Chapter 4

Taxation of Canadian Banks

The sharp decline in the effective tax rate for Canadian chartered banks over the last five years has been the subject of considerable discussion and criticism. The issue is very complex. It must be placed in the perspective of the banks' statutory income tax rate versus its effective tax rate, the large amount of tax-exempt financing done by the Canadian banks, foreign taxation and the high level of interest rates over the last several years. In addition, the banks themselves claim that they have been paying taxes through other means that are not highly visible to the public.

4.1 TRENDS IN EFFECTIVE TAX RATE

As noted in Table 4.1, the history of the chartered banks' effective tax rate from 1971 to 1981 indicates that indeed this rate declined very substantially over that period. From 1971 to 1975 the banks' average effective tax rate was 48.5 per cent. Beginning in 1976, but accelerating in 1978, their average effective tax rate began to drop very sharply, from 44.7 per cent in 1976 to 14.4 per cent in 1980 rising again to 21.1 per cent in 1981. It should also be noted that during this period the banks' after-tax balance of revenue continued to increase.

During the latter part of the 1970s, the absolute level of taxes payable by the chartered banks actually decreased from $536.3 million in 1976 to a low of $209.6 million in 1980. There was a large increase in taxes paid in 1981, but they have since declined in the first half of 1982, giving the Canadian banking industry a small net recovery of taxes. In other words, the Canadian chartered banks have not paid any actual taxes, to date, in 1982.

In order to understand how a bank's effective tax rate can decline, the bank's statutory income tax rate must first be considered.