income (with the largest share of the benefits going to families earning more than $123,400) mainly due to two factors: family composition and the Ontario surtax. On average, families with higher incomes tend to have more income earners, leading to more benefit received per family. In addition, families in the top two income quintiles (earning more than $78,100) receive additional benefits from these tax credits due to the Ontario surtax. Higher-income individuals whose Ontario income tax payable is above a certain threshold[36] pay additional tax on their income tax payable, known as a surtax. For such individuals, the Basic Personal Credit and the CPP/QPP Contributions Credit not only lower their Ontario income tax payable, but also reduce the amount of

[35] See Martin Turcotte, "Charitable Giving by Canadians," Statistics Canada – Catalogue no. 11-008, 2012, p. 22.
[36] In 2019, approximately $4,700 in Ontario tax payable, equivalent to a taxable income of approximately $77,300.

surtax payable. As a result, these two non-refundable tax credits generate more savings for higher-income taxpayers who pay the Ontario surtax than for taxpayers who do not pay the surtax.

Figure 5-7: Distribution of tax credits that provide most benefit to the top 20 per cent of family incomes, 2019-20



Note: 0%-20% represents families with incomes less than $25,100. 20%-40% represents families with incomes between $25,100 and $48,100. 40%-60% represents families with incomes between $48,100 and $78,100. 60%-80% represents families with incomes between $78,100 and $123,400. 80%-100% represents families with incomes above $123,400. Distribution represents the incremental benefit from each tax credit.
Source: FAO analysis using SPSDM.

6 | Appendices

Appendix A: Tax Expenditures Categorized by Major Policy Objective

The FAO examined Ontario's 149 tax expenditures and categorized each tax expenditure into one of six major policy objective categories. For a description of each tax expenditure, please refer to the Province's "Descriptions of the Tax Provisions Listed in the Taxation Transparency Report, 2019."[37] Tax expenditures with zero values in the tables below have estimated costs in 2019-20 of less than $1 million.

Table 6-1: Investment and Savings Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Registered Retirement Savings Plans (RRSPs) — Deduction for Contributions	2,714
Partial Inclusion of Capital Gains (PIT)	2,147
Partial Inclusion of Capital Gains (CIT)	2,084
Registered Pension Plans (RPPs) — Deduction for Contributions	1,382
Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) Contributions Credit	652
Deduction of Carrying Charges Incurred to Earn Income	510
Lifetime Capital Gains Exemption for Farm or Fishing Property and Small Business Shares	384
Tax-Free Savings Accounts (TFSAs) — Non-Taxation of Investment Income	283
Deduction for Employee Stock Options	264
Deduction of Resource-Related Expenditures	62
Deduction for Canada Pension Plan (CPP)/Quebec Pension Plan (QPP) Contributions on Self-Employment and Other Earnings	58
Deductions for CPP and QPP Enhanced Contributions on Self-Employment and Other Earnings and for CPP and QPP Enhanced Contributions on Employment Income	38
Deduction of Allowable Business Investment Losses	10
Ontario Focused Flow-Through Share Tax Credit	3
Total	**10,592**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

[37] See https://budget.ontario.ca/2019/fallstatement/provisions.html. Note that the 15 tax expenditures listed in the 2019-20 Expenditure Estimates are excluded from the Province's document but are included in the tables in this appendix.

Table 6-2: Business Support Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Ontario Small Business Deduction	2,436
Employer Health Tax Exemption for Private-Sector Employers	966
Exemptions/Reduced Rates - Exemption for Coloured Fuel	347
Ontario Production Services Tax Credit	285
Exemptions/Reduced Rates - Reduced Rate for Aviation Fuel	285
Ontario Tax Credit for Manufacturing and Processing	272
Ontario Film and Television Tax Credit	212
Ontario Research and Development (R&D) Tax Credit	206
Small Suppliers' Threshold	196
Ontario Innovation Tax Credit	156
Farm Property Class Tax Rate Reduction	111
Ontario Interactive Digital Media Tax Credit	82
Ontario Co-operative Education Tax Credit	72
Exemptions/Reduced Rates - Reduced Rate for Railway Diesel	60
Ontario Apprenticeship Training Tax Credit	56
Processing Allowance	45
Exemptions - Deferrals and Exemptions for Corporate Reorganizations	40
Ontario Computer Animation and Special Effects Tax Credit	40
Exemptions/Reduced Rates - Exemption for Methanol and Natural Gas	30
Exemptions/Reduced Rates - Reduced Rate for Ontario Wine and Ontario Wine Coolers	25
Vacant Land and Excess Land Sub-Class Tax Rate Reduction	25
Holdback on Progress Payments to Contractors	20
Ontario Business Research Institute Tax Credit	18
Ontario Credit Union Tax Reduction	15
Exemptions - Family Farms	15
Exemptions/Reduced Rates - Reduced Rate for Beer Made by Ontario Microbrewers	15
Exemptions/Reduced Rates - Reduced Rate for Wine that is not Ontario Wine and not Ontario Wine Coolers	10
Eligible Live Performance Theatres Exemption and Professional Sports Facility Tax Rate Reduction	10
Exemptions/Reduced Rates - Reduced Rate for Propane	7
Rebate for Foreign Conventions and Tour Packages	6
Refunds - Auxiliary Power Take-Off Equipment	5

Tax Expenditure	Cost ($ millions)
Reduced Tax Rate for Remote Mines	5
Ontario Book Publishing Tax Credit	4
Vendor Compensation	3
Exemptions/Reduced Rates - Exemption for Promotional Distribution	3
Vacant Commercial and Industrial Unit Rebate	3
Allowable Business Investment Losses	1
Refunds - Tax-Exempt Use in Unlicensed Equipment	1
Community Food Program Donation Tax Credit for Farmers	0
Refunds - Auxiliary Power Take-Off Equipment	0
Refunds - Aviation Fuel	0
Exemptions - Family Business Conveyances	0
Compensation for Tax Collectors	0
Exemptions/Reduced Rates - Reduced Rate for Beer Made and Sold at Ontario Brew Pubs	0
Exemptions/Reduced Rates - Reduced Rate for Wine Coolers	0
Exemptions/Reduced Rates - Reduced Rate for Spirits Coolers	0
Brownfields Financial Tax Incentive Program	0
Eligible Convention Centres Exemption	0
Farmlands Awaiting Development Sub-Class Tax Rate Reduction	0
Annual $500,000 Deduction / Mining Tax Exemption	0
Tax Holiday for New Mines (other than remote mines)	0
Tax Holiday for New Remote Mines	0
Total	**6,089**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Table 6-3: General Tax Relief Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Basic Personal Credit	4,703
Pension Income Splitting	306
Employment Insurance (EI) Premiums Credit	187
Spouse or Common-Law Partner Credit	177
Pension Income Credit	138
Amounts Transferred from a Spouse or Common-Law Partner	25
Total	**5,536**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Table 6-4: Support for Low-income Individuals and Families Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Ontario Sales Tax Credit	1,401
Ontario Energy and Property Tax Credit - Property Tax Component	979
Low-income Individuals and Families Tax (LIFT) Credit	495
Ontario Energy and Property Tax Credit - Energy Component	495
Age Credit	335
Ontario Tax Reduction (OTR)	307
Ontario Senior Homeowners’ Property Tax Grant	201
Guaranteed Income Supplement and Allowance Benefits	55
Social Assistance Benefits and Provincial Supplements	45
Northern Ontario Energy Credit	26
Total	**4,339**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Table 6-5: Public Bodies Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Municipalities	1,409
Hospitals	498
School Authorities	418
Universities	226
Public Colleges	91
Total	**2,642**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Table 6-6: Targeted Supports Tax Expenditures, 2019-20, $ millions

Tax Expenditure	Cost ($ millions)
Zero-Rating of Basic Groceries	2,942
Exemption for Residential Rent (Long-Term)	1,383
Exemption for Automobile Insurance Premiums	1,132
Ontario New Housing Rebate (including new residential rental property)	986
Exemption for Certain Supplies Made by Charities and Non-Profit Organizations	931
Charitable Donations Credit	758
Exemption for Individual Life and Health Insurance Premiums	754
Exemption for Education Services (Tuition)	659
Exemption for Health Care Services	669
Zero-Rating of Prescription Drugs	654
Childcare Access and Relief from Expenses (CARE) Tax Credit	434
Registered Charities	407
Zero-Rating of Medical Devices	287
Refunds - First-Time Home Buyers Refund	241
Child Care Expense Deduction	231
Deduction of Other Employment Expenses	216
Exemption for Water and Basic Garbage Collection Services	216
Deduction of Union and Professional Dues	206
Medical Expense Credit	201
Exemption for Municipal Transit	186
Disability Credit	181
Workers' Compensation Benefits	146

Tax Expenditure	Cost ($ millions)
Prepared Foods and Beverages ($4 or less)	141
Children’s Clothing	136
Exemption for Child Care	136
Deductibility of Charitable Donations	131
Books	116
Eligible Dependant Credit	80
Tuition and Education Credits	70
Qualifying Non-Profit Organizations	60
Treatment of Spousal and Child Support Payments	50
Non-Taxation of Non-Profit Organizations	50
Qualifying Purchases by First Nations	45
Children’s Footwear	40
Print Newspapers	40
Children’s Diapers	35
Exemption and Rebate for Legal Aid Services	25
Exemption for Hospital Parking	25
Caregiver Credit	20
Deduction for Clergy Residence	20
Moving Expense Deduction	20
Exemption for Ferry, Road and Bridge Tolls	20
Zero-Rating of Feminine Hygiene Products	20
Charity Rebate	10
Ontario Political Contribution Tax Credit	10
Student Loan Interest Credit	6
Children’s Car Seats/Car Booster Seats	5
Conservation Land Property Tax Exemption Program	5
Managed Forest Tax Incentive Program	5
Tax Exemptions Under Private Statutes	5
Ontario Seniors Public Transit Tax Credit	3
Northern Residents Deductions	3
Deductibility of Gifts of Cultural Property and Ecologically Sensitive Land	2
Seniors and Persons with Disabilities Property Tax Relief	1
Exemption Where the Value of the Estate Does Not Exceed $50,000	1

Tax Expenditure	Cost ($ millions)
Adoption Expense Credit	0
Community Food Program Donation Tax Credit for Farmers	0
Children's Activity Tax Credit	0
Deductibility of Gifts to the Crown	0
Rebate for Poppies and Wreaths	0
Exemptions - Life Leases	0
Heritage Property Tax Rebate	0
Total	**15,160**

Note: Tax expenditures with zero values have estimated costs in 2019-20 of less than $1 million.
Source: FAO analysis using the Taxation Transparency Report, 2019 and the 2019-20 Expenditure Estimates.

Appendix B: Development of this Report

Authority

The Financial Accountability Officer decided to undertake the analysis presented in this report under paragraph 10(1)(a) of the *Financial Accountability Officer Act, 2013*.

Key Questions

The following key questions were used as a guide while undertaking research for this report:

- What are tax expenditures?
    - How are tax expenditures defined, and how are they distinguished from direct government spending?
    - How are tax expenditures approved and monitored?
    - Which government has the administrative responsibility over tax expenditures?
- How have tax expenditures grown over time?
    - How does tax expenditure growth compare to the growth of the Ontario economy?
    - How does tax expenditure growth compare to the growth of the Province's program spending?
    - How does the growth of tax expenditures differ by tax systems?
    - What is the estimated cost of tax expenditures in 2019-20?
- How are tax expenditure benefits distributed among Ontario families?
    - How are the benefits distributed by family income?
    - How are the benefits distributed by the types of tax expenditures?

Scope

This report does not review the economic impact or effectiveness of the Province's tax expenditures.

Methodology

This report has been prepared with the benefit of publicly available information. All dollar amounts are in Canadian, current dollars (i.e., not adjusted for inflation) unless otherwise noted.

Summation of tax expenditures

The FAO determines the total cost of tax expenditures as the sum of individual estimates from the Province's Taxation Transparency Reports (TTR),[38] the Public Accounts of Ontario and the Expenditure Estimates. However, the TTR notes that this approach should be used with caution due to potential interactions between some tax expenditures. For instance, the elimination of a personal tax deduction could affect the cost of other personal tax credits because they are calculated after taxable income is determined. Overall, the total cost of the Province's tax expenditures could be higher or lower than the FAO's estimate.[39]

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[38] The FAO uses the Province's estimates for the cost of each tax expenditure for 2019 to make a cost projection for 2019-20.
[39] For example, one study estimated the total cost of individual income tax expenditures to be 5 to 8 per cent higher when accounting for interaction effects. See Leonard E. Burman, Christopher Geissler and Eric J. Toder, "How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?" American Economic Review, 98, May 2008, pp. 79-83.

Despite these estimation issues, the FAO has presented the total cost of tax expenditures in order to provide meaningful comparisons and analyses. Other organizations have employed a methodology similar to the FAO to present the total cost of tax expenditures, including Quebec, Washington State, France and the Congressional Budget Office (CBO) in the United States.[40]

Forgone revenue and expense

The FAO includes tax expenditures that are reported as foregone revenue and expense. This report includes every tax expenditure with an estimate in the TTR, the Public Accounts of Ontario and the Expenditure Estimates from 2010 to 2019. For the CARE tax credit, the FAO used its own cost estimate for 2019-20.

Time period of analysis

Tax expenditures included in the Public Accounts of Ontario and the Expenditure Estimates are reported on a fiscal year basis. Tax expenditures reported in the TTRs are presented on a calendar year basis. The FAO adjusts these tax expenditures to a fiscal year basis. The FAO's historical analysis begins in the 2010 calendar year, or 2010-11 fiscal year, because the introduction of the Harmonized Sales Tax (HST) in 2010 makes the analysis of the total cost of tax expenditures for prior years incomparable.

Family net income definition

The distributional analysis in this report is based on family net income, where family is defined as census family. Statistics Canada defines census family as a married couple and their children, a couple living common law and their children, or a single parent and their children. All members of a census family must live in the same dwelling. The FAO uses census family for its distributional analysis, rather than other family definitions, because it closely matches the definition of a family for tax purposes.

Use of SPSDM

The distributional analysis in this report was prepared using Statistics Canada's Social Policy Simulation Database and Model (SPSDM). The distributions generated by SPSDM are simulated results using modelled tax variables. The assumptions and calculations underlying the simulation results were prepared by the FAO and the responsibility for the use and interpretation of these data is entirely that of the authors.

[40] For example, see Office of the Auditor General of British Columbia, "Understanding Tax Expenditures," Appendix D, October 2018 and Congressional Budget Office, "The Distribution of Major Tax Expenditures in the Individual Income Tax System," May 2013.

Financial Accountability Office of Ontario