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THE BENEFITS OF ELIMINATING THE MIDDLE-INCOME TAX BRACKET

By Jason Dean, with the collaboration of Emmanuelle B. Faubert

There have been plenty of tax proposals floating around recently, aimed at easing the financial grind that continues to bear down on Canadian households. These include GST holidays, grocery rebates, and Trump-style tax exemptions on tips.[1] The political incentive is obvious: These measures dominate headlines and provide visible relief for struggling voters. While it is certainly commendable to see policymakers stepping up, it is discouraging that so far, their efforts either target only a narrow slice of those in need[2] or serve as short-lived token gestures. More troubling still, the hard-working middle class are being overlooked.

Despite their economic importance, this core of millions have been neglected by tax policy, leaving them to struggle with rising costs. Their last income tax cut nearly a decade ago was a mirage, as modest relief was quickly erased by the loss of key tax credits for income-splitting, transit, and children's programs, leaving families paying more in the end.[3] The struggles of Canada's middle class are clear from its wide gap with the U.S. middle class. Toronto's median income trails Chicago's by 26%, while Vancouver's lags Seattle's by 39%.[4] Instead of short-term fixes, tax policy must focus on real, lasting reform that delivers broad relief.

With a federal election looming, there is a real opportunity for new leadership to champion lasting tax reforms that eschew headline-grabbing fixes and instead truly ease the burden on the vast majority of middle-class households. Layering rebates on top of exemptions on top of credits only further complicates Canada's already tangled tax code. The country needs a simpler approach that tackles punishing marginal rate jumps, sheds needless complexity, and rewards work instead of penalizing it.

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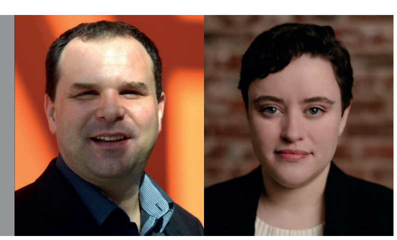


THE CASE FOR MIDDLE-CLASS TAX REFORM

A truly growth-oriented tax code should minimize distortions, adopt sensible marginal rates, and reward productivity. Our tax code does the opposite, imposing high rates and steep bracket jumps that discourage work and create punitive tax cliffs.[5] Moreover, high marginal taxes can shrink the tax base by pushing workers to cut back hours or find ways around the system, with every extra dollar taxed costing $2.86 in lost economic activity.[6] A meaningful first step toward a more growth-oriented tax code is to zero in on the high marginal rates and steep bracket jumps that plague the middle class.

Tackling these challenges requires structural change. Current rates, even at the second bracket, run high, and the steep marginal leap only amplifies the burden. For those who want to work more, moving from the first to the second federal tax bracket triggers an abrupt 5.5 percentage-point increase, from 15% up to a hefty 20.5%, making each extra dollar earned that much less rewarding.[7]

The country needs a simpler approach that tackles punishing marginal rate jumps, sheds needless complexity, and rewards work instead of penalizing it.

A straightforward fix is to remove this hurdle entirely by collapsing the first two brackets, thus simplifying the tax code. More precisely, the second bracket's 20.5% rate should drop to 15%, matching the first bracket and creating a single rate for taxable income up to $111,733 (in 2024). This would effectively establish a flat tax regime for low- and middle-income earners.

This reform would do what short-term fixes and narrowly focused policies never could. It would clear the way for broad middle-class relief, reward effort instead penalizing it, and bring a sustainable solution to the table.

BROAD BENEFITS FOR MILLIONS OF TAX FILERS

Flattening the brackets would make life easier for millions of middle-income workers and avoid any extra red tape or qualifying hoops. For the roughly 8.5 million workers facing the second-tier rate burden in 2024—those with taxable income between $55,867 and $111,733—this would be a welcome change.[8]

As shown in Figure 1, tax savings vary based on income. Those earning $65,000 would save $502, rising to $2,977 for those earning $110,000. The percentage of total income saved follows a similar pattern, from 0.8% at $65,000 to 2.7% at $110,000.[9]

A single filer earning $83,800, which represents the midpoint of the second bracket, would see a 1.8% tax cut, reducing their tax burden by $1,536.[10] A dual-earner family of skilled professionals with a combined taxable income of $175,000—which aligns with the average for full-time, postsecondary-educated workers—split evenly at $87,500 each, would receive $3,380 in combined tax savings under the proposed rate reduction.[11] In total, the proposed cut would deliver $9.4 billion in tax relief for a wide range of middle-income earners, averaging $1,157 per filer.[12]

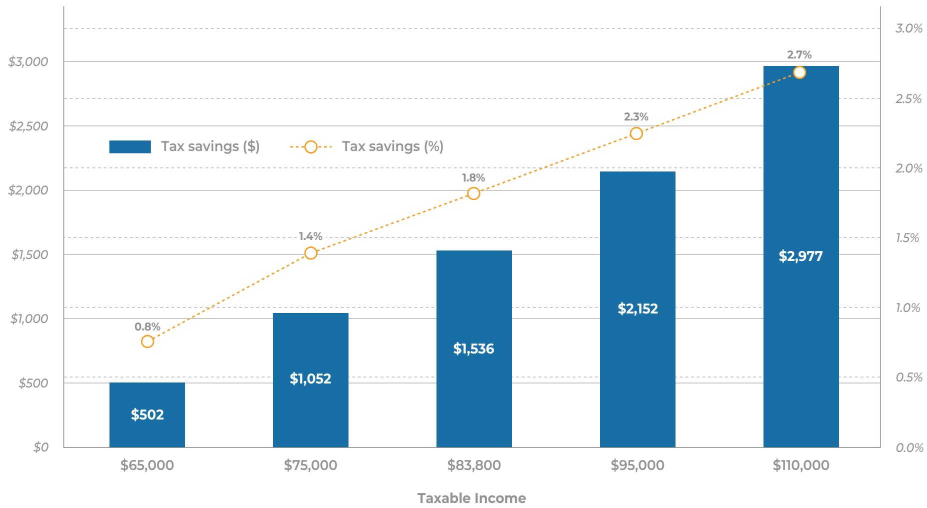
TURNING RELIEF INTO INCENTIVES

The benefits of flattening these tax rates do not stop at a lower tax bill. For those needing to work more just to keep up, it brings relief by ensuring that added effort is actually worth it. The marginal tax changes proposed here can directly influence how much people choose to work. Evidence suggests that Canada is already on the wrong side of the Laffer Curve, beyond the point at which higher tax rates start shrinking the tax base and lowering overall revenue.[13]

One U.S. study shows clearly that both low- and middle-income earners respond measurably to such tax changes, particularly those near bracket thresholds, where incentives to adjust work effort or income reporting are highest.[14] Even lower-bracket earners near the start of the second bracket, being the most sensitive, can benefit from the reform, since it removes the sudden tax jump they face if they work more. A little tax change can go a long way in helping middle-class earners.

Figure 1

Tax savings for selected second-bracket incomes under proposed collapse



Note: These figures are based on the 2024 federal income tax brackets. The tax savings illustrated are hypothetical and reflect a proposed policy to reduce the second federal income tax bracket rate from 20.5% to 15%. Tax credits are not considered, as they are applied after federal rates are calculated. In rare cases where credits fully offset net tax, a filer may not benefit from this policy.
Source: Canada Revenue Agency, Taxes, Income tax, Personal income tax, Income tax rates for individuals, January 21, 2025.

Figure 2 focuses on the federal marginal effective tax rates (METRs) for unattached individuals in and just below the second bracket for Canada and Quebec. METRs measure how much of each extra dollar earned is taken away by taxes and reduced credits. The lower figures for Quebec simply reflect a uniform reduction in federal taxes payable after the Quebec Abatement credit is applied.[15] However, the marginal impact of the reform remains unchanged, and the additional benefit for those who work more is consistent across all Canadian provinces.[16]

The solid lines in the figure, for both Quebec and the rest of Canada, trace out the METRs under the current 2024 rates, while the dotted lines depict them under the proposed rate collapse. A quick comparison of their separate paths makes the sizable “tax cliffs” hard to miss. Crossing the $55,867 threshold triggers a noticeable pinch for middle-class earners, indicated by the gap between the two lines. The figure also makes evident that flattening the rates can benefit all of the over 8.5 million workers whose incomes span the second bracket. Moreover, as noted above, lower bracket earners on the cusp are also positioned to gain.

A well-documented flaw in Canada’s tax system is the heavy burden of high METRs.[17] Consider a full-time low-income worker near the second bracket threshold who, to make ends meet, takes on a second job. For the average worker in this predicament, this second job would yield an extra $18,500, of which about $1,000 would have to be handed over to the federal government alone.[18]

The proposed cut would deliver $9.4 billion in tax relief for a wide range of middle-income earners, averaging $1,157 per filer.

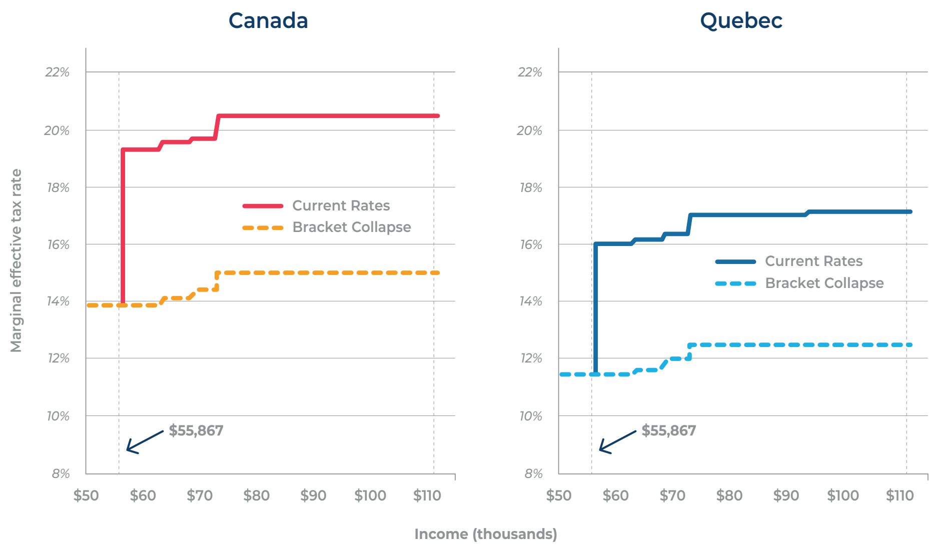
But by ironing out the federal rate bump, we would make real inroads in alleviating this burden, letting workers keep more of their pay and giving them a greater incentive to pick up extra hours, take on a second job, or work overtime without sudden hikes taking such a big bite out of their earnings. This also aligns with the broader push for a genuinely growth-oriented tax code, where simpler, flatter rates can boost productivity and expand the overall tax base, rather than shortchanging the very backbone of the economy.

A POWERFUL BUT SIMPLE REFORM

In one fell swoop, collapsing the first two federal brackets into a unified 15% rate would put real money back into the pockets of millions in the middle class, remove the steep penalties that cramp work incentives, and cut through needless complexity in Canada's tax code. At an estimated $17.9 billion (2022) in forgone tax revenue, this represents just 3.8% of Ottawa's $470-billion budget for 2022–2023.[19] This would be a modest adjustment, but a rare break for the forgotten middle and a strategic investment where it matters.

Figure 2

Impact of proposed federal bracket collapse on 2024 marginal effective tax rates (METRs)



Note: Marginal effective tax rates (METRs) measure the additional tax paid on each extra dollar of earned income for an unattached single filer with no other deductions or investment income. These calculations reflect the 2024 basic personal amount, mandatory CPP/EI contributions (or QPP/QPIP in Quebec), the Canada Workers Benefit, and (for Quebec) the 16.5% federal abatement. Under the proposed "collapsed bracket" policy, the second federal tax bracket (20.5% on income from $55,867 to $111,733) is eliminated, extending the 15% rate across this entire range.
Source: Author's calculations.

If introducing it all at once is too fiscally challenging or politically risky, policymakers could adopt a phased rollout, cutting the rate by 3 points in the first year and 2.5 in the second, for example, or spreading it over three or four years.

Evidence suggests that Canada is already beyond the point at which higher tax rates start shrinking the tax base and lowering overall revenue.

This reform will also help narrow the gap with the United States, where Americans stay in lower tax brackets for longer. While Canadians face a 15% rate as of the first bracket, Americans start with lower rates of 10% and 12% on income up to US$47,150 (C$66,898.50) for singles, with married couples filing jointly staying at just 12% on income up to US$94,300 (C$133,800.64).[20]

Canada slipped from 24th to 31st in global personal tax competitiveness in 2024, while the US climbed from 22nd to 17th.[21] This widening gap highlights the pressing need for genuine tax reform, a priority that new leadership must address before conditions worsen. Adopting a simpler, flatter structure could not only improve our ranking and boost work incentives, but also potentially enhance Canada's ability to retain and attract skilled talent. A more competitive tax code would strengthen long-term economic resilience, supporting wage growth and helping Canada remain an attractive destination for investment and innovation.

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6. Bev Dahlby and Ergete Ferede, *What Are the Economic Costs of Raising Revenue by the Canadian Federal Government?* Fraser Institute, April 2022, p. 3.
7. TaxTips.ca, *op. cit*., endnote 5.
8. See Table 1 in the Appendix on the MEI website.
9. It may seem that higher earners in this bracket receive a greater benefit, given their larger absolute tax savings. However, this follows naturally from the structure of a marginal tax system, where a rate cut applies proportionally to all income within a bracket. This reduction does not alter the progressive nature of the tax system, as marginal rates still rise with income across brackets. It simply lowers the tax burden within the second bracket, ensuring middle-income earners retain more of their earnings without making the system regressive.
10. The 2024 second bracket ranges from $55,867 to $111,733, with a midpoint taxable income of $83,800. The portion above $55,867 is $27,933, which, when multiplied by the 5.5% rate cut, results in estimated savings of $1,536.
11. Author's calculations. Statistics Canada, Table 98-10-0412-01: Employment income statistics by occupation, major field of study and highest level of education: Canada, November 30, 2022.
12. See Tables 2–5 in the Appendix on the MEI website for a detailed breakdown of tax savings and revenue loss estimates under the proposed policy.
13. Daniel J. Mitchell, "Canada's Laffer Curve Lesson: Government Collects Less Revenue from High-Income Earners after Trudeau Tax Hike," Foundation for Economic Education, January 10, 2019.
14. Emmanuel Saez, "The effect of marginal tax rates on income: a panel study of 'bracket creep'," *Journal of Public Economics*, Vol. 87, Nos. 5-6, May 2003, p. 1255.
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16. The combined federal and provincial METRs are not calculated or shown in the figure. Provincial taxes apply separately on top of federal rates, with no direct interaction between the two, and would simply scale the METRs. Thus, the policy's marginal impact remains unchanged across provinces, and including provincial rates would add little value.
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