Summary of 1971 Tax Reform Legislation

Honourable E. J. Benson,
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Introduction

This document summarizes the main provisions of the legislation to reform personal and corporation income taxes, introduced as part of the June, 1971, budget of the Minister of Finance to take effect in 1972.

To permit immediate study, the legislation has been tabled budget night in the form of a Notice of Ways and Means Motion. Under this House of Commons procedure, the legislation is introduced in the form of a bill at the end of the budget debate.

Certain provisions initially described in narrative form will be incorporated in the bill at its introduction. These provisions relate to changes during the period of transition from the old system to the new system, and they include reductions in tax rates for the years 1973 to 1976. The reductions will be set out in detail in the legislation to fulfill the government's undertaking that revenues produced under the new system will not exceed the total that would be produced if the present system remained in effect. The reductions are described in explanatory material accompanying the narrative description of the transitional measures.

This summary, organized under much the same headings as the White Paper on tax reform, explains the proposed new tax system in non-technical terms to permit as wide an understanding as possible of the legislation, which is of necessity written in complex language.

Tables at the end of the chapter on Personal Income illustrate the taxes payable at various income levels for individual taxpayers. A synopsis at the end of the document compares the bill's provisions with the present law, with the proposals of the White Paper and with the recommendations of the Commons Committee on Finance, Trade and Economic Affairs and the Senate Committee on Banking, Trade and Commerce, which studied the White Paper.

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Personal Income

- *Personal exemptions will be raised to $1,500 from $1,000 for single persons, and to $2,850 from $2,000 for married persons.*
- *Child care expenses will be deductible up to $500 per child under 14, with a maximum of $2,000 per family.*
- *An employment expense deduction of 3 per cent of employment income, up to $150 a year, is introduced. No receipts needed.*
- *All taxpayers with married exemption and income solely from wages and salaries will pay less tax than at present. Taxpayers with single exemption and employment income only will pay less tax on incomes under $8,000; above this level the tax increase will not exceed $78 a year.*
- *All taxpayers age 65 and over will receive a special exemption of $650. The guaranteed income supplement will be exempt from tax.*
- *Moving expenses will be deductible for taxpayers changing jobs.*
- *Calculation of tax is simplified by use of a single rate schedule. Top rate, including standard 30-per-cent provincial tax, will be 61.1 per cent.*
- *Employer-paid living expenses for jobs at distant work sites will be made tax-free to more taxpayers.*
- *Limit on deductible donations to charities increased to 20 per cent of income from 10 per cent. Standard deduction for medical expenses and charitable donations remains at $100.*
- *To be taxed as income:*

  One-half of capital gains
  Payments from income maintenance plans to which employer has contributed
  Adult training allowances
  Allowances paid under the Textile and Clothing Board Act
  Unemployment insurance benefits (contributions deductible)
  Scholarships, fellowships and bursaries with $500 exemption
  Amounts contributed on an employee's behalf to a public medical care plan
- *Two types of income averaging replace most of the existing options and create a broader and more generous system than proposed in the White Paper. General averaging will apply automatically when a tax return shows income 10 per cent higher than the preceding year and 20 per cent higher than the average of four preceding years. Forward averaging will permit taxpayers to spread unusual lump-sum receipts over future years through purchase of income-averaging annuities.*
- *Amounts in a pension plan or deferred profit-sharing plan which a taxpayer could withdraw in 1971 may be taxed under existing rules if withdrawn later in a lump-sum.*
- *Maximum deductible contributions are raised to $2,500 from $1,500 for registered pension plans and deferred profit-sharing plans; and to $4,000 (or 20 per cent of earned income) from $2,500 for registered retirement savings plans.*
- *Ten-per-cent foreign investment limit based on cost of assets is established for pension plans, registered retirement savings plans and deferred profit-sharing plans in future. Special tax on excess over 10 per cent.*

The public debate on tax reform strongly supported measures to give tax relief to Canadians of lower incomes. The major changes proposed by the bill for personal income taxes mark a serious attempt to recognize the growing mobility of Canadians and their changing patterns of family life.

The increase in personal exemptions is the broadest and most fundamental move to extend tax relief. Deductions for the costs of child care will ease the burden of a major major expense for working parents. Other significant costs confronting taxpayers and their families become deductible items, such as moving expenses and certain employment expenses.

The legislation introduces a more balanced and fairer approach to taxation of income by making a number of benefits taxable for the first time. In most cases these are payments or allowances that are essentially the same as wage and salary income, and used for the same general purposes.

In addition to these changes in the law which would take effect at the start of the new system, the legislation provides for two systems of income averaging to reduce tax rates on significant increases in income.

Personal Exemptions

The legislation raises personal exemptions to $1,500 from $1,000 for a single taxpayer, and to $2,850 from $2,000 for a married taxpayer.

Changes in the schedule of tax rates will be made at the same time to concentrate the benefit of the exemption increases among lower-income taxpayers and permit larger exemption increases than would otherwise be possible.

The bill changes the existing formula for reducing the married exemption as the wife's own income increases. If she has income of more than $250 in a year, her husband reduces the $1,350 exemption claimed for her by one dollar for each dollar of her income. If she has income of $1,600 or more, both husband and wife file as if they are single.

An unmarried person, including a widow or widower, can claim the married exemption for supporting a brother, child or other relative if that person lives in the taxpayer's home. But a taxpayer claiming the married exemption in these circumstances may not claim the $300 or $550 deduction for that dependant as well.

Current exemptions for dependants are maintained at $300 for dependants under age 16 and $550 for dependants 16 and over. The bill alters the present formula for reducing the benefits of the exemption when a dependant's income rises. The $300 exemption will be reduced by one dollar for each two dollars of the dependant's income in excess of $1,000. The $550 exemption will be reduced by one dollar for each dollar that the dependant's income exceeds $1,050. Thus, there will be no exemption where dependants have sufficient income to be taxable.

The special exemption of $500 for individuals age 70 and over will be increased to $650 and be made available to all taxpayers age 65 and over. Guaranteed income supplement payments will be exempt from tax; however, they will be included in income in determining whether pensioners may be claimed as dependants. Individuals who are blind or confined to a bed or wheelchair now receive a special deduction of $500. This will be increased to $650.

The standard deduction of $100 in lieu of itemized medical expenses and charitable donations will continue to be available to everyone. Thus total exemptions and deductions will be at least

for a single individual ($1,500 + $100) – $1,600

for an individual with full married status ($2,850 + $100) – $2,950

elderly taxpayers

single, age 65 or over ($1,500 + $100 + $650) – $2,250

married status, age 65 or over ($2,850 + $100 + $650) – $3,600

Child Care Expenses

The legislation permits the deduction of child care expenses up to $500 for each child under age 14 and a maximum $2,000 per family. This is in addition to the general deductions for children as dependants and it will normally be claimed by the mother.

The White Paper commented that the difficulty of adequately caring for children when both parents are working, or when there is only one parent in the family and he or she is working, is both a personal and social problem. It estimated that the child care deduction would assist several hundred thousand families.

The Commons committee termed the child care deduction a major innovation for the Canadian tax system. It suggested that the relief be extended to cover the situation where there is a parent at home unable to care for the children because of permanent mental or physical infirmity. This is incorporated in the legislation along with other extensions to cover special situations. The bill permits a deduction for expenses of caring for a child over age 14 who is dependent because of mental or physical infirmity.

Child care expenses which qualify under the bill include baby-sitting costs; day nursery care and up to $15 a week (not exceeding $500 a year) towards lodging paid at schools and camps. Amounts paid to dependants of the taxpayer or to relatives under age 21 will not qualify. Receipts bearing the social insurance number of the individual who performed child care services must be retained.

The deduction will normally be taken by the child's mother but it can be deducted by the child's father if he is a widower, or divorced or separated. He may also make the deduction if the mother is incapable of caring for herself or children or if she is confined for 14 days or more to bed, wheelchair, hospital, mental hospital or prison. For such periods, the father's deduction is limited to a maximum of $15 per week for each child to a total of $60 per week, subject to the over-all limits of $500 per child or $2,000 per year for the whole family.

The child care expense deduction is made from earned income, which for this purpose includes salary, wages, income from carrying on a business, adult training allowances and awards such as scholarships, fellowships and grants. The deduction may not exceed two-thirds of the earned income of the parent making the deduction.

Employment Expenses

The bill provides a deduction for employment expenses of up to 3 per cent of income from an office or employment, to a maximum of $150 a year. No receipts are required.

For many years the law has permitted those in business or the professions to deduct expenses reasonably related to earning income. Employees, however, have been limited to such deductions as union dues and contributions to pension plans. They could not deduct such expenses as the cost of tools and special clothes. The new employment expense deduction attempts to bring the calculation of income for the two groups into better balance.

The legislation also prevents businessmen deducting certain expenses which tend to be personal in nature such as membership in clubs. The right to deduct expenses of attending conventions will be more closely defined. Both businessmen and employees will have to include in income the benefit derived from personal use of a company car.

On the other hand, the legislation allows employees to deduct child care and moving expenses and unemployment insurance contributions, and permits them to exclude from income amounts or benefits received from employers to cover the costs of working away from home.

Income for purposes of the employment expense deduction includes wages, salary and taxable benefits received from an employer, and adult training allowances and research grants. It does not include income from a pension or retirement plan, remuneration as a corporation director or unemployment insurance benefits.

The employment expense deduction is not permitted to a salesman, who may deduct expenses incurred in earning commissions. An individual who holds an elected office will be able to take the deduction only to the extent that it exceeds any tax-free expense allowance he may receive.

Elected members of school boards, boards of education and other elected officers may exclude one-third of their total remuneration as an expense allowance in the same way as members of provincial legislatures and elected municipal officers.

Moving Expenses

The bill provides a deduction of moving expenses by taxpayers who change jobs. The deduction applies both when a person changes employers and when he is transferred by his present employer.

The deduction is available to employees, self-employed persons and full-time students who are not otherwise reimbursed for the costs of the move. The costs will be deductible from income from the new job.

Both the Commons and Senate committees recommended that taxpayers be allowed to deduct their expenses in the year they move or the next year. This is incorporated in the bill to recognize that job-hunting may take time and result in a delay in moving the family.

The deduction is intended to help remove a deterrent to mobility and to put taxpayers who pay their own moving expenses more nearly on a par with others whose moving expenses are paid by their employers.

The new residence must be at least 25 miles closer to a new job location. This is intended to ensure that the move is caused by the new job and not just a personal desire to change accommodation.

Moving expenses include the cost of travel of the taxpayer and members of his household, board and lodging while travelling, transportation and storage costs of household effects, the cost of cancelling a lease and the selling costs of the old residence.

Students who move from a post-secondary school or university to work may deduct moving expenses. Students who win awards for study at other locations may deduct moving expenses from the award.

The deduction does not apply to the expenses of moving into or out of Canada with the exception of certain provisions for students. Foreign students who come to Canada may deduct moving expenses from their grant, as may Canadians who go abroad to study under a grant from a Canadian source.

Away from Home Expenses

Under existing law, construction workers at distant work sites may receive tax-free from their employers amounts covering expenses of transportation, board and lodging. The bill extends this to all employees.

The revision recognizes that many people besides construction workers must leave their normal residence and live and work temporarily at a place where they cannot reasonably be expected to establish homes for their wives and families.

The provision will apply, as it does now, only to an employee who leaves his ordinary residence. It will not apply to a single individual who does not maintain a permanent residence in which he supports a dependant. It is necessary that the employee be away from his ordinary residence for at least 36 hours and the work site must be far enough away that he could not reasonably be expected to return home daily.

Among those who will benefit are lumber and mining workers, oil well drillers, exploration crews, employees at isolated bases and those who work at remote construction sites but do not qualify as "construction workers".

Additional Items of Income

Under the legislation a number of new items will become taxable. Although the income base is widened in this way, new deductions permitted in other sections will make the whole system much more equitable.

To be taxed as income:

- one-half of capital gains;
- payments under an income maintenance insurance plan to which the employer has made a contribution. (Contributions made by the individual since 1967 under the plan will be deductible from any payment he receives);
- allowances paid under the Adult Occupational Training Act, not including the portion for personal or living expenses while away from home for his training;
- allowances paid under the Textile and Clothing Board Act;
- scholarships, fellowships and bursaries with a $500 exemption;
- amounts contributed on an employee's behalf to a public medical care plan.

Many employees receive unemployment insurance benefits for part of a year although they may have earned substantial income during the rest of the year. The change to make these benefits taxable and contributions deductible will produce a more balanced and equitable system.

The bill specifically establishes a taxable value for the personal use of a company automobile. The value will be at least one per cent per month of the original cost of the car or one-third of the rental.

Scholarships, fellowships

Scholarships, fellowships and bursaries in cash or kind will be taxable with a $500 exemption. Research grants, Canada Council and like grants will be taxable, with the costs of equipment, fees, travel, laboratory charges, etc., deductible.

A student with scholarship income would typically have exemptions and deductions totalling at least $2,700. He would be exempt on $500 of the scholarship income, he would have the basic exemption of $1,500, a deduction for his tuition (say, $600) and the standard deduction of $100.

Canadians who leave Canada on a temporary basis to study or teach will continue to be taxed by Canada.

Medical Expenses

As proposed in the White Paper, the bill provides for three general adjustments in treatment of medical expenses.

Amounts contributed by an employer on behalf of his employees to a public medical care plan will be a taxable benefit to the employee (but this will not include payments for retired employees).

Medical expenses for which an individual has been reimbursed under an insurance plan may not be treated as medical expenses for tax purposes.

Premiums paid by an individual to non-government medical or hospital plans will be classed as deductible medical expenses.

The bill also expands the existing list of deductible medical expenses to include payments to a school or other institution for the care and training of mentally or physically handicapped or disabled persons, including those with special learning disabilities.

In the past, an amendment of the Income Tax Act was necessary to expand the list of appliances and equipment required by handicapped or disabled persons and deductible as medical expenses. The bill specifically adds some items to the list and provides that items may be added to this list in future by order in council. This will make possible faster adjustment of the list to respond to improved design of such equipment.

Charitable Donations

The limit on charitable donations is increased to 20 per cent of income from the existing limit of 10 per cent. The existing $100 standard deduction for charitable donations and medical expenses in lieu of itemized receipts is retained.

The legislation provides that donations to national amateur athletic associations will be deductible in the same manner as gifts to charitable organizations.

To qualify, an athletic association created under federal or provincial law must be a non-profit organization, have as its primary purpose and function the promotion of amateur athletics in Canada on a nationwide basis, and be accepted for registration by the Minister of National Revenue.

Tax Rates

Changes are made in the rate schedule to produce revenue approximately equal to present revenues less the amount of the 3-per-cent surtax, and to produce a smooth progression of taxes up the income scale.

The method of calculating personal taxes will be greatly simplified by melding existing special taxes and deductions into a single schedule. These special items include the old age security tax of 4 per cent, the social development tax of 2 per cent and the special tax reduction on basic tax limited to $20. The tax of 4 per cent on foreign investment income is cancelled. The 3-per-cent surtax will not apply in 1972.

One result of the new rate schedule-exemption combination will be to eliminate uneven results in the present rate schedules. For example, the ceilings of $240 on the old age security tax and $120 on the social development tax have resulted in a higher marginal tax rate (28.66 per cent) for taxable income between $4,000 and $6,000 than for the next bracket of taxable income between $6,000 and $8,000 (where the rate is 26.78 per cent). In future, marginal rates will go up in even and gradual steps as taxable income increases.

The existing system has provided for calculation of a federal basic tax, which is abated or reduced by 28 per cent in nine provinces and by 50 per cent in Quebec to allow for provincial income taxes. The higher abatement in Quebec allows Quebec to finance alone certain programs that are financed jointly with other provinces by the federal government. Under the new bill, provincial taxes will be calculated as a percentage of total federal tax, instead of the present system of abatements from "basic tax". The new standard rate of provincial tax will be 30 per cent of total federal tax, which will produce approximately the same provincial revenue as at present.

The result of the new rate schedule and a standard 30-per-cent provincial tax will be *combined* federal and provincial tax rates ranging to 61.1 per cent. This compares with an existing range to 82.4 per cent.

The top rate of 61.1 per cent compares with a White Paper top rate of about 50 per cent and follows the recommendation of the Commons committee for a top rate of 60 per cent, cutting in at taxable income of $60,000.

All taxpayers claiming the married exemption and with income solely from wages and salaries will pay less tax than at present. Taxpayers who claim the single exemption and have only employment income will pay less tax on incomes under $8,000. No single-status taxpayer above this level will have a tax increase of more than $78 on his employment income.

All taxpayers age 65 and over will receive a special exemption of $650. Together with the increase in basic exemptions and the new exemption for the guaranteed income supplement, this will eliminate or reduce taxes for most elderly taxpayers.

Reductions from the existing levels of tax are possible because the income base is broadened to include capital gains and a number of other items, because the 3-per-cent surtax is repealed, and because of reforms in the low rate of tax on corporate income and changes in the taxation of investment income of corporations.

The reductions are more pronounced when compared with the White Paper proposals. First-year revenues under the White Paper system would have been increased by $160 million; under the legislation, first-year revenues will be reduced. Further, the White Paper contemplated 1971, not 1972, as the first year of the new system; by 1972 the increase in revenues at White Paper rates would be have been larger than $160 million.

INCOME AVERAGING

Two distinct types of income averaging are provided in the bill and will replace most of the options available under the old law. They are significantly broader and more generous in scope than the averaging system proposed in the White Paper.

The first is a *general averaging* system which applies *each year*. It cushions the tax effect of significant increases in income and ensures that a taxpayer is not penalized for an unusually successful period.

The second is *forward averaging* which permits a taxpayer to spread the taxes on certain large receipts over a *number* of years. It can be applied in addition to general averaging.

Farmers may continue to use the present five-year block averaging system for their income. The bill has provisions to prevent overlapping use of the two systems.

General Averaging

The bill provides that an automatic tax reduction can occur when an individual's income for the year shows an unusual increase over the average for the previous four years. This will alleviate the result of applying a progressive tax system in a year of unusually high income.

An automatic calculation will be made by the Department of National Revenue using information on the taxpayer's returns for the taxation year and the preceding four years. The taxpayer will not have to elect or make the calculation. The calculation can never increase the tax payable. When the calculation reduces the tax it will increase the taxpayer's refund or reduce any unpaid balance.

The White Paper said general averaging should be available to everyone and should not be difficult to operate. Because individuals are taxed on their income each year using a progressive schedule of rates, any large receipt or extra amount received in a year will normally be taxed more heavily than if it is received over a period of years. Present rules provide that certain lump-sum receipts may be taxed under a variety of special formulas. These formulas are not uniform and they do not apply to all income.

The proposal to tax capital gains will substantially increase the number of cases where individuals have unusual amounts of income in certain years. This increases the need for a satisfactory averaging formula.

Averaging is intended to apply to an unusual amount of income in a year and a method must be established to determine what is unusual. The White Paper proposed that taxpayers could average when their income exceeded their average income for the preceding four years by 33 1/3 per cent. This was criticized as being too restrictive.

The new formula permits taxpayers to average when their income is 20 per cent more than the average of the preceding four years and 10 per cent more than the immediately preceding year. This will make averaging available to more taxpayers and allow more income to be averaged when an individual has a substantial unusual receipt. But it will still reduce the benefit from averaging for individuals with steadily rising incomes.

Under the bill the averaging calculation will first apply in 1973 using only one preceding year.

To cover individuals just entering the labor force the bill provides that a minimum $1,600 income will be assumed for the preceding years.

For an individual who moves to Canada from another country and becomes resident here the calculation will apply to the one, two or three immediately preceding years in which he was a resident in Canada for the entire year.

In the case of a return filed for an individual who has died during the year, any increase in the year over the past four years will be averaged.

Forward Averaging

The purpose of forward averaging is to spread unusual lump-sum receipts in equal portions over the current and future years. Forward averaging will be accomplished through the purchase of a special type of annuity called an income-averaging annuity. Taxes will be payable when annuity payments are received. The annuity may be for life or for a period of up to 15 years.

For example, a taxpayer has an unusual receipt of $12,000 and wants to spread it over eight years. He uses $10,500 of the sum to buy an annuity of $1,500 per year for seven years (ignoring interest). He has $1,500 income in the first year, and an equal amount from the annuity over each of the nest seven years. In this way, the tax on the original $12,000 is spread over eight years.

Unusual receipts eligible for forward averaging:

1. Capital gains.
2. Income from production of a literary, dramatic, musical or artistic work.
3. Income from activities as an athlete, musician or public entertainer.
4. A single payment received from a superannuation or pension plan such as a return of contributions upon termination of employment or the death of an employee.
5. A payment upon retirement of an employee in recognition of long service.
6. A single payment received from a deferred profit-sharing plan upon retirement or withdrawal as a member from such a plan or upon the death of a member of such a plan.
7. A payment received under a death benefit plan for employees.
8. A return of premiums received from a registered retirement savings plan upon the death of the annuitant.
9. Proceeds from disposition of depreciable property.
10. Proceeds from sale of inventory or certain accounts receivable on the termination of a business.
11. Proceeds from disposition of certain special property such as business goodwill.
12. Benefits received by an employee under a stock option plan.

The portion of the unusual receipt left after buying the annuity must be at least as large as the payment expected in each year of the annuity.

To qualify for forward averaging the annuity must be purchased within 60 days after the end of the year. An "income-averaging annuity" will be a contract that meets certain requirements including the following:

1. It must be purchased by a single premium from a person authorized under the laws of Canada or a province to carry on an annuities business.
2. It must provide for payment to the purchaser of a series of equal amounts each year starting not later than 10 months after the contract is purchased; these yearly amounts may be divided into monthly or other periodic payments throughout the year.
3. Payments may be for a specific number of years up to 15, or for the lifetime of the purchaser. A life annuity may not have a guaranteed term of more than 15 years and an individual age 70 or over may not purchase an annuity for a guaranteed term greater than the difference between his age and 85.

RETIREMENT PLANS

Deductible contributions to retirement plans are increased substantially. This will serve both to improve retirement incomes and to make available large additional sums for investment and growth.

The bill raises the limits on contributions to registered pension plans and deferred profit-sharing plans to $2,500 from $1,500. Contribution limits on registered retirement savings plans are raised to $4,000 (or 20 per cent of earned income) from $2,500.

A taxpayer who has accumulated funds in a registered pension plan or deferred profit-sharing plan under the present system may apply the old averaging provisions to lump-sum withdrawals of those amounts made after the new system begins.

Registered Retirement Savings Plans

The proposed legislation repeals the previous flat rate of 15 per cent which applied to amounts paid upon death under a registered retirement savings plan. These payments, referred to as a return of premiums, will be included in income but will be eligible for special treatment. Such payments to a widow or a widower may be transferred tax-free into another registered retirement savings plan or used to buy an income-averaging annuity. Where such an amount is received by any other person it may be used to buy an income-averaging annuity.

Proceeds from cancelled or amended plans will continue to be taxable, but the bill also repeals the minimum tax of 15 per cent. Payments of such proceeds to non-residents will be subject to a 25-per-cent withholding tax.

As the White Paper observed, it is essential to be sure that tax-free funds cannot be diverted through investment in such a way as to bring current benefits to those who control retirement plans. It is therefore necessary to provide penalties for investments made contrary to the rules.

The present rules concerning non-qualified investments of deferred profit-sharing plans will therefore also apply, with some modifications, to investments of registered retirement savings plans. It will not be necessary to dispose of past investments that would be disqualified under the new rules.

Any income of a trust for a registered retirement savings plan from operating a business will be subject to tax. Any trust for a plan that borrows money will lose its tax-exempt status.

Foreign Investments

The legislation limits foreign investments of employee pension plans, registered retirement savings plans and deferred profit-sharing plans to 10 per cent of the cost of their assets. Past foreign investment limits have been based on foreign income rather than cost of foreign assets, and the limits have not applied to registered retirement savings plans. A special tax will be imposed on excess foreign investments held at the end of each month. This will be one per cent of the cost of the excess investments held.

If the cost of foreign investments held on budget day 1971 exceeds the 10-per-cent limit, plans will not be taxed on this excess or forced to reduce it, but they will be taxed on any additional purchases of such investments while over the limit.

Comparative Tables

TABLE 1

Present Schedules of Rates Applied to Taxable Income

	Federal Tax		Combined Federal and 28% Provincial Tax	
Taxable Income Bracket	*Tax at the beginning of the bracket*	*Tax rate on income in the bracket*	*Tax at the beginning of the bracket*	*Tax rate on income in the bracket*
$	$	%	$	%
0 – 909	0.00	11.72	0.00	14.80
909 – 1,000	106.55	13.92	134.55	17.00
1,000 – 1,643	119.20	16.08	150.00	20.00
1,643 – 2,000	222.57	16.50	278.57	20.42
2,000 – 3,000	281.50	18.75	351.50	23.51
3,000 – 4,000	469.00	20.25	586.60	25.57
4,000 – 6,000	671.50	22.50	842.30	28.66
6,000 – 8,000	1,121.50	19.50	1,415.50	26.78
8,000 – 10,000	1,511.50	22.50	1,951.10	30.90
10,000 – 12,000	1,961.50	26.25	2,569.10	36.05
12,000 – 15,000	2,486.50	30.00	3,290.10	41.20
15,000 – 25,000	3,386.50	33.75	4,526.10	46.35
25,000 – 40,000	6,761.50	37.50	9,161.10	51.50
40,000 – 60,000	12,386.50	41.25	16,886.10	56.65
60,000 – 90,000	20,636.50	45.00	28,216.10	61.80
90,000 – 125,000	34,136.50	48.75	46,756.10	66.95
125,000 – 225,000	51,199.00	52.50	70,188.60	72.10
225,000 – 400,000	103,699.00	56.25	142,288.60	77.25
400,000 –	202,136.50	60.00	277,476.10	82.40

Federal tax includes the old age security tax, the social development tax and the 3 per cent surtax, and is after deducting the 20 per cent reduction (maximum $20) and the provincial abatement of 28 per cent of basic tax.

Combined tax includes the federal tax and a provincial income tax at 28 per cent of basic tax.

TABLE 2

Proposed Schedule of Rates for 1972 Applied to Taxable Income

Taxable Income Bracket	Federal Tax: Tax at the beginning of the bracket	Federal Tax: Tax rate on income in bracket	Combined Federal and 30% Provincial Tax: Tax at the beginning of the bracket	Combined Federal and 30% Provincial Tax: Tax rate on income in the bracket
$	$	%	$	%
0 – 500	0	17	0	22.1
500 – 1,000	85	18	110.50	23.4
1,000 – 2,000	175	19	227.50	24.7
2,000 – 3,000	365	20	474.50	26.0
3,000 – 5,000	565	21	734.50	27.3
5,000 – 7,000	985	23	1,280.50	29.9
7,000 – 9,000	1,445	25	1,878.50	32.5
9,000 – 11,000	1,945	27	2,528.50	35.1
11,000 – 14,000	2,485	31	3,230.50	40.3
14,000 – 24,000	3,415	35	4,439.50	45.5
24,000 – 39,000	6,915	39	8,989.50	50.7
39,000 – 60,000	12,765	43	16,594.50	55.9
60,000 –	21,795	47	28,333.50	61.1

Initial federal rate of 17 per cent reduced in 1973 to 15 per cent, in 1974 to 12 per cent, in 1975 to 9 per cent and in 1976 to 6 per cent.

TABLE 3

SINGLE TAXPAYER – NO DEPENDANTS

All Income from Salary or Wages

Income	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
1,200	15	–	–	– 15	**– 15**
1,400	44	–	–	– 44	**– 44**
1,600	74	11	–	– 63	**– 74**
1,800	104	54	32	– 50	**– 72**
2,000	133	96	75	– 37	**– 58**
2,500	230	207	187	– 23	**– 43**
3,000	331	324	304	– 7	**– 27**
4,000	563	576	547	+ 13	**– 16**
5,000	817	841	803	+ 24	**– 14**
6,000	1,100	1,132	1,076	+ 31	**– 24**
7,000	1,387	1,448	1,355	+ 61	**– 32**
8,000	1,657	1,780	1,654	+ 124	**– 3**
9,000	1,924	2,122	1,960	+ 198	**+ 36**
10,000	2,229	2,481	2,285	+ 251	**+ 56**
11,000	2,538	2,839	2,616	+ 301	**+ 78**
12,000	2,894	3,206	2,967	+ 313	**+ 73**
13,000	3,254	3,590	3,331	+ 336	**+ 77**
14,000	3,661	3,974	3,734	+ 313	**+ 73**
15,000	4,073	4,372	4,137	+ 299	**+ 64**
20,000	6,334	6,574	6,373	+ 240	**+ 39**
25,000	8,651	8,878	8,648	+ 227	**– 3**
30,000	11,170	11,405	11,144	+ 235	**– 26**
50,000	21,928	21,645	21,765	– 283	**– 163**
75,000	36,806	34,445	36,429	–2,361	**– 377**
100,000	52,715	47,245	51,704	–5,470	**–1,011**

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for single taxpayers of $1,500, plus provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill taxpayers receive the employment expense deduction of 3 per cent, maximum $150. No account has been taken of other proposed adjustments to income, such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

Taxpayers are assumed to be under age 65.

TABLE 4

MARRIED TAXPAYER – NO DEPENDANTS

All Income from Salary or Wages

Income	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
2,200	15	–	–	– 15	**– 15**
2,400	44	–	–	– 44	**– 44**
2,600	74	–	–	– 74	**– 74**
2,800	104	–	–	– 104	**– 104**
3,000	133	2	–	– 131	**– 133**
3,500	230	108	98	– 122	**– 132**
4,000	331	219	211	– 112	**– 120**
5,000	563	461	450	– 102	**– 113**
6,000	817	729	709	– 88	**– 108**
7,000	1,100	1,010	980	– 90	**– 120**
8,000	1,387	1,316	1,253	– 71	**– 134**
9,000	1,657	1,647	1,550	– 10	**– 107**
10,000	1,924	1,980	1,849	+ 56	**– 75**
11,000	2,229	2,337	2,171	+ 108	**– 58**
12,000	2,538	2,696	2,496	+ 157	**– 42**
13,000	2,894	3,054	2,844	+ 160	**– 50**
14,000	3,254	3,437	3,195	+ 183	**– 59**
15,000	3,661	3,821	3,593	+ 160	**– 68**
20,000	5,870	5,929	5,759	+ 59	**– 111**
25,000	8,188	8,233	8,034	+ 45	**– 154**
30,000	10,655	10,688	10,460	+ 33	**– 195**
50,000	21,361	20,928	21,011	– 433	**– 350**
75,000	36,188	33,728	35,604	–2,460	**– 584**
100,000	52,045	46,528	50,879	–5,517	**–1,166**

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for married taxpayers of $2,850, plus provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill taxpayers receive the employment expense deduction of 3 per cent, maximum $150. No account has been taken of other proposed adjustments to income such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

Taxpayers are assumed to be under age 65.

TABLE 5

MARRIED TAXPAYER – TWO DEPENDENT CHILDREN UNDER AGE 16

All Income from Salary or Wages

Income	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
2,800	15	–	–	– 15	– 15
3,000	44	–	–	– 44	– 44
3,500	118	–	–	– 118	– 118
4,000	210	83	73	– 127	– 137
5,000	422	309	302	– 113	– 120
6,000	663	568	553	– 96	– 110
7,000	928	841	816	– 87	– 112
8,000	1,215	1,132	1,089	– 83	– 126
9,000	1,496	1,448	1,370	– 48	– 126
10,000	1,764	1,780	1,669	+ 17	– 95
11,000	2,044	2,122	1,976	+ 78	– 68
12,000	2,353	2,481	2,301	+ 128	– 52
13,000	2,677	2,839	2,634	+ 161	– 43
14,000	3,038	3,206	2,985	+ 168	– 53
15,000	3,414	3,590	3,351	+ 177	– 63
20,000	5,592	5,652	5,486	+ 60	– 106
25,000	7,910	7,956	7,761	+ 47	– 149
30,000	10,346	10,381	10,156	+ 35	– 190
50,000	21,022	20,621	20,675	– 401	– 347
75,000	35,818	33,421	35,238	–2,397	– 580
100,000	51,643	46,221	50,513	–5,423	–1,130

The present tax is current tax including old age security tax, social development tax, and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for married taxpayers of $2,850, plus provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill taxpayers receive the employment expense deduction of 3 per cent, maximum $150. No account has been taken of other proposed adjustments to income such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

Taxpayers are assumed to be under age 65.

TABLE 6

SINGLE TAXPAYER – NO DEPENDANTS

Not Eligible for 3% Employment Expense Deduction

Income	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
1,200	15	–	–	– 15	– **15**
1,400	44	–	–	– 44	– **44**
1,600	74	22	–	– 52	– **74**
1,800	104	65	44	– 38	– **60**
2,000	133	109	88	– 24	– **45**
2,500	230	224	204	– 6	– **26**
3,000	331	346	326	+ 15	– **5**
4,000	563	608	579	+ 45	+ **16**
5,000	817	883	844	+ 66	+ **27**
6,000	1,100	1,178	1,117	+ 77	+ **17**
7,000	1,387	1,498	1,400	+ 111	+ **13**
8,000	1,657	1,830	1,699	+ 174	+ **42**
9,000	1,924	2,176	2,009	+ 252	+ **85**
10,000	2,229	2,534	2,334	+ 305	+ **105**
11,000	2,538	2,893	2,669	+ 355	+ **131**
12,000	2,894	3,264	3,020	+ 370	+ **126**
13,000	3,254	3,648	3,392	+ 394	+ **138**
14,000	3,661	4,032	3,795	+ 371	+ **134**
15,000	4,073	4,435	4,198	+ 362	+ **125**
20,000	6,334	6,643	6,442	+ 309	+ **108**
25,000	8,651	8,947	8,717	+ 296	+ **66**
30,000	11,170	11,482	11,220	+ 312	+ **50**
50,000	21,928	21,722	21,849	– 206	– **79**
75,000	36,806	34,522	36,521	–2,284	– **285**
100,000	52,715	47,322	51,796	–5,393	– **919**

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for single taxpayers of $1,500, plus provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the credit for dividends or new adjustments to income such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

Taxpayers are assumed to be under age 65.

TABLE 7

MARRIED TAXPAYER – NO DEPENDANTS

Not Eligible for 3% Employment Expense Deduction

Income	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
2,200	15	–	–	– 15	– **15**
2,400	44	–	–	– 44	– **44**
2,600	74	–	–	– 74	– **74**
2,800	104	–	–	– 104	– **104**
3,000	133	22	11	– 111	– **122**
3,500	230	132	122	– 98	– **108**
4,000	331	248	240	– 83	– **91**
5,000	563	500	488	– 63	– **75**
6,000	817	771	748	– 46	– **69**
7,000	1,100	1,055	1,021	– 45	– **79**
8,000	1,387	1,364	1,295	– 23	– **92**
9,000	1,657	1,697	1,594	+ 40	– **63**
10,000	1,924	2,033	1,895	+ 108	– **29**
11,000	2,229	2,391	2,220	+ 162	– **9**
12,000	2,538	2,749	2,546	+ 211	+ **8**
13,000	2,894	3,110	2,897	+ 216	+ **3**
14,000	3,254	3,494	3,251	+ 240	– **3**
15,000	3,661	3,878	3,654	+ 217	– **7**
20,000	5,870	5,998	5,827	+ 128	– **43**
25,000	8,188	8,302	8,102	+ 114	– **86**
30,000	10,655	10,765	10,536	+ 110	– **119**
50,000	21,361	21,005	21,094	– 357	– **267**
75,000	36,188	33,805	35,696	–2,383	– **492**
100,000	52,045	46,605	50,971	–5,440	**–1,074**

The present tax is current tax including old age security tax, social development tax and 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for married taxpayers of $2,850, plus provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the tax credit for dividends or new adjustments to income such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

Taxpayers are assumed to be under age 65.

TABLE 8

SINGLE TAXPAYER – AGE 65 TO 69 – NO DEPENDANTS

No Income from Employment

Income Plus G.I.S.	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
960 + 660	77	26	–	– 51	– 77
1,200 + 540	95	52	–	– 43	– 95
1,400 + 444	110	75	–	– 35	– 110
1,600 + 340	124	96	–	– 28	– 124
1,800 + 240	140	118	–	– 22	– 140
2,000 + 144	159	142	–	– 17	– 159
2,500	230	224	55	– 6	– 175
3,000	331	346	169	+ 15	– 162
4,000	563	608	413	+ 45	– 150
5,000	817	883	670	+ 66	– 147
6,000	1,100	1,178	939	+ 77	– 161
7,000	1,387	1,498	1,212	+ 111	– 175
8,000	1,657	1,830	1,505	+ 174	– 152
9,000	1,924	2,176	1,804	+ 252	– 120
10,000	2,229	2,534	2,122	+ 305	– 107
11,000	2,538	2,893	2,447	+ 355	– 91
12,000	2,894	3,264	2,792	+ 370	– 102
13,000	3,254	3,648	3,143	+ 394	– 111
14,000	3,661	4,032	3,533	+ 371	– 128
15,000	4,073	4,435	3,936	+ 362	– 137
20,000	6,334	6,643	6,146	+ 309	– 188
25,000	8,651	8,947	8,421	+ 296	– 230
30,000	11,170	11,482	10,891	+ 312	– 279
50,000	21,928	21,722	21,486	– 206	– 442
75,000	36,806	34,522	36,124	–2,284	– 682
100,000	52,715	47,322	51,399	–5,393	–1,316

The amount of guaranteed income supplement payable to single persons with low incomes is shown in addition to other income. The present tax and White Paper tax are calculated on the combined amounts. Under the new bill the guaranteed supplement will not be subject to tax.

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for single taxpayers of $1,500 plus a special exemption of $650. It includes provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the tax credit for dividends or new adjustments to income such as the taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

TABLE 9

MARRIED TAXPAYER – AGE 65 TO 69 – NO DEPENDANTS

No Income from Employment

Income Plus G.I.S.	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax White Paper*	*Change from Present Tax* New Bill
$	$	$	$	$	$
2,200 + 600	104	–	–	– 104	– **104**
2,400 + 540	124	9	–	– 115	– **124**
2,600 + 492	149	42	–	– 107	– **149**
2,800 + 444	179	75	–	– 104	– **179**
3,000 + 396	209	108	–	– 101	– **209**
3,500 + 276	285	195	–	– 90	– **285**
4,000 + 144	362	283	88	– 79	– **274**
5,000	563	500	326	– 63	– **237**
6,000	817	771	578	– 46	– **239**
7,000	1,100	1,055	844	– 45	– **256**
8,000	1,387	1,364	1,117	– 23	– **270**
9,000	1,657	1,697	1,400	+ 40	– **257**
10,000	1,924	2,033	1,699	+ 109	– **225**
11,000	2,229	2,391	2,008	+ 162	– **221**
12,000	2,538	2,749	2,334	+ 211	– **204**
13,000	2,894	3,110	2,669	+ 216	– **225**
14,000	3,254	3,494	3,020	+ 240	– **234**
15,000	3,661	3,878	3,392	+ 217	– **269**
20,000	5,870	5,998	5,532	+ 128	– **338**
25,000	8,188	8,302	7,806	+ 114	– **382**
30,000	10,655	10,765	10,206	+ 110	– **449**
50,000	21,361	21,005	20,731	– 356	– **630**
75,000	36,188	33,805	35,299	–2,383	– **889**
100,000	52,045	46,605	50,574	–5,440	**–1,471**

The amount of guaranteed income supplement payable to a married person with a low income whose spouse is not eligible for the old age pension or guaranteed supplement is shown in addition to other income. The present tax and White Paper tax are calculated on the combined amounts. Under the new bill the guaranteed supplement will not be subject to tax.

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for married taxpayers of $2,850 plus a special exemption of $650. It includes provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the tax credit for dividends or new adjustments to income such as the taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

TABLE 10

SINGLE TAXPAYER – AGE 70 OR OVER – NO DEPENDANTS

No Income from Employment

Income Plus G.I.S.	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax White Paper*	**New Bill**
$	$	$	$	$	$
1,600 + 340	50	–	–	– 50	**– 50**
1,800 + 240	65	9	–	– 56	**– 65**
2,000 + 144	80	31	–	– 49	**– 80**
2,500	133	109	55	– 24	**– 78**
3,000	230	224	169	– 6	**– 61**
4,000	446	474	413	+ 28	**– 33**
5,000	689	742	670	+ 53	**– 19**
6,000	957	1,024	939	+ 67	**– 18**
7,000	1,244	1,331	1,212	+ 87	**– 32**
8,000	1,523	1,664	1,505	+ 141	**– 18**
9,000	1,790	1,997	1,804	+ 207	**+ 14**
10,000	2,075	2,355	2,122	+ 280	**+ 47**
11,000	2,384	2,714	2,447	+ 330	**+ 63**
12,000	2,713	3,072	2,792	+ 359	**+ 79**
13,000	3,074	3,456	3,143	+ 382	**+ 69**
14,000	3,455	3,840	3,533	+ 385	**+ 78**
15,000	3,867	4,224	3,936	+ 357	**+ 69**
20,000	6,102	6,413	6,146	+ 311	**+ 44**
25,000	8,420	8,717	8,421	+ 297	**+ 1**
30,000	10,912	11,226	10,891	+ 314	**– 21**
50,000	21,645	21,466	21,486	– 179	**–159**
75,000	36,497	34,266	36,124	–2,231	**–373**
100,000	52,380	47,066	51,399	–5,314	**–981**

The amount of guaranteed income supplement payable to single persons with low incomes is shown in addition to other income. The present tax and White Paper tax are calculated on the combined amounts. Under the new bill the guaranteed supplement will not be subject to tax.

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal tax for 1972 using a new rate schedule and a basic exemption for single taxpayers of $1,500 plus an additional deduction of $150 and the extra $500 deduction for persons age 70 or over. It includes provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the tax credit for dividends or new adjustments to income such as taxation of capital gains.

In all cases it assumed that taxpayers take the optional standard deduction of $100.

TABLE 11

MARRIED TAXPAYER – AGE 70 OR OVER – NO DEPENDANTS

No Income from Employment

Income Plus G.I.S.	*Present Tax*	*White Paper*	*New Bill*	*Change from Present Tax* *White Paper*	**New Bill**
$	$	$	$	$	$
2,200 + 600	30	–	–	– 30	**– 30**
2,400 + 540	50	–	–	– 50	**– 50**
2,600 + 492	73	–	–	– 73	**– 73**
2,800 + 444	95	–	–	– 95	**– 95**
3,000 + 396	118	–	–	– 118	**– 118**
3,500 + 276	185	82	–	– 103	**– 185**
4,000 + 144	259	165	88	– 94	**– 171**
5,000	446	371	326	– 75	**– 120**
6,000	689	635	578	– 54	**– 111**
7,000	957	911	844	– 46	**– 113**
8,000	1,244	1,208	1,117	– 36	**– 127**
9,000	1,523	1,531	1,400	+ 8	**– 123**
10,000	1,790	1,864	1,699	+ 74	**– 91**
11,000	2,075	2,212	2,008	+ 137	**– 67**
12,000	2,384	2,570	2,334	+ 186	**– 50**
13,000	2,713	2,929	2,669	+ 216	**– 44**
14,000	3,074	3,302	3,020	+ 228	**– 54**
15,000	3,455	3,686	3,392	+ 231	**– 63**
20,000	5,638	5,768	5,532	+ 130	**– 106**
25,000	7,956	8,072	7,806	+ 116	**– 150**
30,000	10,397	10,509	10,206	+ 112	**– 191**
50,000	21,078	20,749	20,731	– 329	**– 347**
75,000	35,879	33,549	35,299	–2,330	**– 580**
100,000	51,710	46,349	50,574	–5,361	**–1,136**

The amount of guaranteed income supplement payable to a married person with a low income whose spouse is not eligible for the old age pension or guaranteed supplement is shown in addition to other income. The present tax and White Paper tax are calculated on the combined amounts. Under the new bill guaranteed supplement will not be subject to tax.

The present tax is current tax including old age security tax, social development tax and the 3 per cent surtax, plus provincial tax at 28 per cent of basic tax.

White Paper tax is federal tax plus provincial tax at 28 per cent as shown in the White Paper.

Tax under the new bill is federal for 1972 using a new rate schedule and a basic exemption for married taxpayers of $2,850 plus an additional deduction of $150 and the extra $500 deduction for persons age 70 or over. It includes provincial tax at 30 per cent of federal tax.

In calculating tax under the new bill it is assumed that taxpayers do not have any income from salary or wages. No account has been taken of the tax credit for dividends or new adjustments to income such as taxation of capital gains.

In all cases it is assumed that taxpayers take the optional standard deduction of $100.

TABLE 12

Operation of General Income Averaging for Individuals

Assume that a married taxpayer with no dependants has income as follows:	1972	$ 8,000
	1973	9,000
	1974	9,000
	1975	10,000
	1976	22,000
Income Calculations:		
Average of years 1972 to 1975 inclusive		$ 9,000
120% of average income	(A) $10,800	
110% of income in 1975	(B) 11,000	
Threshold amount is the greater of (A) and (B)		11,000
Excess of income in 1976 over threshold amount ($11,000 + $2,200)		11,000
Divide this excess by 5		2,200
Add this 1/5 excess to threshold amount		13,200
Tax Calculations:		
Tax on $13,200		$ 2,967
Tax on threshold amount ($11,000)		2,220
Difference is tax on 1/5 excess		$ 747
Multiply tax on 1/5 excess by 5 = tax on excess		$ 3,735
Tax on threshold amount		2,220
Total is tax on income of $22,000 in 1976		$ 5,955

The example applies the proposed rate schedule for 1972.
The taxable income for 1976 is $19,050, calculated as follows:

Income		$22,000
Less: personal exemption	$2,850	
standard deduction	100	2,950
Taxable income		$19,050

The tax on income of $22,000 in 1976 without averaging would be $6,737. Thus the tax saving from averaging in this example is $782.

If the income in the above example for the year 1976 were $32,000 the saving from averaging would be $1,758. Unless the taxpayer's income in 1976 exceeds $11,950 there would be no saving from averaging. Table 13 gives some further examples of the results from using the general averaging formula.

For comparative purposes the averaging examples are identical to those used in the White Paper. In the above example, the tax savings from averaging under the White Paper system were $446 in the situation where income in the last year was $22,000 and $1,455 when income increased to $32,000. In examples 1 to 5 of Table 13 the corresponding tax savings under the White Paper were $314, $316, $185, $173 and $671 respectively.

TABLE 13

Operation of General Income Averaging for Individuals

	1972	1973	1974	1975	1976
	$	$	$	$	$
Example 1					
Income	2,100	2,100	2,100	2,100	8,000
Tax saving from averaging					146*
Example 2					
Income	2,000	2,000	6,000	8,000	10,000
Tax saving from averaging					NIL
Example 3					
Income	6,000	6,000	6,000	6,000	15,000
Tax saving from averaging					343
Example 4					
Income	10,000	6,000	9,000	11,000	18,000
Tax saving from averaging					265
Example 5					
Income	15,000	15,000	15,000	15,000	40,000
Tax saving from averaging					679

The examples apply the proposed rate schedule for 1972.

For these calculations it is assumed that the taxpayer is married with no dependants and has no other deductions except the $100 standard deduction and the $2,850 personal exemption.

*Where 110 per cent of the previous year's income or 120 per cent of the average income for the four previous years is less than the total personal exemptions and deductions, the threshold amount is the total of personal exemptions and deductions ($2,950 in this example).

2

Capital Gains

- *The legislation establishes a general rule that one half of capital gains will be included in income and taxed at normal personal or corporate rates.*
- *A second general rule is that all taxpayers may deduct one-half of capital losses against one-half of capital gains; individual taxpayers may also deduct up to $1,000 of capital losses against other income. The deductions may be made in the current year, preceding year or any number of subsequent years until losses are fully absorbed.*
- *Gains will generally be taxable and losses deductible when a taxpayer sells an asset, when he makes a gift of an asset, or at his death. Capital gains will be deferred on gifts or bequests to wife or husband.*
- *With the inclusion of capital gains in income and the taxation of accrued gains at death, federal estate and gift taxes will be eliminated. These taxes will end December 31, 1971.*
- *The White Paper proposal for valuation of listed shares every five years is dropped.*
- *Any gain realized by a taxpayer in selling his home and up to an acre of surrounding land will be entirely exempt. Alternatively, a farmer may deduct $1,000 per year from gain on sale of home and farm property.*
- *No gain realized on an item of personal property will be taxed unless the asset's selling price is more than $1,000.*
- *Provisions to defer gains will be permitted in the case of destruction or expropriation, sales of property to a controlled corporation and certain corporate reorganizations.*
- *Gains on assets held at the start of the system may be measured against the higher of original cost or Valuation Day value.*

Debate on the White Paper revealed a clear consensus that the taxation of capital gains should be part of the Canadian tax system. The debate did not, however, support the full taxation of gains as recommended by the Royal Commission on Taxation, or the White Paper's modified system of full rates on assets other than shares of widely-held Canadian corporations.

The Commons committee said it was the view of the private sector and provincial governments that "capital gains should not suffer the same weight of tax as other income", and the committee recommended taxing one-half of realized gains as a general rule.

The legislation proposes to include one-half of capital gains in the taxpayer's income to be taxed at personal rates if the taxpayer is an individual, or at corporate rates if the taxpayer is a corporation. The system makes capital gains part of the progressive rate system for individuals, taxing gains in the same manner as other income, according to ability to pay.

Let us assume that a taxpayer has other taxable income of $10,000, a marginal tax rate of 35 per cent and receives a capital gain of $100 on sale of shares. He would take $50 into income and pay $17.50 on the gain. On the same gain, another taxpayer with $25,000 of taxable income and a marginal rate of 50 per cent would pay $25.

The legislation drops a proposal of the White Paper to tax accrued gains on listed shares every five years. As indicated in a paper submitted by the Minister of Finance to the two parliamentary committees, two important consequences follow from any decision to eliminate such periodic valuation.

The first is the need to tax accrued gains on death to prevent the perpetual deferral of tax. The legislation makes gains taxable at death, but also eliminates federal estate and gift taxes.

The second is the requirement to limit the amount of losses that may be deducted in any one year from ordinary income, because taxpayers will have more control over the timing of gains and losses on their readily marketable assets.

The legislation permits a deductible loss to be absorbed fully over a period of time, just as averaging provisions will reduce the immediate tax impact of a large gain received at one time. But a taxpayer may not deduct capital losses from other income in full as proposed by the White Paper.

The legislation permits an individual to deduct one-half of capital losses in a year first against one-half of capital gains in that year, and up to $1,000 of any deductible excess against other income. If part of the loss is still not absorbed, it may be applied in the same manner for the previous year and any number of future years until it is absorbed.

The following table shows how an individual taxpayer obtains a deduction for one-half of a $30,000 capital loss in the year of the loss (Year 3), the previous year and subsequent years.

	Year 1	*Year 2*	*Year 3*	*Year 4*	*Year 5*	*Year 6*
	$	$	$	$	$	$
CAPITAL GAINS (LOSSES)	2,000	4,000	(30,000)	6,000	4,000	20,000
CALCULATION OF TAXABLE INCOME						
Ordinary income less expenses and personal exemptions	10,000	10,000	10,000	10,000	10,000	10,000
Taxable capital gains	1,000	2,000	–	3,000	2,000	10,000
	11,000	12,000	10,000	13,000	12,000	20,000
Deductible capital losses:						
– from taxable capital gains	–	2,000	–	3,000	2,000	4,000
– from ordinary income	–	1,000	1,000	1,000	1,000	–
	–	3,000	1,000	4,000	3,000	4,000
TAXABLE INCOME	11,000	9,000	9,000	9,000	9,000	16,000

- In Year 3 a taxpayer suffers a capital loss of $30,000, of which $15,000 (one-half) is deductible. Since there are no capital gains in that year the maximum deduction is $1,000. This leaves $14,000 to be deducted.
- The taxpayer then recalculates his taxable income for the previous year, Year 2, and the deduction in that year is $3,000, ($2,000 against capital gains and $1,000 against ordinary income). This leaves a balance of $11,000.
- In Year 4 the deductible capital loss is $4,000, ($3,000 from capital gains and $1,000 from ordinary income), leaving a balance of $7,000.
- In Year 5 the deductible capital loss is $3,000, ($2,000 from capital gains and $1,000 from ordinary income), leaving a balance of $4,000 to be carried forward to Year 6.
- In Year 6 the balance of $4,000 is deducted.

Corporations may deduct capital losses against capital gains, but not against other income. They have the same provisions as individual taxpayers for carrying losses back one year and forward until absorbed.

When control of a corporation changes, any unused capital losses will expire and may not be deducted from gains realized by the corporation after control changes. This provision is necessary to prevent dealing in corporations with capital loss carry-overs.

Because capital gains will not be fully taxed like other income, it will be necessary to continue to distinguish between income receipts and capital receipts. There will be no change in the tax position of taxpayers in the business of dealing in certain assets; their profits on transactions in these assets continue to be fully taxable as business income and their losses fully deductible as at present.

Homes

The government has expressed the view that as a general rule Canadians should not be taxed on the increase in value of their homes. The White Paper proposed to accomplish this by a formula exempting profits of up to $1,000 a year and allowing for actual improvements or a flat $150 a year. Provisions to defer gains would have been allowed a taxpayer who sold one home and bought another because he had moved his family in changing jobs.

Many who commented on the provisions felt that substantial tax liabilities would still occur in areas where pressure on the housing market pushed prices up strongly and that homeowners would continue to face uncertainty about their tax position. It was also argued that the economic use of our housing stock might be inhibited if families could not "move up" to larger homes as they grew and established themselves.

The government has decided that these arguments can best be met by a complete exemption. This will save homeowners from valuation problems and meet the very strong views of Canadian homeowners and many other Canadians who aspire to home ownership.

The legislation exempts a taxpayer's principal residence, together with up to an acre of surrounding land if the land "contributes to the use and enjoyment" of the home as a residence.

More than one surrounding acre may qualify for exemption in limited circumstances if the taxpayer establishes that it is necessary for use and enjoyment of his residence. If a taxpayer lives in a co-operative housing unit, any gain on the sale of his shares in the co-operative housing corporation is exempt.

In some cases the complete exemption of a farmer's farm house and one acre may be less beneficial to him than the White Paper formula for a $1,000 annual deduction against gains on his farm house and all his farm property. He may choose either formula.

As a general rule, when a personal asset is converted to a business use, it would be treated as having been sold at its fair market value. However, if a taxpayer rents his principal residence and elects not to depreciate it as a business asset, it will remain exempt for four years.

The exemption for principal residences is not extended to second homes, such as summer homes and cottages, for reasons of equity. A taxpayer with more than one home will have to declare which is his principal residence. It is also necessary to limit the amount of surrounding land in order to control the exemption.

Personal Property

The government believes Canadians should not be caught up in needless record-keeping to account for the costs and returns they experience in the normal course of collecting stamps, and coins, or occasionally buying and selling paintings and sculptures.

The White Paper proposed to minimize record-keeping and prevent abuse by providing that when a taxpayer sells such an asset he would not be taxed unless the proceeds exceeded $500. Realized gains would have been taxed at full personal rates.

Some groups argued that capital gains on personal property should not be taxed at all because Canadians are collectors, not traders; but clearly, a complete exemption within a general system of capital gains would invite taxpayers to enter such a trade to the distortion of both the price structure and the ownership of works of art. To make gains realizable only on death would be no solution; tax could be avoided simply by a sale before death.

As recommended by the Commons committee, the legislation replaces the $500 floor with a floor of $1,000 and makes items of personal property subject to the one-half rule on realization.

If the proceeds of sale of a personal asset exceed $1,000, the individual may deduct from those proceeds either his cost or $1,000, whichever is greater. Record-keeping will be necessary only if the cost of the asset exceeds $1,000. Items normally sold as a set will be regarded as part of a single asset and a series of sales of the items will be regarded as a single sale in applying the $1,000 limit.

For example, let us assume an individual buys an antique in 1973 for $900 and sells it in 1975 for $1,500. His gain is $500 (the difference between $1,000 and $1,500) and he includes $250 (half of $500) in his income.

Losses will not be deductible unless the item sold costs more than $1,000. If an asset does cost more than $1,000, the deductible loss will be computed by deducting from the cost either the proceeds or $1,000, whichever is greater.

As the White Paper explained, a loss on a personal item that depreciates through use could not be deductible because it would amount to government subsidization of personal expenses. There will be no deduction, for example, for losses on furniture, cars, boats and cottages.

Personal-use property that does not depreciate through use is defined to include paintings, prints, rare folios, manuscripts, books, etchings, drawings, sculptures, or other similar works of art, jewellery and coin and stamp collections. On these items, losses will be deductible against gains realized on the sale of other personal property. Deductibility against other income would not be consistent with the personal nature of the assets. If gains in the current year are not sufficient to absorb the deductible loss, the balance can be offset against such gains in the immediately preceding or the following five years.

Persons in the business of dealing in such assets will, of course, continue to be taxable in the normal manner.

Valuation Day

With the introduction of a system taxing capital gains for the first time, rules must be provided to guarantee that only gains arising after the start of the system are taxed.

The basic guarantee for this purpose is the establishment of a Valuation Day close to the commencement of the system. Gains and losses will generally be measured from this day.

As the White Paper explained, Valuation Day will be announced after it has passed; to name the day in advance would be to invite speculation that would drive up asset prices arbitrarily.

On some assets, post-Valuation Day gains may represent only a recovery or partial recovery of the original cost paid for the asset. As explained later, special transitional provisions permit such recoveries to be made tax-free.

Most taxpayers will not be affected by Valuation Day. Their most important assets will be exempt from capital gains tax. This will be the case with a taxpayer's home and with all personal effects of a value below $1,000. The great majority of personal possessions decline rather than increase in value over time.

Further, Valuation Day has no application to an asset acquired after the system starts. It is important only in the case of assets held at that time, and becomes relevant only when three further circumstances come together:

1) the taxpayer sells the asset;
2) the sale results in a gain or a loss; and
3) the gain or loss is taxable or deductible even after exemptions are taken into account.

No taxpayer is required to report any information to the Department of National Revenue on Valuation Day. There are circumstances under which he may wish to obtain certain information on or after Valuation Day about some of his assets. The most important circumstances are as follows:

1) When he owns a second residence, cottage, farm or rental real estate.

   A reasonable value may be established by sales of comparable property in the area. Taxpayers may wish to record information of this kind, which is widely available.

2) When he owns antiques, art collections or other similar items worth more than $1,000.

   Again, there are a number of ways to establish such values. These articles may already have their values established for insurance purposes.

3) When he owns shares in public corporations, certain bonds and other widely traded securities.

   Most of these securities are covered daily in widely published listings. They are available from newspapers, stock exchanges and brokers.

4) When he owns shares or other interests in private corporations.

There is no standard formula for establishing values in this area. The taxpayer may wish to obtain professional advice or help.

All taxpayers will receive information about Valuation Day from the Department of National Revenue.

A taxpayer's reasonable valuation of an asset will be accepted by the department.

Assets Held at the Start of the System

The legislation provides that capital gains and losses on assets held at the start of the system may be measured against either their actual cost or their value on Valuation Day.

This provision expands a proposal in the White Paper and ensures that a gain under the new system is not taxed if it represents merely a recovery of all or part of the original cost of the asset. The counterpart of this provision will be that an asset's decline in value will not be deductible if it is merely a return to its original cost.

This will accomplish the objective of taxing only what might be called "real" gains after the new system starts, and permitting a deduction only for "real" losses under the new system.

Three sets of circumstances illustrate the application of the rule.

If an asset is sold for an amount that is less than both the original cost and the value on Valuation Day, then a capital loss will result to the extent that the sale price is below the lower of the cost price or Valuation Day value.

If an asset is sold for an amount that lies between its original cost and its value on Valuation Day, neither a capital gain nor a capital loss results for tax purposes.

If an asset is sold for an amount that is greater than both the original cost and the value on Valuation Day, a capital gain will result to the extent that the sale price exceeds the greater of the cost price or the Valuation Day value.

This range between cost and Valuation Day value might be called a "tax-free zone". The following table shows the result of transactions made below, within and above this zone.

	$	$	$
Cost or amortized cost	100	100	100
Valuation Day value	80	90	110
Tax-free zone	80 – 100	90 – 100	100 – 110
Proceeds	75	95	115
Gain (loss)	(5)	–	5

Where cost records are unavailable, or where it is to the taxpayer's advantage, he may elect to use Valuation Day value as the basis for computing gains and losses on all his assets. In this event he foregoes the "tax-free zone". One alternative or the other must be used for all assets.

If a taxpayer has made a number of purchases of the same asset (e.g., common shares in a corporation) he will calculate one average cost for those on hand at the start of the system and another for those subsequently acquired. When part of these assets are sold, the "first-in, first-out" method will determine which average cost is used to calculate a capital gain or loss.

Gifts and Bequests

In general, accrued gains on capital assets will be taxable at death. The combination of this provision with estate taxes could in some instances result in substantial tax impact arising on the death of a taxpayer.

The Commons committee recommended that the impact be lessened by a substantial reduction of estate taxes. The Senate committee recommended that the estate tax field should be vacated in favor of the provinces.

A reduction of estate taxes to the extent suggested by the Commons committee would result in a revenue loss of about half the $55 million now received by the federal government from this source. Since 1964, provincial governments have received about 75 per cent of all death duties in Canada; 75 per cent of federal estate taxes are turned over to seven provinces and the others either levy their own death duties to the same extent or receive the equivalent amount by combining their own death duties and federal payments.

Two provinces now return their entire share of estate taxes to estates and it is no longer possible to establish a uniform national system of death duties through federal legislation.

In these circumstances, it has been decided that the federal government will vacate the estate and gift tax field on December 31, 1971.

No capital gains tax will be imposed on bequests from husband to wife or wife to husband. A wife inheriting property from her husband will acquire the assets at her husband's original cost. No capital gains tax will be payable until the wife sells the property or transfers it by gift or bequest.

When a taxpayer makes a gift of an asset, he is considered to have sold it at fair market value and he brings into income half the difference between his cost and that value. Again, the accrued gain on property given by a husband to his wife either outright or through a trust is not taxed at that time. When the asset is sold, the capital gain will be the difference between its selling price and the husband's original cost. One half of this gain will be included in the husband's income as if he had continued to own the asset. This attribution rule is similar to existing rules for income earned on property transferred to a spouse or to a person under 19 years of age.

Depreciable Property

When depreciable property is transferred on death, the deceased will be considered to have sold the property at an amount midway between fair market value and the original cost less depreciation. This deemed sale price will be used as the basis for calculating recaptured depreciation and capital gains taxes.

Deferred Recognition of Gains

Normally when a taxpayer disposes of a property, a taxable gain or loss results. However, in the case of a property which is destroyed or expropriated, the capital gain may be deferred if the compensation received is reinvested by the end of the following year in equivalent property. The cost of the new property will be reduced by the amount of the capital gain arising from the disposition of the old property.

For example, a property which originally cost $100 is expropriated and the compensation received is $300. This is a capital gain of $200. However, if the taxpayer uses the proceeds to buy another property at a cost of $500, the capital gain of $200 is not taxed. Instead it reduces the cost basis of the new property to $300. If the taxpayer later sells the new property, any gain or loss is measured from the adjusted cost basis of $300.

When a taxpayer transfers property to a controlled corporation a deferral is permitted under special rules. Similar provisions apply to exchanges of shares and certain corporate reorganizations. These are detailed in the chapter on Corporations and Shareholders.

Special rules for transferring assets to partnerships and trusts and for valuing partnership and trust interests held at the start of the system are detailed in the chapter on Business and Property Income.

Leaving and Entering Canada

Under the White Paper an individual would have paid tax on his accrued capital gains when he gave up Canadian residence. If it is a sound principle to require taxpayers to meet their income tax obligations when leaving the country, it is no less fair in principle to tax capital gains enjoyed while the taxpayer has shared the rights and responsibilities of residence in Canada.

It was argued that the proposal would seriously deter the mobility of Canadians, especially when a Canadian resident is contemplating a short-term transfer to another country to work or study.

The legislation offers the taxpayer a choice. He may pay tax on his accrued gain at departure with an exemption for the first $5,000 of gains. Alternatively, the taxpayer may elect to defer any capital gain at that time and agree to file a return as a resident of Canada in any year in which he sells assets. Reasonable security would have to be given at the time of departure to cover the tax on the accrued gain. In filing a Canadian tax return when assets are sold he would pay tax on his world income and receive credit for any foreign taxes paid.

When a taxpayer moves to Canada he will be treated as if he at that time purchases his assets at their fair market value. This will ensure that Canada imposes tax only on gains enjoyed while he is in Canada.

These rules for entering and leaving Canada do not apply to Canadian assets on which a non-resident would normally be taxed, as outlined below.

Non-Residents

The general rule to bring one-half of capital gains into income and to allow a deduction of one-half of capital losses will apply to non-residents on the sale of

- real property interests situated in Canada;
- assets used in carrying on business in Canada;
- interests in certain partnerships and trusts;
- shares in Canadian private corporations;
- shares in Canadian public corporations; where the non-resident owned a 25 per cent or greater interest.

The extension of the tax on capital gains to non-residents is subject to tax treaties between Canada and other countries.

3

Corporations and Shareholders

- *The legislation modifies the main elements of the existing system of taxing corporations and their shareholders to achieve greater fairness and efficiency. The legislation does not establish an integrated system as proposed in the White Paper.*
- *The dividend tax credit will be increased to 33 1/3 per cent from 20 per cent and included in income before the tax calculation. The combination of the two changes will make the credit more valuable to lower-income shareholders.*
- *A reformed low rate of corporate tax is retained as a small business incentive; the rate is 25 per cent on the first $50,000 of business income of Canadian-controlled private corporations. The low rate is no longer available to public corporations or foreign-controlled corporations.*
- *The general rate of tax for corporations is 50 per cent, reducing by one percentage point annually to 46 per cent in 1976.*
- *On investment income (including one-half of capital gains but excluding dividends) of private corporations 25 percentage points of the tax paid is refunded to the corporation as it pays dividends to shareholders. For every $3 of dividends paid, $1 of tax is refunded. The refundable tax provisions do not apply to public corporations.*
- *Dividends received by one corporation from another corporation generally continue to be exempt from tax. However, dividends received by private corporations from non-subsidiary corporations are subject to a special 33 1/3-per-cent tax which is fully refunded to the corporation as dividends are paid to shareholders; for every $3 of dividends paid, $1 of tax is refunded.*
- *The cost of the refundable tax on investment income and dividend income will be borne by the federal government.*
- *One-half of capital gains realized by private corporations can be distributed tax-free to Canadian shareholders.*
- *On the incorporation of a proprietorship or partnership and on certain corporate reorganizations, realization of capital gains may be deferred, provided the person transferring the assets to a corporation retains a certain percentage interest in that corporation.*
- *Surplus accumulated before the start of the new system may be paid out to shareholders tax-free, on payment of a special 15-per-cent tax by the corporation on undistributed income.*
- *The new rules for taxing corporations will apply from January 1, 1972, with special rules for corporations whose fiscal years straddle that date.*
- *Dividends received by shareholders after December 31, 1971 will be eligible for the reformed dividend tax credit of 33 1/3 per cent.*

The present system of taxing corporations and their shareholders provides for one tax when income is earned by a corporation, and a second tax when the after-tax income of the corporation is distributed to shareholders as a dividend.

Assuming a provincial rate of 10 per cent, all corporations now pay income tax at the rate of 21 per cent on the first $35,000 of taxable income and 50 per cent on taxable income in excess of $35,000. A corporation with $35,000 or more of income in a year pays $10,150 less than if the corporate rate was 50 per cent. This two-rate system was introduced in 1949 and its objective was to assist small corporations in accumulating funds to finance business expansion.

A Canadian individual receiving a dividend from a "taxable Canadian corporation" has been allowed to reduce his income tax by 20 per cent of the dividend. For shareholders of corporations with annual earnings of $35,000 or less, the 20-per-cent tax credit in effect offsets the 21-per-cent corporation tax paid. For shareholders of larger corporations, the dividend tax credit partially offsets the corporation tax paid and provides an incentive to Canadians to invest in Canadian corporations.

The present system also provides that in most instances dividends may flow tax-free from one Canadian corporation to another. This is necessary to limit the taxation of corporate income to the intended two tax payments – one by the corporation earning the income and the second by the individual receiving a dividend.

THE NEW SYSTEM IN BRIEF

The new bill retains the basic features of the present system of taxing corporations and their shareholders, with some modifications to make the system more equitable.

Dividend Tax Credit

The legislation increases the dividend tax credit to 33 1/3 per cent, but it is now included in income. These two changes make it relatively more beneficial to low-income shareholders than the existing tax credit. The credit continues to be available on all dividends from "taxable Canadian corporations", regardless of corporation taxes paid. The following table illustrates the mechanics of applying the new dividend tax credit:

	Marginal Rate of the Taxpayer		
	25%	40%	60%
Dividend received	$300	$300	$300
Add dividend tax credit – 33 1/3%	100	100	100
Taxable amount	$400	$400	$400
Income tax before credit	$100	$160	$240
Less dividend tax credit – 33 1/3%	100	100	100
Income tax payable	$ 0	$ 60	$140
After-tax dividend	$300	$240	$160

If the dividend tax credit exceeds the tax on the dividend, the excess will reduce other taxes payable. The excess is not refundable.

Under the present tax system the dividend tax credit is 20 per cent and is a "tax-free amount" (not included in income). The mechanics of applying the existing tax credit are illustrated in the following table:

	Marginal Rate of the Taxpayer		
	25%	40%	60%
Dividend received	$300	$300	$300
Income tax before credit	$ 75	$120	$180
Less dividend tax credit – 20%	60	60	60
Income tax payable	$ 15	$ 60	$120
After-tax dividend	$285	$240	$180

The following table shows the after-tax income for shareholders with marginal tax rates ranging between 25 per cent and 60 per cent on a $300 dividend, received under the old and new system.

Dividend: $300

	After-tax Income	
Marginal Rate	New	Old
25%	$300	$285
30%	280	270
40%	240	240
50%	200	210
60%	160	180

Small Business Incentive

The legislation continues a low rate of corporate tax, but on a more selective basis aimed at direct assistance to small business. The rate will be 25 per cent on the first $50,000 of business income of Canadian-controlled private corporations. The cost of the incentive will be borne by the federal government. The incentive will result in an annual tax saving of up to $12,500 for a corporation with $50,000 of income. It will not be available on investment income or to public corporations or foreign-controlled corporations.

A public corporation is defined as a corporation whose shares are listed on a prescribed Canadian stock exchange or traded "over the counter", or a corporation that meets certain conditions and either is designated by the Minister to be, or elects to be, a public corporation. A private corporation is any corporation that is not a public corporation or that is not controlled by a public corporation.

Under the present system the 21-per-cent low rate of corporate tax is available to all corporations, regardless of their size, their financial resources, or their need for funds to finance growth. However, the new legislation will reserve the benefit of the incentive to small corporations, by providing that as soon as $400,000 of taxable income has been accumulated, the low rate will no longer be available. The legislation also stipulates that income taxed at the low rate must be used in the business or paid out as dividends which will be taxable to shareholders. Otherwise the benefits of the low rate on that income will be eliminated. These changes, then, will limit the incentive to smaller private Canadian-controlled corporations that require, and in fact use, the tax savings to invest in their businesses or to pay dividends to shareholders.

Special rules will apply in the initial calculation of the incentive for corporations whose fiscal years straddle January 1, 1972.

Investment Income

The effect of new rules for taxing the investment income of private corporations will be to impose a tax on the corporation and on its shareholders when the income is distributed that in total is approximately equal to the tax payable if the shareholders had personally received the investment income. This means that the system is neutral in the taxation of investment income, neither penalizing nor benefitting individuals who choose to make their investments through a corporation rather than the more normal practice of personally owning investments. These new rules eliminate the need for special tax treatment for "personal corporations".

For private corporations, investment income other than dividends (such as interest, rent, royalties and one-half of capital gains) will be subject to the normal rate of corporate tax, 25 percentage points of which will be refunded to the corporation when dividends are paid to shareholders. On dividends received from portfolio investments (where the ownership interest is 50 per cent or less) the tax is 33 1/3 per cent, which is fully refunded to the corporation when dividends are paid to shareholders. The refunded tax will ensure that investment income received by a private corporation is no longer taxed at a considerably lower rate than investment income received directly by individuals. Dividends received by a private corporation from a subsidiary corporation (more than 50-per-cent ownership interest) continue to be tax-exempt as under the present system.

One further feature of the new system is that one half of capital gains realized by private corporations may be distributed tax-free to shareholders. When viewed together with the refundable tax provisions and dividend tax credit, this will result in approximately the same total taxes as if the shareholder had personally received the capital gain.

Dividends received by public corporations continue to be exempt from tax as under the present tax system and other investment income is taxed at the general rate.

RATES OF TAX

General Rate

Under the present system the rates of tax for corporations are 21 per cent on the first $35,000 of taxable income and 50 per cent on the excess.

Under the new bill, the general rate of tax is 50 per cent in 1972, reduced annually by one percentage point to 46 per cent in 1976. However, this rate is reduced by the small business incentive and partly offset by the refundable tax provisions for investment income of private corporations.

Small Business Incentive

The legislation provides that a Canadian-controlled private corporation pays a 25-per-cent tax on the first $50,000 of business income and the general rate on business income in excess of $50,000. (These rates include an assumed 10-per-cent provincial tax).The term "business income" means the net profit from carrying on an active financial, commercial, industrial or professional business.

In order to limit the low rate of tax to small corporations, the legislation provides that once a corporation has accumulated taxable income of $400,000 the benefits of the low rate of tax will no longer be available. This accumulation is calculated by adding the taxable income for each year after the new system starts and by deducting 4/3 of taxable dividends paid to shareholders. This deduction cannot be made for dividends which occasion a refund.

If a corporation has business income of $50,000 each year and has no other income and pays no dividends the accumulated taxable income will be $400,000 at the end of eight years and therefore the benefits of the low rate will no longer be available. This is shown in the following table. In 1980 (the ninth year of the example) the low rate is not available because the cumulative limit of $400,000 has been reached.

	1972	1973	1974	1975	1976	1977	1978	1979	1980
	$	$	$	$	$	$	$	$	$
After-Tax Income:									
Active business income	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Income tax – $50,000 at 25%	12,500	12,500	12,500	12,500	12,500	12,500	12,500	12,500	–
– $50,000 at 46%									23,000
After-tax income	37,500	37,500	37,500	37,500	37,500	37,500	37,500	37,500	27,000
Accumulated Taxable Income:									
Taxable income for the year	50,000	50,000	50,000	50,000	50,000	50,000	50,000	50,000	–
Taxable income for previous years	–	50,000	100,000	150,000	200,000	250,000	300,000	350,000	400,000
Accumulated taxable income	50,000	100,000	150,000	200,000	250,000	300,000	350,000	400,000	400,000
Maximum amount allowed	400,000	400,000	400,000	400,000	400,000	400,000	400,000	400,000	400,000
Amount of taxable income that can be accumulated in subsequent years before the low rate is withdrawn	350,000	300,000	250,000	200,000	150,000	100,000	50,000	–	–

To ensure that the low rate is not applied to more than $50,000 of business income by a group of related corporations, the present rules for determining associated corporations are retained. The maximum annual amount of $50,000 to which the low rate can be applied must be allocated within the group of corporations, and the accumulated taxable income limit of $400,000 will be determined for the group as a whole.

As long as the accumulated taxable income of a corporation is less than $400,000 it may use the low rate of tax. By paying regular dividends to its shareholders, a corporation can systematically reduce this accumulation and in many cases the benefits of the low rate will be available indefinitely. Every $3 of dividends paid reduces accumulated taxable income by $4, except that dividends which result in a refund of tax cannot be deducted.

This provision will be important to many small corporations unable to use the tax saving that results from the incentive for business expansion because their shareholders depend on regular dividends as a main source of income. One example would be a family-controlled enterprise. If these corporations pay dividends to their shareholders the net effect is, first, to tax the corporate income at the individual shareholders' rates of tax, and secondly, to preserve the use of the low rate for future years.

For example if a corporation has business income of $40,000 it will pay a tax of $10,000 (25 per cent) and will have $30,000 available for business purposes or for payment of dividends. If it pays a dividend of $30,000 out of after-tax income, the deduction on the $3-for-$4 ratio means that another $40,000 of business income may be taxed in future at the low rate, (assuming the corporation has not gone beyond the $400,000 cumulative limit because of other income).

The effect of paying a dividend out of income that has been taxed at the low rate is to tax the corporation's income at the individual shareholder's rates. As indicated below, this occurs because the 33 1/3-per-cent reformed dividend tax credit completely offsets a corporate tax of 25 per cent.

Corporation

Low rate income	$40,000
Tax at 25%	10,000*
Available for dividends	$30,000

Shareholders

Dividends received	$30,000
Add dividend tax credit – 33 1/3%	10,000
	$40,000
Income tax thereon (say at 40%)	$16,000
Less dividend tax credit – 33 1/3%	10,000
Tax payable	$ 6,000*

In total the tax is $16,000 * on the corporation's low-rate income of $40,000 ($10,000 paid by the corporation and $6,000 paid by shareholders) which is equal to the tax that would have been paid had the shareholders earned the income in their own hands, assuming the shareholders' tax rate to be 40 per cent.

The main objective of continuing the incentive is to provide private corporations with funds for use in their businesses. Many closely-held corporations do not require funds of this magnitude for business purposes and it is the government's intention to extend the incentive only to income used for direct business purposes.

The legislation provides that when income taxed at the low rate is used for non-business purposes an additional tax shall be paid at the rate of $1 for each $2 so used and this tax is refunded when the funds used for ineligible investments are reinvested in business assets or paid out as dividends to shareholders.

For example, if a corporation earns $40,000 of business income and pays tax of $10,000 (25 per cent) it has $30,000 of after-tax income to be used in its business. If the corporation invests $20,000 of this income in marketable securities, it would be required to pay an additional tax of $10,000. The net effect is to impose a 50-per-cent tax on the original income. If the $20,000 is later used for business purposes or paid out as dividends, the $10,000 additional tax will be refunded.

Investments that do not qualify include portfolio investments in shares of other corporations, bonds, mortgages and similar items. Cash and short-term notes are not included and therefore a corporation can accumulate cash or invest its excess funds in short-term notes in preparation for future expansion without being required to pay an additional tax.

If two private corporations become associated or amalgamate, the rules for limiting the small business incentive will not apply retroactively. If the combination of their separate accumulated taxable incomes is more than $400,000, the benefits of the low rate will no longer be available. However, the bill does not require the group to pay back any of the savings that resulted from using the low rate. Such a requirement could seriously impede the free flow of capital.

Nor is a repayment required if a private corporation that has enjoyed the low rate becomes a public corporation, because this would set up a barrier to "going public" and the tax saved will eventually become payable by the corporation's shareholders when dividends are paid to them, as it would if the corporation had remained a private corporation.

If a private corporation that has enjoyed the low rate becomes a foreign-controlled corporation, the bill provides that tax savings from use of the small business incentive must be repaid over a five-year period. This has the effect of taxing the corporation as if it had always been a foreign-controlled corporation, and protects the Canadian revenue against the loss of tax that would otherwise have become payable by Canadian shareholders when the low-rate income is distributed to them as dividends.

INVESTMENT INCOME

The investment income (other than dividends) of a private corporation is subject to the general rate of tax, 25 percentage points of which is refunded to the corporation as it pays dividends to shareholders. This refund provision does not apply to investment income earned by public corporations. Investment income means interest, rent, royaltie, one-half of capital gains and similar types of income that result from holding property. Dividend income is also included in the term investment income, but is taxed separately under different rules.

For example, if a corporation has interest income of $80,000 it will pay a tax of $40,000, of which $20,000 will be refundable.

Interest income	$80,000
Tax – 50%	40,000
After-tax income	$40,000
Refund available	$20,000

For every $3 of dividends paid to shareholders, the corporation will receive a refund of $1. For example, if in the above illustration the corporation pays a dividend of $60,000 it will receive a refund of the full $20,000. Alternatively, if the corporation pays a dividend of only $45,000, the refund will be limited to $15,000 and the remaining $5,000 will still be available.

If a corporation pays a dividend before the end of the taxation year in which investment income is received instead of receiving a refund, it may reduce its tax otherwise payable for the year by the amount of the refund.

If a corporation pays a dividend of $60,000 before the end of the year, the result is that the investment income of the corporation is taxed at the effective tax rates of its shareholders. The reason for this is that the new graduated dividend tax credit completely offsets 25 points of the corporate tax. Subject to timing differences, substantially the same net effect is produced if payment of the dividend is deferred until a subsequent year.

Corporation		
Interest Income		$80,000
Tax – 50%	$40,000	
Less refund (1/3 of dividend paid)	20,000	
		20,000
Paid as dividend		$60,000
Shareholders		
Dividends received		$60,000
Dividend tax credit – 33 1/3%		20,000
		$80,000
Income tax (say at 40%)		32,000
After-tax dividend		$48,000

DIVIDEND INCOME

As under the present system, dividends received by a public corporation from another corporation are exempt from tax unless they are paid out of the designated surplus of a controlled corporation.

Dividends received by a private Canadian corporation from another Canadian corporation are subject to two sets of rules: one for dividends from controlled corporations (more than 50-per-cent ownership) and the other for dividends from portfolio investments (ownership of 50 per cent or less).

Dividends received from controlled corporations continue to be exempt from tax, subject to two exceptions. If they are paid out of designated surplus they are taxed in the hands of the recipient. (This is similar to the rule in the present law.) If a dividend paid by a controlled corporation results in that controlled corporation qualifying for a refund of tax, the receiving corporation pays a special fully refundable tax equal to the refund. This rule is necessary to ensure that the refundable tax is in fact paid on investment income flowing through more than one corporation.

Dividends received on portfolio investments will be subject to a special 33 1/3-per-cent, fully-refundable federal tax. The tax is equivalent to the tax that would have been paid on such dividends by an individual taxpayer at a 50-per-cent marginal rate, and is therefore consistent with the taxation of other investment income of private corporations. This refundable tax will be pooled with the refundable tax on other investment income and subject to refund at the same rate of $1 for every $3 of dividends paid.

If a corporation receives dividends of $60,000 on portfolio investments, it will pay a 33 1/3-per-cent refundable tax of $20,000. If the corporation then pays a dividend of $15,000 it will receive a refund of $5,000. If the corporation pays a dividend of $60,000 before the end of its fiscal year none of the refundable tax will have to be paid. The effect of this is shown as follows:

Corporation	*A* Same Year Flow-Through	*B* Subsequent Year Flow-Through
Dividend income	$60,000	$60,000
Fully refundable tax	–	20,000
Surplus	60,000	40,000
Refund	–	20,000
Dividends paid	$60,000	$60,000
Shareholders		
Dividends received	$60,000	$60,000
Dividend tax credit – 33 1/3%	20,000	20,000
	80,000	80,000
Income tax (say at 40%)	32,000	32,000
After-tax dividend	$48,000	$48,000

Note that the result of paying a dividend of this magnitude is to have the company's dividend income taxed only in the hands of its shareholders and in exactly the same way it would have been if the original portfolio dividends had been received directly by the shareholders. Subject to timing differences, substantially the same net effect is produced if payment of the dividend is deferred until a subsequent year (Column B).

CAPITAL GAINS

The general rule in the legislation is that one-half of a capital gain realized by a private corporation may flow tax-free to its shareholders. This reflects the government's conclusion that capital gains realized in a corporation of this kind should not be subject to further tax when distributed to shareholders.

For example, if a private corporation realizes a capital gain of $2,000 it will include one-half of the gain in income and pay a tax of $500. One-half of the gain ($1,000) will be placed in a capital gains surplus account. Dividends paid by a corporation that are designated by its directors as being paid out of the capital gains surplus account will be tax-free to shareholders.

Since capital gains are considered to be investment income, one-half of the tax paid on the other half of the capital gain is refundable to the corporation when it pays dividends. This is illustrated as follows:

Corporation

Capital gain	$2,000
Tax – 50% of $1,000	500
	$1,500
Included in ordinary surplus	500
Included in capital gains surplus	1,000
	$1,500
Refund available	$ 250

The capital gains surplus balance of $1,000 can be distributed tax-free to shareholders by the payment of a special dividend and this dividend will not reduce the cost or beginning value of the shareholders' shares. The ordinary surplus can be distributed to shareholders by the payment of a dividend of $750 ($500 from surplus and $250 refund) and assuming an effective tax rate of 40 per cent, the shareholders' tax on the $750 dividend would be $150, calculated as follows:

Shareholders

Dividend	$ 750
Add dividend tax credit – 33 1/3%	250
	$1,000
Income tax (say at 40%)	400
Less dividend tax credit – 33 1/3%	250
Tax payable	$ 150

The total tax paid by the corporation and its shareholders on the $2,000 capital gain is $400 ($250 by the corporation and $150 by its shareholders). This is exactly the same amount of tax that would have been paid if the shareholders of the corporation had personally realized the $2,000 capital gain, again assuming a 40-per-cent tax rate for the shareholders.

FOREIGN CORPORATIONS RESIDENT IN CANADA

Corporations now resident in Canada but not incorporated in Canada will be considered "Canadian corporations" for all intents and purposes as long as they remain resident. These corporations will be eligible for the low rate if they are Canadian-controlled private corporations, and will be eligible for the refundable tax provisions if they are private corporations. Their Canadian shareholders will be entitled to the reformed dividend tax credit.

This provision applies only to foreign corporations resident in Canada on budget day, 1971. In future, a corporation must be incorporated in Canada to be classified as a "Canadian corporation" and to obtain certain benefits of the new system, such as the new dividend tax credit for their dividends.

DISTRIBUTION OF CORPORATE SURPLUS

The present tax system contains many complex rules for distributing the surplus of a corporation. Generally speaking, the after-tax income of a corporation (referred to as undistributed income on hand) must be fully distributed to shareholders as dividends before capital gains and other tax-free amounts can be distributed. The present system also permits a corporation to pay a special 15-per-cent tax on specified amounts of undistributed income and to distribute tax-free to shareholders the remaining 85 per cent (technically referred to as tax-paid undistributed income). However, the tax-free distribution of the remaining 85 per cent usually has to be made by paying a stock dividend in redeemable preferred shares which are later redeemed for cash or property. A stock dividend is required because under the present system an ordinary cash dividend paid by a corporation is fully taxable to shareholders regardless of the makeup of the corporation's surplus.

Under the present system, a corporation must distribute its earned surplus (undistributed income on hand) before it can reduce its capital. The new bill will permit a shareholder to receive a return of his investment in a corporation, whether by way of repayment of a loan or by redemption of shares, as a tax-free capital receipt regardless of the corporation's surplus position.

The new legislation simplifies the rules for distributing a corporation's surplus by allowing the directors of a corporation to specify the type of surplus out of which a cash dividend may be paid. This will eliminate the need for stock dividends and similar special forms of distribution.

After the new system starts the surplus of a corporation will be made up of four items:

(1) undistributed income on hand at the start of the system (called "1971 undistributed income on hand");

(2) realized capital gains and other tax-free amounts on hand at the start of the system and any gains accrued at the start of the system and subsequently realized (called "1971 capital surplus");

(3) one-half of capital gains realized after the start of the system; and

(4) the remaining balance, generally made up of after-tax income earned since the start of the system and differences between income for accounting purposes and income for tax purposes.

The legislation provides that a corporation may at any time pay a 15-per-cent tax on all or part of its "1971 undistributed income on hand" and then distribute the net amount tax-free to shareholders. This distribution will be considered as a return of capital to the shareholders, reducing the cost of their shares for purposes of calculating a subsequent capital gain. A corporation's "1971 capital surplus" may also be distributed tax-free to shareholders but only after the 15-per-cent tax has been paid on all "1971 undistributed income on hand". These distributions will similarly be considered as a return of capital.

For private corporations, the legislation provides that one-half of their capital gains may be distributed free of tax as dividends to shareholders, but only after all "1971 undistributed income on hand" and all "1971 capital surplus" has been fully distributed. These capital gain dividend distributions will not reduce the cost or beginning value of the shareholders' shares.

Finally, the legislation provides that all other distributions out of surplus will be treated as ordinary dividends to shareholders, without reference to the corporation's post-1971 undistributed income on hand. In fact, the undistributed income on hand of a corporation will no longer be important, except for the limited purpose of calculating designated surplus where that becomes relevant.

CAPITAL GAINS vs. INCOME

Under the present tax system capital gains are exempt from tax and therefore there can be a significant advantage for shareholders of private corporations to convert income receipts, such as dividends, into capital receipts. For this reason there are a number of rules in the present system to prevent the conversion of taxable income receipts into tax-exempt capital receipts.

Under the new system, capital gains that represent taxable corporate surplus will continue to be taxed at a more favorable rate than will distribution of that surplus as dividends for taxpayers with marginal tax rates above 40 per cent. Therefore it is necessary to continue many of the rules in the present system, such as the designated surplus and the dividend-stripping provisions.

INCORPORATION OF A PROPRIETORSHIP OR PARTNERSHIP

When the capital assets of a proprietorship or partnership are sold to a corporation or when any assets are sold to a corporation the bill provides that any capital gain that would otherwise be taxed may be deferred in certain circumstances. The proprietor or partnership must own at least an 80-per-cent interest in the corporation immediately after the sale and the fair market value of any consideration, other than shares of the corporation, received from the corporation must not exceed the cost or beginning value of the assets. In effect the corporation is considered to have purchased the assets at their cost or beginning value. The proprietor or partnership is considered to have purchased the shares of the corporation at a cost equal to the cost or beginning value of assets transferred to the corporation. This is referred to as a "rollover". The rule also applies to the sale of assets to a subsidiary corporation.

Where cash or any property other than shares of the acquiring corporation is received by a proprietor from a corporation as part consideration for the transfer of assets, this will first reduce the proprietor's cost basis for the shares and then any excess will be taxed as a capital gain.

For example, assume that an individual has capital assets with a total original cost of $10,000. The individual sells these assets to a corporation in exchange for $4,000 cash and 80 per cent of the shares of the corporation. The remaining 20 per cent of the corporation is owned by a third person who paid the $4,000 to the corporation. The corporation is considered to have paid $10,000 for the assets (their original cost). This $10,000 is called the cost basis. The individual is considered to have purchased 80 per cent of the shares of the corporation for $6,000, ($10,000 which is the original cost of the assets, less $4,000 received in cash). If the individual were to subsequently sell his 80-per-cent interest in the corporation for more than $6,000, one-half of the excess would be included in his income.

The legislation also provides that a proprietor or partner is not required to defer any capital gain. If the proprietor elects to treat the sale as if it were made to a third person, i.e., at fair market value, and accordingly includes one-half of any capital gain in his income, the corporation will be considered to have acquired the assets at their fair market value. If the fair market value exceeds original cost the sale can be considered to take place at any value chosen by the taxpayer between these two amounts.

Where a proprietor or partner sells assets to a controlled corporation at a capital loss, this loss is not deductible. The cost basis of the assets to the corporation is fair market value and the loss on sale will be added to the cost basis of the proprietor's or partner's shares.

CORPORATE REORGANIZATIONS

Liquidation of Corporations

On the liquidation of a corporation, the general rule is that there will be a deemed realization of all of the corporation's assets at fair market value at the time of liquidation. Tax will be payable by the liquidating corporation on any gains produced by the deemed realization.

Shareholders of the liquidating corporation will take over any assets received at a cost equal to their fair market value. The value of assets received by a shareholder will be treated as a return of capital on his shares to the extent of the paid-up capital value of his shares in the liquidating corporation. Any amount received in excess of that paid-up capital value will generally be deemed to be a dividend received by the shareholder.

An exception to the "deemed realization on liquidation rule" permits a tax-free rollover on the liquidation by a Canadian corporation of a wholly-owned subsidiary corporation.

Capital Reorganizations

When a corporation reorganizes its capital structure by calling in some or all of its issued shares and issuing new shares in exchange, any capital gain on the exchange transaction may be deferred. The cost basis of the old shares carries over to the new shares and no gain is recognized until the new shares are sold. Where shares of more than one class are received in exchange for the old shares, a set of specific rules spreads the cost basis of the old shares over the new shares for purposes of computing subsequent gains or losses.

As part of an exchange of shares, shareholders sometimes receive cash or other property in addition to new shares. This cash or other property reduces the shareholders' cost basis for the new shares, and if the fair market value of the cash or other property received exceeds the cost basis of the old shares, the excess is taxed as a capital gain.

If no shares are received in exchange for old shares, the transaction is treated as a redemption of the shares for an amount equal to the fair market value of all property received in exchange and the normal rules regarding return of capital by way of redemptions of shares apply. This means that the amount of paid-up capital attributed to the shares will be treated as a tax-free return of capital. Other proceeds received will be treated as an ordinary dividend.

Statutory Amalgamations

When two corporations amalgamate under the provisions of a corporations act, the rules are substantially the same as under the present law. The new amalgamated corporation is treated as a continuation of the two predecessor corporations and all asset accounts, tax reserve accounts, special distribution accounts, etc., are carried over and added together. There is no deemed realization of assets owned by the amalgamating corporations.

When there is an inter-corporate shareholding between corporations that amalgamate, the new bill contains specific rules:

- to ensure that tax is paid on existing designated surplus in respect of the inter-corporate holding;
- to reflect the reduction in paid-up capital that results from the disappearance of the inter-corporate holding; and
- to reflect any difference between the cost of assets for tax purposes and the paid-up capital value of the inter-corporate shareholding that disappears upon amalgamation.

For a shareholder of an amalgamating corporation who receives shares in the new amalgamated corporation in exchange for his old shares, a gain on the transaction may be deferred:

- if he held preferred shares in a predecessor corporation, he receives shares with substantially equivalent rights in the amalgamated corporation, and
- if he held common shares in a predecessor corporation he, together with all other common shareholders of that corporation, receives not less than 25 per cent of the issued shares of each class of common shares of the new amalgamated corporation.

If a shareholder of an amalgamating corporation does not qualify under the above rules, the exchange of his old shares for the shares of the new corporation will be treated as a sale at fair market value, and a capital gain or loss will result.

4

Mining and Petroleum

- *Substantial tax incentives are maintained to recognize the risks involved in exploration and development, the international competition for capital and the levels of incentives available in other countries.*
- *Taxpayers whose principal business is not mining or petroleum will be allowed more generous deductions for Canadian exploration and development expenses.*
- *All taxpayers will be allowed more generous deductions for foreign exploration and development expenses.*
- *Acquisition of mining properties and royalty interests will be treated as exploration and development expenses, and proceeds on disposal will be fully taxable, subject to a sliding-scale exemption.*
- *Three-year tax exemption for new mines will be withdrawn after 1973 and replaced by an accelerated write-off of capital equipment and on-site facilities, including townsite facilities such as sewage plants, roads, schools and hospitals. The accelerated write-off will also apply to a major expansion of an existing facility where capacity is increased by at least 25 per cent.*
- *Present system of automatic depletion for mining and petroleum corporations will continue until 1976.*
- *After 1976 the 33 1/3-per-cent operators' depletion will have to be earned at the rate of $1 for every $3 of eligible expenditures.*
- *After 1976, the 25-per-cent non-operators' depeletion will be cancelled. Starting in 1977 royalty income will be classed as production income and will be eligible for the 33 1/3-per-cent earned depletion.*
- *All eligible expenditures after November 7, 1969 will earn depletion, and the White Paper list of eligible expenditures is expanded. Earned depletion can be accumulated until 1976 and applied thereafter against income.*
- *Rates of depletion for profits on gold or coal will be 33 1/3-per-cent after 1976 and depletion will have to be earned.*
- *Federal corporate tax abatement on mining profits increased by 15 percentage points. This abatement which commences in 1977 would also apply in the Yukon and Northwest Territories.*
- *Shareholders' depletion allowances of up to 20 per cent on dividends from mining and petroleum corporations are discontinued.*

The White Paper proposals were followed in August, 1970 by an announcement of important changes affecting the mining industry. The legislation incorporates these changes, which together will ensure sustained exploration and development, while making really profitable projects subject to a reasonable level of taxation.

Exploration and Development Costs

Existing law permits a corporation whose principal business is mining, oil production and allied activities, to deduct the costs of exploration and development in Canada against any income in the year incurred or in subsequent years. This insures that no tax will be payable until all exploration and development costs have been recovered.

Taxpayers who do not meet the "principal business" test are at present entitled to deduct exploration and development expenses only from mining and petroleum income. To encourage exploration and development in Canada, these expenses will be deductible from other income over a period of time if they exceed mining and petroleum income. Taxpayers will be entitled to put expenses in an asset class and to deduct annually from any income the greater of:

1. an amount equal to their income from mineral and petroleum properties, before any deduction for exploration and development expenses, or
2. 20 per cent of the net book value of the class.

Income from mineral and petroleum properties includes production profits, royalties and proceeds on sale of mineral rights, oil and natural gas rights and royalty interests.

Existing law permits taxpayers to deduct certain foreign drilling expenses from directly related foreign-source income, but this provision is very restrictive. The new legislation permits all taxpayers to put foreign exploration and development expenses in a separate asset class and to deduct annually from any income the greater of:

1. an amount equal to their income from foreign mineral and petroleum properties before any deduction for exploration and development expenses, or
2. 10 per cent of the net book value of the class.

For example, if a taxpayer has foreign exploration and development expenses of $5,000 and if his income consists of $300 in foreign mining income and $6,000 in salary, his deduction is the greater of $300 (the mining income) or $500 (10% of the new class of expenses). He would deduct $500 and the remaining expenses of $4,500 would be available for deduction in subsequent years.

Purchase and Sale of Mineral Rights

Since 1962, the costs of acquiring oil rights or natural gas rights have been deductible as exploration and development expenses, and proceeds on their disposal have been fully taxable. The legislation extends this treatment to mining properties and royalty interests, which are not deductible or taxable under existing law.

Because mineral properties and royalty interests have until now been tax-exempt, a special transitional rule is provided for taxing proceeds on sale of these properties and interests owned at the commencement of the new system. Proceeds on sale of these properties will be taxable to the extent of 60 per cent if sold in the first year of the new system, 65 per cent if sold in the second year, and so on until the ninth and subsequent years when all of the proceeds will be included in income. Because the costs of these properties would be deductible if purchased after the start of the new system, prices can be expected to rise and the transitional rules will provide a fair after-tax return to the present owners.

The legislation also provides that no amount will be included in income when individual prospectors and grubstakers sell mining properties to a corporation for shares of that corporation. The individual will be considered to have acquired the shares at no cost and will therefore be taxed on one-half the proceeds of eventual sale of the shares under the normal capital gains rules. The cost of the mining property to the corporation will be considered to be nil and therefore the company will get no deduction for this purchase. This provision will not apply to mining properties purchased by a prospector or grubstaker for resale to a corporation.

New Mines

Under existing law the profits derived during the first three years of operation of a new mine are exempt from Canadian income tax. This three-year exemption will be withdrawn on December 31, 1973.

In place of the three-year tax exemption, the legislation provides for an accelerated write-off of capital equipment and facilities for a new mine. The assets eligible for accelerated depreciation are:

1. a building acquired for the purpose of gaining or producing income from the new mine (except an office building that is not situated on the mine property);
2. mining machinery and equipment including access roads and on-property railroads;
3. a refinery;

4. "social capital" such as sewage plants, water systems, housing, roads, firehalls, schools, hospitals and recreational facilities;
5. airports and docks situated off the mine property, but not railroads.

In each instance the assets must be related to a new mine. The assets listed in items 3, 4 and 5 extend the fast write-off provisions beyond the proposals of the White Paper and the August, 1970, announcement. All of the assets subject to accelerated depreciation will be placed in a new capital cost allowance class, one class for each new mine. Taxpayers will be allowed an annual write-off equal to the greater of

1. an amount equal to the income from the new mine, or
2. 30 per cent of the net book value of the class.

Mining assets not eligible for accelerated depreciation will continue to be depreciable at the same rate as provided by existing law.

The accelerated write-off and the deductions for exploration and development expenses together ensure that the profits from a new mine will not be taxed until after the original investment has been fully recovered.

The accelerated write-off provision will also apply in the case of a major expansion of an existing mine where there has been at least a 25-per-cent increase in milling capacity. The list of eligible assets which will be in a separate capital cost allowance class is the same as for new mines except that "social capital" and off-site airports and docks do not qualify. Taxpayers will be allowed an annual deduction equal to the greater of:

1. an amount equal to income from the expanded mine, or
2. 30 per cent of the net book value of the class.

The present three-year tax exemption for new mines will continue until December 31, 1973. New mines which have come into production in reasonable commercial quantities before publication of the White Paper, November 7, 1969, will be eligible for the exemption but will not be able to take advantage of the new legislation concerning fast write-off. New mines which came into production after November 7, 1969, but before December 31, 1973 will be entitled to elect to take advantage of either incentive but not both. Specifically, taxpayers will be entitled to claim exemption of the profits earned either in the first three years of operation or in the period remaining to December 31, 1973, if that is shorter. At the end of the exempt period they will be entitled to the fast write-off of the capital cost of their eligible mine assets, but only if the book value of those assets is reduced by the full amount of their exempt profits. Taxpayers who do not elect to take the fast write-off will not be required to reduce the book value of these assets by the amount of exempt profits, but their annual write-off will be limited to normal depreciation.

Operators' Percentage Depletion

The legislation follows the White Paper proposal that depletion must be earned by carrying on exploration and development. The formula adopted is that for every $3 of eligible expenditures made after November 7, 1969 a taxpayer would earn the right to deduct $1 of depletion in computing his taxable income after 1976, subject to maximum depletion provisions.

The legislation provides that operators will be allowed to deduct the automatic 33 1/3 per cent depletion until the end of 1976, and that eligible expenditures made after November 7, 1969 can be accumulated for the purposes of calculating earned depletion for 1977 and subsequent years. This transitional provision will provide a gradual introduction to the earned depletion concept.

The types of expenditure that are eligible to earn depletion have been expanded from the White Paper proposals by the August 1970 letter and the list now includes most assets that qualify for accelerated depreciation (other than "social capital") as well as all exploration and development costs which earned depletion under the White Paper proposals. Exploration and development expenditures will be limited to expenditures incurred prior to attaining production in reasonable commercial quantities (the normal starting date for the three-year exemption). The costs of acquiring mineral and oil and gas properties are classified as exploration and development for purposes of expense deduction, but they do not earn depletion.

As announced in the August 1970 letter the definition of expenditures which earn depletion has been enlarged to include new facilities located in Canada to process mineral ores to the "prime metal stage" or its equivalent. Because this incentive is given to encourage the processing of ores in Canada, it is limited to situations where the processing would otherwise be done outside Canada. Also, a new processing facility will not be eligible for accelerated depreciation unless it is an integral part of a new mine or a major expansion of an existing mine.

Rates of depletion for gold and coal will be the same as for other minerals after 1976.

Percentage Depletion for Non-operators

Under the present legislation a depletion allowance of 25 per cent may be deducted by non-operators from their income from mineral and petroleum properties. The White Paper proposed that this depletion allowance be repealed. The legislation extends the automatic depletion allowance until the end of 1976 in order to give non-operators the same five-year introduction that is given to operators. After 1976 the non-operators' 25-per-cent depletion allowance will be cancelled. Royalty income received after 1976 will be classified as production income and will be eligible for the 33 1/3-per-cent earned depletion.

Shareholders' Depletion

Under the present legislation a depletion allowance of up to 20 per cent may be deducted from dividends received from a mining or petroleum corporation, the percentage depending on the proportion of the income of the corporation which is derived from production. This deduction was intended to recognize the wasting nature of mining and petroleum properties and the fact that each dividend received by a shareholder might in fact be partly a return of capital. Under the new legislation, this fact is more accurately recognized by the deduction granted for one-half of capital losses. Accordingly the shareholders' depletion allowance is removed at the start of the system.

Provincial Corporate Tax Abatement

The existing law now permits corporations to reduce their federal income tax by 10 per cent of taxable income to offset the provincial income tax paid by these corporations. As announced by the Minister of Finance in August 1970, when the system of earned depletion comes into effect in 1977 the provincial corporate tax abatement will be increased by 15 per cent of mining production profits, with a ceiling of 25 per cent of taxable income. This increased abatement will apply as well in the Northwest Territories and Yukon. The legislation also provides that provincial mining taxes will no longer be deductible in computing income after 1976. The increased abatement will offset these taxes.

The reduction of federal taxes on mining profits recognizes that the provinces levy mining taxes and that in some circumstances maximum tax rates on income from producing mines could be higher than rates on corporations in other industries. The higher abatement creates room for the provinces to increase their own corporate rates, to leave their rates unchanged and thus flow the entire tax reduction through to mining corporations, or to selectively change their own rates.

5

Business and Property Income

- *Existing principles of taxing business and property income are retained.*
- *Canadian corporations will be allowed a full deduction for interest paid on money borrowed to buy shares in other corporations.*
- *One-half of the cost of goodwill and similar intangible assets will become deductible at a rate of 10 per cent on a declining balance. One-half of the proceeds of sale of such assets will be included in income, with special transitional rules for goodwill owned at the start of the new system.*
- *Membership fees in recreational and social clubs, and the expenses of a yacht, camp or lodge will not be deductible.*
- *Entertainment and convention expenses continue to be deductible on a basis similar to that of the present system, except that conventions become subject to geographical restrictions.*
- *Special rules limit deductions for losses on rental property and vacant land.*
- *Taxpayers in the professions will bring amounts into income as fees are billed.*
- *Farmers and fishermen continue to calculate income on a cash basis and retain special averaging provisions. The basic herd and straight-line depreciation provisions are phased out.*
- *The three-year tax holiday for new co-operatives is withdrawn. Patronage dividends paid will continue to be deductible in computing income, but may not reduce income below 5 per cent of capital employed by members.*
- *Caisses populaires and credit unions will be taxed on a basis similar to co-operatives.*
- *Mutual funds and investment corporations will be treated essentially as conduits between their shareholder – investors and the sources from which their income is derived.*
- *Estates and trusts are taxed on the same basis as under the existing system, except that personal trusts which accumulate income are taxed at the higher of 50 per cent or the personal rate schedule (the flat 50-per-cent rate does not apply to investment income of most personal trusts in existence at the start of system).*
- *There are special rules for valuing trust property, trust interests and partnership interests for capital gains tax purposes.*

General Principles

Under the present tax system the determination of income from a business or property begins with a calculation of profit according to normal commercial or accounting principles. Then a number of adjustments are made to this profit to meet income tax rules. Certain expenditures may not be deducted; for example, personal or living expenses, unreasonable expenses, or expenses that would artificially reduce income. Other rules specify the year in which certain expenditures may be deducted. For example, capital cost allowance provisions set out a maximum annual deduction for the cost of buildings and other depreciable property used to earn income. Still other rules specify the time at which certain items of income are taken into account. For example, if property is sold and the proceeds are to be collected over a number of years, the profit on the sale of property may be brought into income over the payment period for the property.

Interest on Money Borrowed to Buy Shares

The present tax system does not permit a corporation to deduct interest on money borrowed to buy shares of other corporations because the dividends on these shares are normally tax-exempt. To encourage Canadian ownership and investment, the bill provides a full deduction for interest on money borrowed by a corporation to buy shares in any other corporation. The present system allows a deduction for individual taxpayers and this is retained.

This deduction for interest provides a substantial incentive for Canadian corporations to invest in other corporations and permits them to compete on an even footing with foreign corporations. Assuming a tax rate of 50 per cent, the cost of borrowing money for share purchases will be cut in half.

Goodwill and Similar Assets

Certain business expenditures have come to be known as "nothings" because taxpayers could not deduct them in the year incurred (because they were capital in nature) or over a number of years by way of depreciation (because no asset was acquired on which depreciation could be claimed). Goodwill has been an important asset of this kind. If a taxpayer purchased a business, he could not deduct or depreciate the portion of his purchase price that related to the goodwill of the business. Other examples of "nothings" have been costs of incorporation and costs of acquiring intangible rights of an indefinite duration.

The new legislation creates an account comparable to a capital cost allowance class for these assets. Taxpayers will put one-half of their cost in this new class and deduct 10 per cent of the book value on a declining balance basis. Only such assets acquired after the new system starts are eligible for this treatment.

Because "nothings" are very closely related to capital gains and losses, only one-half of the proceeds on their sale will be included in income and one-half of their cost will be deductible in this manner.

In the case of a sale of goodwill in businesses that commence operation under the new system, one-half of the proceeds will be credited to the class, and this will result in a "recapture" or a "terminal loss." That is, if the decline in value is less than the deductions, the difference will be taxable. If it is more, the difference will be deductible.

For goodwill in existence at the start of the new system, the legislation provides that a taxpayer who sells goodwill in the first year of the new system will include 20 per cent of the proceeds in his income, 22 1/2 per cent if the sale is in the second year, 25 per cent if the sale is in the third year, and so on until the thirteenth and subsequent years when 50 per cent of the proceeds will be included in income. This formula is very similar to the proposal in the White Paper except that the percentages are cut in half.

Entertainment and Related Expenses

Under the present tax system there are no specific provisions covering entertainment and related expenses. The Income Tax Act simply provides that expenses are not deductible unless they are incurred for the purpose of earning income, are reasonable, and are not personal or living expenses.

The new legislation provides certain specific restrictions to disallow amounts paid to maintain or operate a yacht, camp, lodge or golf course facility. Also disallowed are amounts paid as membership fees or dues in clubs which exist principally for the purpose of providing dining, recreational or sporting facilities for members.

The deduction permitted by the existing system for expenses of attending two conventions a year will be continued. However, the conventions must be at a location consistent with the territorial scope of the organization.

The new bill also requires that an individual include in income the value of having a company car available for personal use.

The new legislation otherwise continues to permit a deduction for reasonable entertainment expenses incurred to earn income on the same basis as the present system.

Depreciation

The legislation continues the present depreciation, or capital cost allowance system, with three modifications designed to overcome inequities of the present system.

First, the legislation provides that when depreciable property is bequeathed to someone other than a spouse, the beneficiary will take over the property at an amount midway between fair market value and original cost less depreciation. Under the present system the inheritor of depreciable property is allowed to use the fair market value of the property as the base for depreciation, even though the estate is not required to pay any tax on any recaptured depreciation.

Secondly, the legislation provides that in future each rental building costing $50,000 or more will be placed in a separate capital cost allowance class. As each building is sold a taxpayer will bring into income recaptured depreciation or deduct a terminal loss. Under the present system all buildings of a particular construction are pooled and the day of reckoning can be indefinitely postponed by adding new buildings to the pool.

A loss created by capital cost allowance on the rental of real property may reduce other rental income, but not non-rental income. This provision is similar to the White Paper proposal except that it applies only to real property held as an investment and only to losses arising from capital cost allowance, not interest and property taxes.

The carrying charges on undeveloped real property (e.g. vacant land) will not be deductible from other income in situations where the property is being held as a capital investment. These charges, such as interest and property taxes, will be added to the cost of the property for the purpose of calculating a capital gain or loss when the property is eventually sold.

Taxpayers in the Professions

Taxpayers in the professions (doctors, dentists, lawyers, chartered accountants, engineers etc.) have been permitted to compute their income on the "cash basis". This means that amounts are included in income only when cash is received and amounts are deducted only when cash is disbursed.

The new bill requires that these taxpayers record income when fees are billed and expenses when they are incurred for fiscal years ending after December 31, 1971. Because of the difficulty in valuing unbilled time, the legislation provides that work in progress need not be brought into income unless the taxpayer chooses to do so.

To provide for an orderly changeover, accounts receivable at the start of the system will be brought into income over a number of years, on a basis similar to the White Paper proposals. Specifically, these taxpayers will pay tax on the higher of their income computed under the cash basis or billed basis each year, calculated cumulatively, until the original total of deferred income has been eliminated. The deferred income of professional corporations must be reduced by at least 10 per cent each year on a cumulative basis.

The deferred income of professional partnerships must be allocated to partners who will be personally responsible for bringing it into their income over a period of time. To permit a professional to change firms, a partner or proprietor may transfer his deferred income from one firm to another in certain circumstances without the payment of tax.

Farmers and Fishermen

The present tax system contains four special rules for farmers and fishermen. First, they are allowed to compute their income on a cash basis. Secondly, livestock farmers have been able to treat part of their herds as a non-taxable asset – referred to as a "basic herd". Thirdly, farmers and fishermen are not subject to tax on the difference between actual and claimed depreciation when they sell their assets if they depreciate on what is called the straight-line system – computed at rates generally one-half of those used under the normal diminishing balance system, and applied to original cost rather than depreciated cost. Any profit on the sale of such a depreciable asset is considered to be capital gain. Finally, farmers and fishermen are allowed to average their income every five years.

The new legislation continues to permit farmers and fishermen to compute their income on a cash basis and to average their income every five years. However, this special averaging provision will be related to the new general-averaging and the income-averaging annuity provisions so that farmers and fishermen may use the system most beneficial to them.

Because the legislation makes capital gains part of the tax base, the need for the basic herd and straight-line depreciation is substantially reduced. Accordingly the new legislation provides that these two provisions will be phased out.

Livestock farmers will be able to establish a basic herd as at December 31, 1971, but no additions may be made to the basic herd after that date. The accrued gain on a basic herd as at December 31, 1971 will be a tax-free capital gain, as under the present law. When livestock is sold after December 31, 1971 a farmer may consider the sale as being out of the basic herd or the other herd, subject to special rules, but the legislation requires that the sale reduce the basic herd when the total livestock on hand is less than the remaining total of the basic herd. The proceeds in excess of the value of the basic herd on Valuation Day will be treated as part of farming income and will be eligible for general averaging or the income-averaging annuity.

Straight-line depreciation will continue to be available for assets acquired before the new system starts. Depreciation will be calculated on the diminishing balance system for assets acquired after December 31, 1971. If the assets depreciated on a straight-line basis are subsequently sold for more than original cost or Valuation Day value, the difference will be a capital gain. As at present there is no recapture of straight-line depreciation.

Hobby Farmers

The present system limits the deduction from other income of losses suffered on the operation of what are commonly referred to as "hobby farms". A hobby farmer is a taxpayer who carries on the operation of a farm as a part-time venture, and not as his main source of income. These taxpayers may deduct only $5,000 of farming losses from other income – all of the first $2,500 of loss and one-half of the next $5,000. Any losses not deducted against other income in the year they are suffered may be carried back one year and forward five years and deducted from farming income.

The new legislation continues this $5,000 limitation. In addition, where interest and property taxes have not been deducted because of this limitation, they may be applied against any proceeds on eventual sale of the farm. This procedure will reduce any capital gain that eventually results on the sale of the farm, but will not be allowed to create a capital loss.

Investment Income of Clubs and other Non-profit Organizations

Under the present law certain clubs and other non-profit organizations are exempt from tax on all of their income. Under the new bill, the investment income in excess of $2,000 each year of social and recreational clubs will be subject to tax at the rate of 50 per cent.

Co-operatives, Caisses Populaires and Credit Unions

Under the present tax system a co-operative is exempt from tax for the first three years of its existence. This exemption is withdrawn. Co-ops may continue to deduct patronage dividends; but the deduction may not reduce taxable income below 5 per cent of capital employed by members. The present limit is 3 per cent, calculated on a somewhat broader definition of capital employed. Interest paid to members is a further deduction in arriving at taxable income.

Caisses populaires and credit unions are now exempt from tax. Starting on January 1, 1972 they will be taxed on a basis similar to co-operatives, and permitted reserves for doubtful debts and market liquidity similar to those allowed to banking institutions.

Mutual Funds and Investment Corporations

The main objective of the new legislation is to treat mutual funds and investment corporations essentially as conduits between their shareholder – investors and the sources from which their income is derived.

An open-end mutual fund corporation or a closed-end investment corporation may continue to elect to qualify for preferential treatment as an "investment corporation".

An investment corporation is not taxable on dividends received from taxable Canadian corporations. Other income, including the full amount of capital gains, will be taxed at 25 per cent. Ordinary dividends paid to shareholders will be eligible for the new 33 1/3-per-cent dividend tax credit. By means of special "capital dividends" (or, in the case of an open-end mutual fund corporation, by redemption of its shares), the corporation can obtain a refund of the tax paid on capital gains. These special distributions will be treated as capital gains in the hands of shareholders. Redemptions of shares by an open-end mutual fund corporation will be capital gain (or loss) transactions. Redemptions of shares by a closed-end investment corporation will be subject to the normal rules for other corporations.

If an open-end mutual fund corporation does not qualify as an "investment corporation" the corporation's income and distributions will be taxed as follows:

- Dividends received will be subject to a special 33 1/3-per-cent tax which is refunded to the corporation as dividends are paid to shareholders.
- Capital gains will be taxed at 25 per cent and this tax will also be refunded to the corporation when it pays special "capital dividends" to shareholders or when it redeems shares.
- Other income will be taxed at the normal corporate rate.
- Ordinary dividends paid to shareholders are eligible for the dividend tax credit; special "capital dividends" will be treated as capital gains in the hands of shareholders; and redemptions of shares will be capital transactions.

If a closed-end investment corporation does not qualify as an "investment corporation" it will be taxed as an ordinary corporation.

A mutual fund organized as a unit trust is taxed in much the same manner as under the present system. These funds will allocate their income, and the Canadian dividend and foreign tax credit elements will continue to be flowed through to the unit holders. Capital gains not allocated to unit holders in any year will be taxed in the mutual fund at 25 per cent and this tax will be refunded to the mutual fund on a formula basis as units are redeemed. All redemptions of units will be treated as capital transactions to unit holders and any capital gain or loss will be subject to the general rules.

Trusts

Under the present tax system, all taxable trusts or estates are subject to the same set of rules, the most important of which are as follows:

(1) generally income received by the trust and payable to beneficiaries in the year received is taxable to the beneficiary, not the trust;

(2) income that is not so payable is taxable to the trust, and for this purpose the trust uses the personal rate schedule (although it is not entitled to a personal exemption); and

(3) once the trust has paid income tax on an amount, the balance can usually be distributed in subsequent years without further tax.

The new legislation continues the present tax treatment for the first category of income. This income will be taxed in the hands of the beneficiaries, and deducted in computing the income of the trust.

For trusts which accumulate income, the new bill distinguishes between estates (trusts created by a will) and personal trusts (trusts created by a living person).

In the case of an estate, income not payable to beneficiaries in the year received is taxed to the estate under the same system as at present. The estate uses the personal rate schedule, but is not entitled to personal exemptions.

In the case of a personal trust, income not payable to beneficiaries in the year received is taxed to the trust at the higher of 50 per cent or the personal rate schedule.

The new bill also provides that the minimum 50-per-cent tax on investment income of personal trusts will not apply to trusts in existence on budget day 1971 unless that trust receives additional contributions or borrows any money from a non-arm's-length lender after that date.

The new bill also provides that the preferred beneficiaries of a personal trust or estate may elect to include in their income the income of the trust that is being accumulated for their benefit. If this election is made the income is not taxed to the trust. This election may be made by any or all of the preferred beneficiaries, but the election by each is limited to his share of the trust income. Preferred beneficiaries are defined as the spouse or children of the person who established the trust. When the beneficiaries or their "shares" cannot be ascertained, the bill provides rules based on reasonable but generous assumptions, to determine each beneficiary's share of income. This election will also permit capital gains realized by a trust and otherwise included in its income to be taxed in the hands of lower-rate beneficiaries.

With the introduction of a tax on capital gains a number of special rules are needed to cover trusts. These rules are somewhat complex because of the extreme complexity of trusts, and the following summary is intended to give a general understanding of these rules.

When property is transferred to a trust this will generally be regarded as a sale at fair market value and accordingly a capital gain or loss will result. The cost of the property to the trust will be the fair market value of the property at the date of transfer.

When property is transferred to a special trust under which a spouse is a beneficiary, the capital gain on the transfer can be deferred under certain circumstances. In these cases the trust will take over the property at the cost of the person establishing the trust. On the death of the spouse the trust will be considered to have sold the property at its fair market value and accordingly a capital gain or loss will result. The cost of the property to the trust for tax purposes will then be increased to the fair market value of the property.

For trusts in existence at the start of the new system, the cost of the trust property will be original cost or fair market value on Valuation Day.

When a trust transfers property to its capital beneficiaries, the beneficiaries will take over the property at the trust's cost. This tax-free transfer recognizes the fact that a trust is, in a sense, the agent of its beneficiaries.

If a beneficiary sells or otherwise disposes of an income interest in a trust, all of the proceeds received will be treated as ordinary income but the purchaser will be able to deduct his cost from trust income received. If a beneficiary sells or otherwise disposes of a capital interest in a trust, the capital gain or loss will be measured against his pro rata share of the cost of the trust property to the trust at the time of sale.

The property of a trust, other than a special trust for a spouse, will be revalued every 21 years for capital gains tax purposes. This provision is necessary to prevent the indefinite postponement of capital gains taxes through the use of long-term trusts.

Partnerships

Under the existing tax system partnerships are not taxed as separate entities. Instead, the partners are taxed on their share of the partnership income, as if they had personally received the income. The new bill continues this tax treatment for partnership income, although the computation of income will be made at the partnership level.

Under existing law capital cost allowance may be claimed only by the partners, not by the partnership, although in practice it has often been claimed by the partnership. The new bill provides that capital cost allowance will be taken by the partnership and there are transitional provisions to transfer the depreciation base from the partners to the partnership.

With the introduction of a capital gains tax, rules are necessary to cover situations where property is transferred to a partnership, where property is received from a partnership and where partnership interests are sold. The general rule is that transfers of property to or from a partnership will take place at fair market value and accordingly a capital gain or loss will result. However there are a number of special provisions.

The new bill provides that a partner may contribute property to a partnership without a capital gain being realized. The partnership will simply take over the property at the partner's cost.

The new bill also provides that on its dissolution a partnership may transfer property to its partners without realizing a capital gain provided each partner receives the same percentage interest in that asset as he receives in every other asset distributed. In these situations:

(a) if the cost of the assets distributed is greater than the cost of the partner's partnership interest, the difference is treated as a capital gain; and

(b) if the cost of the assets distributed is less than the cost of the partnership interest, the difference may be spread over the cost of the distributed assets in a prescribed manner.

Where a partnership dissolves and one of the remaining partners carries on the business of the old partnership and uses property of the old partnership, the property may be transferred from the old partnership into the new business at tax cost.

Where a partnership dissolves as a result of the death or retirement of a partner and the remaining partners carry on the business using substantially all of the property of the old partnership, the old partnership will be deemed not to have dissolved.

After the new system starts the sale of a partnership interest or the liquidation of a partnership will generally result in a capital gain or loss, and this gain or loss will be measured from the partner's adjusted cost basis of his partnership interest. For partnerships existing at the start of the system, a partnership interest will be valued on the basis of the cost of the underlying partnership assets. However, if the partnership interest is subsequently sold, a portion of the gain will be exempt provided the buyer agrees to reduce his cost for tax purposes by the "exempt amount". The exempt amount will be the partner's share of that portion of the value of assets of the partnership on hand at the start of the system which would be treated as exempt if sold by the partnership.

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International Income

- *Most changes in taxation of international income do not take effect until 1976. This will allow time to negotiate new tax treaties and to renegotiate existing treaties.*

Foreign Income of Canadians

- *Dividends received by Canadian corporations from "foreign affiliates" continue to be exempt from tax if paid out of pre-1976 profits. For dividends paid out of post-1975 profits, the exemption continues if profits are earned in a treaty country; if earned in a non-treaty country part or all of the dividends may be exempt, depending on the level of foreign taxes paid.*
- *Two special concessions are extended to non-exempt dividends received from foreign affiliates after 1975. Under the first, Canada will give relief for taxes spared or waived under incentive measures provided in developing countries. In addition, the portion of dividend that would otherwise be taxed will be treated as a return of capital invested before 1976.*
- *After 1972, a Canadian shareholder of a "foreign affiliate" will be required to include in his income his proportionate share of the affiliate's "foreign accrual property income", whether or not that income is distributed. Such income is limited to income from property such as investment income and capital gains.*
- *Taxes paid to political subdivisions of foreign countries will be deductible from foreign income or included in the foreign tax credit calculation, depending on treatment given these taxes in the foreign country.*
- *Foreign taxes on business income in excess of the foreign tax credit available may be carried forward for five years.*
- *After 1975, the foreign tax credit on investment income of individuals will be limited to 15 per cent; any excess over 15 per cent will be treated as an expense.*
- *The exemption from tax for foreign business corporations will be phased out over five years. Dividends paid after 1971 will be eligible for the new dividend tax credit.*

Canadian Income of Non-Residents

- *The general rate of withholding tax on investment income paid to non-residents remains at 15 per cent until the end of 1975, then increases to 25 per cent unless reduced by treaty.*
- *Rate of withholding tax on dividends paid by a corporation with a degree of Canadian ownership continues to be five percentage points less than the general or treaty rate.*
- *Pension and similar payments to non-residents after 1971 will be subject to withholding taxes at the general rate. Old Age Security pensions and $1,290 annually of Canada or Quebec Pension Plan benefits will be exempt. A non-resident may elect to file a Canadian tax return, to calculate his tax on his Canadian non-investment income at graduated personal rates, and thereby to obtain a refund of excess withholding tax, if appropriate.*
- *The special branch tax paid by non-Canadian corporations will be increased to the general withholding tax rate and the allowance for investment will be expanded to include working capital, but will be subject to recapture if investment is reduced.*
- *If the ratio of total shareholders' equity to debt due to non-resident shareholders, who have a 25-per-cent or more ownership interest, is less than 1:3, part of the interest paid to non-resident shareholders will not be deductible.*
- *The rate of tax on non-resident-owned investment corporations remains at 15 per cent until the end of 1975, then increases to 25 per cent. Income of these corporations includes full amount of capital gains that would be taxable to non-residents, but not other gains. As dividends are paid to shareholders, income taxes paid (including one-half the tax on capital gains) will be refunded to the corporation, and these dividends will be subject to normal rate of withholding tax.*

The new legislation reflects some changes in the system of taxing international income, but the basic features of the system continue. Residents of Canada continue to be taxed on their world income, and any foreign taxes paid on this income are taken into account in determining Canadian tax. Non-residents continue to be taxed on their Canadian employment and business income, and the tax will be extended to certain capital gains of non-residents. Investment income received from Canada by non-residents continues to be taxed at a flat rate of withholding tax.

Many of the changes proposed by the new bill will not take effect until 1976. This will allow a reasonable period of time to negotiate new tax treaties with other countries, and to renegotiate existing treaties. Tax treaties are an essential part of the taxation of international income and it is expected that the network of Canada's tax treaties will be considerably expanded before 1976.

The changes in the tax treatment of foreign income of Canadians and in the tax treatment of Canadian income of non-residents are discussed separately below.

FOREIGN INCOME OF CANADIANS

Foreign Tax Credit

Residents of Canada are generally taxable on their world income, even though part of this income may have been taxed in a foreign country. To ensure that foreign income is not subject to double taxation, the foreign tax credit provisions allow foreign taxes to offset the Canadian tax otherwise payable on overseas income.

For example, assume that a resident earns $100 of interest income from abroad, from which a 15-per-cent foreign tax has been deducted. On his Canadian tax return, the $100 would be reported as income and the $15 of foreign tax paid would be deducted from Canadian tax otherwise payable on that income.

Three basic changes to the foreign tax credit provisions are reflected in the new bill.

First, foreign taxes paid on overseas business income in excess of the foreign tax credit available may be carried forward for up to five years. At present there is no carry-forward. This change is effective at the start of the new system.

Second, after 1975 the foreign tax credit on investment income of individuals will be limited to 15 per cent, and any excess over 15 per cent will be treated as a deductible expense. For example, if $100 of foreign interest income had been subject to a 25-per-cent withholding tax abroad, the foreign tax credit would be limited to $15 and the remaining $10 would be treated as a deductible expense. In other circumstances the foreign tax credit will continue to be calculated as at present.

Third, under the present system, no relief is given for income taxes paid to states, provinces or other political subdivisions of foreign countries. The new legislation provides that after 1971 these taxes will be recognized either as a deductible expense or as an income tax eligible for the foreign tax credit. If state or local income taxes are deductible as an expense in the foreign country (as they are in the U.S.) they will be deductible as an expense in Canada. In other circumstances, the state or local income tax will be included in the foreign tax credit calculation.

Foreign Affiliate – Definition

A foreign corporation is a "foreign affiliate" of a taxpayer if:

- it is controlled by the taxpayer, either alone or together with other related taxpayers;
- 25 per cent of its voting shares or 50 per cent of any class of shares are owned, directly or indirectly, by the taxpayer; or
- 10 per cent of its voting shares are owned by the taxpayer, and the taxpayer elects to have the corporation qualify as a foreign affiliate.

The effect of this definition is to include as a foreign affiliate a foreign subsidiary, a foreign sub-subsidiary and any number of foreign corporations in a chain, provided the qualifications are met.

Foreign Affiliate – Dividends

Under the present tax system dividends received by a Canadian corporation from a foreign corporation in which it owns more than 25 per cent of the voting shares are exempt from tax.

Under the new legislation dividends received by a Canadian corporation from a "foreign affiliate" (as defined above) will be exempt from tax if the dividends are paid out of profits earned by the affiliate prior to 1976. Dividends paid out of post-1975 profits will also be exempt if the profits are earned in a country with which Canada has a comprehensive tax treaty.

Dividends paid out of post-1975 profits earned in a non-treaty country will be wholly or partly exempt from tax in Canada, depending on the amount of income tax paid by the foreign affiliate on its earnings in non-treaty countries and the withholding tax imposed on the dividend. In determining the taxable portion of the dividend, a deduction will be made for foreign taxes imposed on the earnings from which the dividend is paid and by twice the amount of foreign withholding tax imposed on the dividend.

For example, assume that in 1976 a wholly-owned foreign subsidiary earns $1,000 of profit, pays a 30-per-cent tax on this profit and subsequently distributes those earnings as a dividend subject to a 20-per-cent withholding tax.

Foreign Affiliate		
Income		$1,000
Income tax-30%		300
Paid as dividend		700
Less foreign withholding tax-20%		140
Net receipt by Canadian corporation		$560
Canadian Corporation		
Income – dividend received		$700
Deduction for foreign tax:		
Underlying tax on profit	$300	
Twice foreign withholding tax	280	580
Taxable income		$120
Canadian tax payable (50%)		$ 60

The total tax paid in these circumstances would be $500 consisting of $440 of foreign tax and $60 of Canadian tax.

The Canadian tax paid is the same as would be payable under the foreign tax credit provisions for a Canadian corporation that carried on business abroad. In circumstances comparable to those in the preceding example – that is, if the foreign branch earnings of $1,000 attracted $440 of tax abroad – the corporation would pay the same $60 of Canadian tax.

Canadian Corporation		
Income of foreign branch		$1,000
Canadian tax thereon:		
Corporation tax (50%)	$500	
Less foreign tax credit	440	60
Foreign tax		440
Total tax payable		$500

The general effect of the provisions in this area is to place dividends from foreign affiliates in non-treaty circumstances on the same basis as foreign branch earnings of corporations. The Canadian tax imposed on dividends from foreign affiliates and overseas branch earnings is restricted to the amount necessary to bring the total burden of tax, both foreign and domestic, up to the level of Canadian tax.

In order to avoid uncertainty and to avoid impeding investment abroad while an expanded network of tax treaties is concluded, a special concession will apply to dividends received by a Canadian corporation on shares of foreign affiliates owned at the end of 1975. To the extent that any such dividend would otherwise attract Canadian tax, it may be treated as a return of capital. In the previous example, the taxable portion of the dividend received from the foreign affiliate was $120. The Canadian corporation could choose to exclude this amount from its income and instead apply the $120 to reduce the adjusted cost of its shares in the affiliate.

A second concession applies to investments in developing countries. For projects undertaken by the end of 1975, the government has agreed to give relief for taxes "spared" under incentive legislation of such countries. In the absence of this concession Canadians might be discouraged from investing in projects in these countries in advance of a treaty being concluded.

Foreign Affiliates – Diverted Income

The new bill contains special rules for taxing the foreign accrual property income of a foreign affiliate after 1972. The purpose of these special rules is to remove the tax advantage that would otherwise be gained from the transfer of investments abroad, particularly to those jurisdictions which are popularly referred to as "tax havens". These rules will not apply to active business income.

A Canadian shareholder of a foreign affiliate will be required to include in his income his proportionate share of the affiliate's diverted income (generally, investment income and capital gains) whether or not that income is actually distributed to him. Relief will be given for any foreign income taxes paid on that income. A foreign trust in which a Canadian beneficiary has a substantial interest will be treated as a foreign affiliate for purposes of the diverted income rules.

Foreign Business Corporations

The exemption from Canadian tax of a foreign business corporation will be phased out over five years. In 1972, 4/5ths of its taxable business income will be exempt; in 1973, 3/5ths will be exempt, and so on until 1976 when the exemption will no longer apply. Dividends paid by these corporations after 1971 will be eligible for the new dividend tax credit.

CANADIAN INCOME OF NON-RESIDENTS

Withholding Tax

The general rate of withholding tax on investment income paid to non-residents will remain at 15 per cent until December 31, 1975; thereafter it will increase to 25 per cent unless reduced by treaty.

The existing exemptions from withholding tax for interest on government and government-guaranteed bonds will continue for securities issued before 1976. The special exemption for interest payable to foreign charitable organizations, pension funds and other exempt institutions abroad will be continued.

The rate of withholding tax on dividends paid by a corporation with a degree of Canadian ownership will continue to be five percentage points less than the general rate. Therefore, after 1975 it will be 20 per cent for shareholders in non-treaty countries and will be reduced to 10 per cent for shareholders in most treaty countries.

Pension and Similar Payments

Pension and similar payments will be subject to the non-resident withholding tax after 1971. The rate of withholding tax will be 15 per cent up to 1975 and 25 per cent thereafter, unless reduced by tax treaty. However, pensioners living outside Canada may receive free of withholding tax the full $960 of Old Age Security payments and up to $1,290 from the Canada or Quebec Pension Plans to make the exemption equal to the normal personal exemptions and standard deductions.

The recipient of pension and similar payments will be entitled to file a Canadian tax return, to calculate his tax liability at ordinary personal rates on Canadian income (other than investment income) and to obtain a refund if the tax withheld exceeds his liability.

Branch Tax

Under present law, a foreign corporation carrying on business in Canada through a branch is required to pay a special 15-per-cent tax on the after-tax branch profits that are not re-invested in capital assets. This special tax is altered in the new bill to place non-Canadian corporations that carry on business in Canada through a branch in a comparable position to such corporations that carry on business in Canada through a subsidiary. The rate of tax will be increased to 25 per cent after 1975 unless reduced by treaty. In addition, the allowance for investment in Canadian business assets will be extended to working capital and will be subject to recapture if investment is reduced.

Thin Capitalization

Under present law it is attractive for non-residents who control corporations in Canada to place a disproportionate amount of their investment in the form of debt rather than shares. The interest payments on this debt have the effect of reducing business income otherwise taxed at 50 per cent and attracting only the lower rate of withholding tax on interest paid abroad.

Under the new bill, if the ratio of total shareholders' equity to debt due to non-resident shareholders, having a 25-per-cent or more ownership interest, is less than 1:3, an appropriate part of the interest paid to non-residents will not be deductible. In effect, the part of the debt in excess of the 1:3 ratio will be treated as equity and the interest on that excess as dividends.

Non-resident-owned Investment Corporations

The special tax treatment for non-resident-owned investment corporations (NRO's) is continued in the new bill.

Once the new system is fully operative in 1976, it will provide for:

- a 25-per-cent tax on the income of the NRO, including capital gains that are taxable to non--residents, but excluding other gains; the tax paid (including only one-half of the tax on capital gains) will be refunded to the corporation when the earnings are distributed; and normal withholding tax on dividends paid;
- a requirement that NRO's must be 100-per-cent owned by non-residents, compared with the existing 95-per-cent ownership rule.

Until 1976 the rate of tax on income will stay at 15 per cent and the new ownership rules will not apply.

7

Administrative Changes

- *Onus of proof placed on the Crown to establish the facts necessary to support a penalty.*
- *Restrictions placed on issue of search warrants and retention of seized documents.*
- *Taxpayer entitled to be present at enquiry into his affairs, be represented by counsel, and be provided with a transcript of the evidence.*
- *Faster appeal procedures established; Federal Court rules to govern appeals; questions of fact or law may be referred for an opinion.*
- *Some restrictions placed on changes that may be made in income tax returns reassessed after more than four years.*
- *Appeals allowed against Minister's refusal to register charitable organizations, registered retirement savings plans, or to issue certificates of exemption to non-residents.*
- *A common factual issue affecting two or more taxpayers can be dealt with singly.*

The new legislation contains a number of changes in the administrative and penalty provisions which will benefit the taxpayer. Many of these changes result from representations made by taxpayers and tax practitioners in recent years.

The existing search and seizure powers under the Income Tax Act are being restricted. Some powers of the Minister of National Revenue are being limited. And the appeal sections are being broadened and procedures refined.

In total, the changes combine to produce a substantial reform of the civil rights enjoyed under the Canadian income tax system, and make methods and procedures easier and faster for the taxpayer.

Penalties

A penalty by definition is a form of punishment for wrong-doing, and thus it seems only logical that the Crown should be obliged to prove the facts on which it is based.

Under the existing Income Tax Act, the onus is on the taxpayer to "demolish the basic fact on which his liability for the penalty rests."

The new legislation provides that in the case of appeals from the assessment of penalties, the onus is on the Crown to establish the facts necessary to support the imposition of the penalty as distinguished from the tax.

Search Warrants

Under the existing Income Tax Act, the Minister of National Revenue may issue search warrants with the consent of a judge, whenever he feels they are necessary.

The new legislation safeguards the taxpayer's civil rights by restricting the authorization of search warrants to occasions when there are reasonable grounds for believing that an offence has been committed. Information, on oath, must be submitted to a court.

In addition, documents seized other than by search warrant in the course of an investigation must be returned within a reasonable time unless a court decides otherwise. A person whose documents are seized will have the opportunity of reviewing them.

Enquiries

At the present time, an enquiry may be held in the course of the administration or enforcement of the Income Tax Act without the presence of the taxpayer concerned. The new legislation will entitle the taxpayer, in most cases, to attend or be represented.

Other Changes

The new legislation allows a taxpayer to appeal directly to a court without further consideration by the Department of National Revenue. The purpose here is to speed procedures when it is obvious to both sides that an issue must eventually be decided by the court.

The Minister of National Revenue, with the consent of the taxpayer, will be able to refer questions of law to the court for its opinion. This will allow quick settlement of cases in which there is no dispute as to the facts.

The present tax law allows the Minister to reassess an income tax return more than four years in the past in cases of misrepresentation or fraud. Once a case is opened, however, reassessments may include amounts in no way related to the original basis of assessment. The new legislation restricts such actions.

Appeals will be permitted to the Federal Court if the Minister of National Revenue refuses to register for tax-exemption purposes charitable organizations, deferred profit-sharing plans, retirement savings plans, and certificates of exemption for non-residents. Appeals are restricted to those issues which do not involve any consideration of matters of policy.

In many situations there are questions of fact which affect more than one taxpayer. For example, in the case of an alimony payment, one spouse is concerned because the payment represents a deduction of income; the other spouse, because the payment is an inclusion in income. To speed up settlement of disputed cases, the new legislation will permit a court to determine a common question of fact between two taxpayers.

8

Revenues

The effect of the reform measures on combined federal and provincial government revenues in 1972 is estimated as follows:

Corporation income tax changes	$ + 30 million
Withholding tax changes	+ 5 million
Individual income tax changes	– 290 million
Estate and gift tax changes	– 65 million
	$ – 320 million

These figures relate to combined federal and provincial taxes, with provincial rates at 30 per cent of federal tax on individuals and 10 per cent of corporate taxable income. Of the $320 million reduction in revenue, $315 million is a federal reduction and $5 million is a provincial reduction. Because personal tax rates in some provinces are higher than the equivalent of the new 30-per-cent standard rate, actual provincial revenues from this source are estimated to decline by approximately $23 million. Almost all of this provincial reduction will be offset by the government's revenue guarantee to the provinces and the balance by an adjustment in equalization payments.

The reduction in federal revenues of $315 million fulfills the government's commitment concerning revenues from the reformed system in the first year. Had the present system been continued, but without the present 3-per-cent surtaxes on personal and corporate income, federal revenues in 1972 would have been reduced by $305 million, which is the yield of the surtaxes.

As the new system matures, it will generate more revenue annually than would the existing system had it continued to operate under current rules and rates. It is estimated that this additional amount will be about $850 million by the fifth year of the system. Reductions in tax rates designed to offset the revenue increase will be set out for the years 1973 to 1976 as part of the revenue commitment, and they are described in explanatory material accompanying the narrative description of transitional measures tabled budget night.

In brief, the reductions will be made both in the general rate of corporation income tax and in the federal rate on the first $500 of taxable personal income. The corporate rate will be reduced from 50 per cent in 1972 to 49 per cent in 1973, 48 per cent in 1974, 47 per cent in 1975 and 46 per cent in 1976. The 17-per-cent federal rate on the first $500 of taxable personal income will be reduced to 15 per cent in 1973, 12 per cent in 1974, 9 per cent in 1975 and 6 per cent in 1976.

Estimating Procedures

The estimates of the effect of the reform proposals on government revenues have been made by computer simulation, employing two samples of 1968 income tax returns-- one sample of the returns of individuals and the other of corporations. These samples, and the computer programs which permit alternative computations based upon the information in the samples, were designed and operated by officials of the Department of National Revenue after consultation with officials of the Department of Finance. This permitted the tax data to be used without jeopardizing the confidential nature of the information in the tax returns.

The sample of individual returns contained 100,000 returns, drawn from a larger sample used by the Department of National Revenue to produce its publication "Taxation Statistics", which analyzed 1968 T1 individual income tax returns. The sample was drawn to represent as closely as possible the entire tax-paying population.

Since it is proposed that the tax changes come into effect in 1972, it was necessary to estimate the revenue effects for 1972. To accomplish this, population and economic changes between 1968 and 1972 were estimated and the computer information modified to reflect the changes. The modifications were based upon the latest information available concerning trends and outlooks. Nevertheless it is important to caution that forecasting revenues entails risks. It is believed, however, that the forecast of over-all revenue effects is subject to only a modest margin of error. But even a 1-per-cent margin of error on an income tax base of $10 billion can result in a discrepancy of $100 million.

The statistical basis for developing corporate revenue yields has been the sample prepared by the Dominion Bureau of Statistics, working from financial statements filed under the Corporations and Labour Unions Returns Act. This sampling basis encompasses all taxable corporations with $5 million or more in assets, 50 per cent of taxable corporations with assets from $1 million to $5 million and 5 per cent of taxable corporations with less than $1 million in assets.

It has been possible to employ this sample of about 16,000 corporations to duplicate within less than one per cent the actual taxable income of the approximately 195,000 Canadian corporations in 1968.

Officials of National Revenue have coded the records so that it is possible to obtain sub-totals for all public corporations, for all corporations controlled directly by foreign corporations, and for the subsidiaries of those corporations. These sub-totals were essential to the estimates pertaining to some of the proposals.

In some instances the information necessary to estimate the 1968 revenue effect was in the 1968 tax returns, permitting a simple recomputation of tax due under the new rules. This was the case for personal exemption changes, the new rate schedule, the exemption of guaranteed income supplement payments, the deduction of unemployment insurance contributions, and the reform of the dividend tax credit.

In other instances, some of the information required was on computer, but it was necessary to supplement this information in some respects by estimates based on other data. For individuals, this procedure was used for calculating the tax effect of the increase in the limits on the deductibility of charitable donations and contributions to pension plans and retirement savings plans. This was also the case for the restriction on the deduction of depreciation on rented buildings. For corporations this procedure was used for the low corporate rate and the amount of net investment income, the flow of dividends between corporations, the deductibility of "nothings" and interest on money borrowed to buy shares, and capital gains realized.

For a third category of proposals very little or no information could be obtained from the 1968 returns. For those proposals, estimates were based upon information from other sources – U.S. studies, publications of the Department of Labour and the Unemployment Insurance Commission, and others – and the results were fed into the computer. This category included capital gains, moving and living-away-from-home expenses, child care allowances, the taxation of unemployment insurance benefits and the benefit received by an employee when part or all of his medicare premiums are paid for him by his employer, and several smaller items.

The most difficult item to estimate was capital gains. Capital gains on shares of corporations are by far the largest component of total gains. The amount of these gains likely to be realized by individuals was computed by two methods and the results were compared and analyzed. The first method was based upon the relationship between dividends paid and capital gains realized on Canadian corporate shares as determined in studies for the Royal Commission and 1971 studies for the Department of Finance. An adjustment was made with respect to corporations which do not pay regular dividends, since these corporations were under-represented in the corporate samples. The second method was based upon the relationships between share prices, undistributed corporate profits and capital gains reported for tax purposes in the United States, and between capital gains reported for tax purposes and gains accrued at the death of the holder.

Both methods have indicated that share gains realized and accrued by individual Canadians in Canadian corporations in 1968 were of the order of $2 billion. The taxable gains occurring in 1972 and for several subsequent years will, of course, be substantially less than these figures. No gains accruing prior to Valuation Day will be taxable, and the buildup of accrued but unrealized gains after the start of the system will initially be small, with a gradual increase occurring year by year. It is estimated, for example, that net revenues from capital gains in the first year will be an estimated $80 million. The calculation of the amount of gains realized in the early years of the new system has been based on U.S. data for the periods that assets are held by taxpayers, with an adjustment with respect to gains accrued at death.

Detailed estimates of the changes in corporate and personal income tax revenues are contained in the following tables.

Revenue Effect of Corporation Income Tax Changes
in the First Year of the New System

	On the Basis of 1968 Incomes	*On the Basis of 1972 Incomes*
	($ million)	
1. Change in the low rate of corporation income tax and reducing the amount of income taxed at the low rate	+ 75	+ 85
2. Reduction to 25% from 50% of the corporation tax rate applied to the investment income of private corporations that is distributed to shareholders	– 20	– 30
3. Net tax collected on portfolio dividends received by private corporations	+ 35	+ 50
4. End of the corporation surtax	– 80	– 90
5. Tax collected on capital gains of corporations	+ 40	+ 50
6. New deduction for "nothings" and for interest on money borrowed to buy shares	– 25	
7. New rules for deducting exploration and development expenditures by corporations whose principal business is not mining, petroleum or gas, and new rules for exploration and development outside Canada	– 10	– 35
8. Cancellation of deduction for club dues, yatchts, camps and lodges, etc.	+ 5	
	+ 20	+ 30

Revenue Effect of Personal Income Tax Changes
in the First Year of the New System

	On the Basis of 1968 Incomes	*On the Basis of 1972 Incomes*
	($ million)	
1. Increase in basic exemptions and rate schedule changes	– 190	– 120
2. Additional exemption for those over 65 and the exemption of GIS payments	– 55	– 90
3. Employment expense allowance, moving expenses and other deductions for expenses	– 205	– 285
4. Child care allowance	– 35	– 50
5. Inclusion in income of unemployment insurance benefits	+ 90	+ 130
6. Deduction of unemployment insurance premiums paid by employees	– 65	– 100
7. Increase in limits on deductions for contributions to pension and retirement savings plans	– 20	– 30
8. Increase in limit on deduction for charitable donations	– 10	– 10
9. Inclusion in income of medicare premiums paid on an employee's behalf by his employer	n/a	+ 80
10. Restriction on deduction for depreciation of rented buildings	+ 25	+ 45
11. Other expense deductions limited and other items included in income (see below)	+ 50	+ 65
12. Inclusion in income of one-half of net capital gains	+ 70	+ 80
13. Amendment to dividend tax credit formula	– 25	– 5
Total	– 370	– 290

The composition of Item 11 above is as follows:

	1968	*1972*
	($ million)	
Expense deductions limited:		
Restriction of deduction for club dues, etc.	4	6
Change in definition of deductible medical expenses	6	9
Other items included in income:		
Adult training allowances	15	20
Armed forces changes	10	15
Personal use of business cars	5	5
Additional interest paid by co-ops, caisses populaires and credit unions	5	5
Fellowships, scholarships, bursaries and grants	5	5
	50	65

Tax Reform Synopsis

ITEM	OLD LAW	NEW BILL
Single taxpayer – basic exemption	$1,000	$1,500
Married taxpayer – basic exemption	$2,000	$2,850
Spouse's income	Spouse's exemption of $1,000 reduced $1 for every $1 that income exceeds $250.	Spouse's exemption of $1,350 reduced $1 for every $1 that income exceeds $250.
Married exemption for supporting dependant	$2,000 when unmarried taxpayer supports dependent child or dependent relative.	$2,850 – Dependant must live with taxpayer. Exemption reduced where dependant has income over $250.
Children under 16	Parent deducts $300. If child's income is over $950, excess may be added to parent's tax (notch provision).	Parent deducts $300 which is reduced $1 for every $2 of child's income over $1,000.
Children over 16	Parent deducts $550. If child's income is over $950, excess may be added to parent's tax (notch provision).	Parent deducts $550 which is reduced $1 for every $1 of child's income over $1,050.
Other dependants	Taxpayer deducts $300 or $550, depending on dependant's age. If dependant's income is over $950, excess may be added to taxpayer's tax (notch provision).	Taxpayer deducts $300 or $550 depending on age of dependant, and reduces exemption as above if dependant's income exceeds $1,000 or $1,050.
Unmarried clergymen	Deduct $1,000 if fulltime servant employed in dwelling.	No deduction.
Elderly taxpayers	Additional $500 exemption if age 70 or over.	Exemption in creased to $650 and extended to taxpayers age 65 or over. Guaranteed income supplement made exempt.
Special deduction	Individuals who are blind or are confined to bed or wheel chair are allowed a special deduction of $500 a year.	Special deduction increased to $650 a year.
Child care expenses	No deductions.	Up to $500 per child under 14 or over 14 and infirm with a limit of $2,000 per family. Deductions may not exceed 2/3 of income of parent claiming deduction. Receipts needed. Deducted by mother unless unable to work. Payments to dependants or to relatives under 21 do not qualify.
Employment expenses	Very limited; e.g. union dues.	3% of gross employment income up to $150 deductible.
Expenses when working away from home	Amounts received from employer by construction workers for board, lodging and transportation at distant sites not taxable.	Old law extended to all employees.

INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
$1,400	$1,400 only if taxpayer's income does not exceed $3,000.	$1,400
$2,800	$2,800 only if taxpayer's income does not exceed $8,500.	$2,800
Same as White Paper.	Same as White Paper.	Spouse's exemption of $1,400 reduced $1 for every $1 that income exceeds $100.
Same as White Paper.	Same as White Paper.	Similar to bill but exemption $2,800.
Same as White Paper.	Same as White Paper.	Similar formula but reduction started at $900.
Same as White Paper.	Same as White Paper.	Similar formula but reduction started at $950.
Same as White Paper.	Same as White Paper.	Similar formula but reduction started at $900 or $950.
Same as bill.	Same as bill.	Same as bill.
No change from old law.	No change from old law.	No change from old law.
No change.	No change.	No change.
Similar to bill but deduction allowed only to parent with lower earned income. Would include care for incapacitated spouse.	Similar to bill.	Not allowed to father if mother unable to provide care or for children over age 14. Limited to 2/3 income of parent with lower income.
Similar to bill. Would allow alternative of itemized expenses.	Similar to bill.	Similar to bill.
No comment.	No comment.	Promised some tax relief.

ITEM	OLD LAW	NEW BILL
Moving expenses	Employer may deduct as business expense. No deduction by employee.	Employees and self-employed may deduct from income from new job with one year carry-over. Must move 25 miles closer to job. Special rules for students.
Medical expenses	Allowable expenses deductible to the extent they exceed 3% of net income.	List of allowable expenses increased to include training institutions for disabled persons and prescribed appliances and equipment.
	Insurance premiums not deductible.	Premiums to plans other than government are classed as medical expenses.
	Expenses reimbursed by government plans not deductible.	Expenses for which taxpayer has been reimbursed under a plan not classed as medical expenses.
	Employers' contributions to public hospital plans and some medical plans result in taxable benefit; contributions to private plans do not.	Employers' contributions to all government plans result in taxable benefit.
Unemployment insurance	Contributions not deductible; benefits not taxable.	Contributions deductible; benefits taxable.
Club fees, convention expenses, entertainment costs	Generally deductible by persons carrying on a business or profession.	Yachts, lodges and club dues disallowed; geographical restrictions placed on conventions.
Charitable donations	Donations to registered charitable institutions limited to 10% of net income.	Limit on donations 20% of net income. Donations to national amateur athletic associations qualify.
	Donations to federal and provincial governments deductible without limit.	Same provisions for donations to governments.
Pension plans, registered retirement savings plans and deferred profit-sharing plans	Limit on deductible contributions of \$1,500 for pension plans and profit-sharing plans and \$2,500 for retirement savings plans.	Limits increased to \$2,500 for pension plans and profit-sharing plans and to \$4,000 for retirement savings plans.
	Foreign-source income of pension plans and profit-sharing plans may not exceed 10% to qualify for tax-free status.	90% of assets of all plans must be Canadian. Penalties for having more than 10% foreign assets; not necessary to dispose of present excess foreign assets.
	Some restrictions on investments of pension plans and profit-sharing plans. No restrictions on investments of retirement savings plans.	Investments of retirement savings plans to be restricted on same basis as profit-sharing plans.
	Special rules for taxing lump-sum withdrawals from pension plans and profit-sharing plans.	Withdrawals taxed at ordinary rates (but may average or defer tax under new rules). Special rule for present accumulations in pension and profit-sharing plans.

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to bill. Recommended that certain time must be spent in new location.	Similar to bill.	Similar to bill but without one year carry-over or reference to students.
No comment.	No comment.	Did not increase list of eligible expenses.
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Same as bill.	Same as bill.
Tighter enforcement of existing laws, continued deduction of proven entertainment expenses and geographical restrictions for conventions.	Retain old law with better enforcement to prevent abuse.	Similar to bill, but entertainment and convention costs not deductible.
No comment on limit except that it should be removed for gifts to Canadian public institutions. Suggested extension of list of registered organizations.	No comment on limit. Would enlarge list of registered organizations.	Did not increase limit on donations.
Recommended a switch to benefit based contributions as soon as feasible.	Recommended further study of benefit based contributions.	Did not increase contributions.
Similar to bill.	Similar to bill.	Similar to bill.
Similar to bill.	Similar to bill.	Similar to bill.
Special averaging for payments on death.	Under certain conditions withdrawals tax-free. Suggested more generous rules for taxing lump-sum withdrawals from plans.	Did not provide special rule for present accumulations or for income averaging annuities.

ITEM	OLD LAW	NEW BILL
Fellowships, scholarships, bursaries	Not taxable unless related to employment.	Taxable with an annual exemption of $500.
Training allowances	Not taxable.	Taxable except for living away from home allowance.
Research grants	Not taxable unless related to employment.	Taxable with deduction for research expenditures.
Benefit from personal use of automobile provided by employer or business	Taxed in some circumstances.	Minimum value set for personal use.
Income maintenance insurance	Not taxable if received from an insurance company.	Taxable if employer contributes to premiums, but with a deduction from benefits for premiums paid since 1967.
Income averaging	Special rules for special types of receipts. Five-year block averaging for farmers and fishermen.	General averaging for all taxpayers whose income in a year exceeds four-year average by 20% and immediately preceding year by 10%. Income of each preceding year deemed to be not less than $1,600. Also special forward averaging for certain receipts through the acquisition of an income-averaging annuity. Averaging for farmers and fishermen will continue as in the old law. Present special rules remain for three or five years.
Servicemen	Special rules – taxed on a monthly basis.	Treated as ordinary taxpayers.
Rate schedule	Rates (including provincial tax at 28%, old age security tax and other special taxes) from 14.8% to 82.4%. Surtax on foreign investment income – 4%.	Rates (including provincial tax at 30%) from 22.1% to 61.1% in 1972. In years 1973-76, federal rate of 17% on first $500 reduced in steps to 6%. Surtax on foreign investment income eliminated.

INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Same as bill.	Should not be taxable.	Taxable, with no exemptions.
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Should not be taxable.	Same as bill.
Similar to bill.	Retain old law with better enforcement to prevent abuse.	Similar to bill.
No comment.	No comment.	No provision.
Agreed with White Paper.	One type of averaging for general use, similar to that granted to farmers and fishermen under the old law; and a special formula for lump-sum receipts from plans. Retain present special averaging for lump-sum business receipts but restrict to small corporations.	Averaging if income exceeds four-year average by 33 1/3%. Restrictions for persons formerly dependent and for those under age 25. No provision for income-averaging annuities.
Same as bill.	Same as bill.	Same as bill.
Approved White Paper, but recommended top rate of 60% and no phase-in. The 50% rate to cut in at $30,000; the 60% rate at $60,000.	Reduce top rate to 50% for combined federal and provincial taxes. No increase in tax for middle income groups. Eliminate 4% surtax on foreign investment income.	Rates (including provincial tax at 28%) from 21.76% to 51.2%. Top rates to 81.92% in 1972 but reduced over five-year period.

ITEM	OLD LAW	NEW BILL
General rule	Not taxed.	One-half capital gains to be included in income. One-half losses deductible from gains. Losses not deducted in the year are carried back one year and forward indefinitely. Individuals may also deduct up to $1,000 of losses each year from other income.
Valuation Day		General rule: cost basis of asset to be higher of original cost or fair market value on V-Day in determining gains and lower of cost or market in determining losses. For bonds, etc., cost in these rules is amortized cost. Taxpayer may elect to use fair market value on V-Day for all assets.
Homes		No tax on sale of principal residence and one acre of land or additional land surrounding residence if proven necessary to enjoyment as residence. Farmer has alternative to deduct $1,000 per year on home and farm.
Works of art, jewellery, etc.		$1,000 minimum cost per item or set of items. Losses allowed against gains from similar assets and excess carried back one and forward five years with same restriction.
Other personal property		$1,000 minimum cost per item, or set of items. Losses not allowed.
Shares		Same as general rule.
Bonds, mortgages, agreements for sale, etc.		Same as general rule. Deep discounts half-deductible to issuer.
Windfall gains	Capital gains from gambling, sweepstakes and the like not taxable; losses not deductible.	No change.
Rollovers (carry-over of basis and deferral of gain)		Rollovers permitted for: – expropriation and destruction – transfers to an 80%-owned corporation – liquidation of a wholly-owned subsidiary – certain amalgamations and corporate reorganizations – transfers to a partnership – certain dissolutions of partnerships.
Gifts		No deemed realization for gifts to spouse; on subsequent sale, capital gains tax paid by donor. Deemed realization at time of other gifts.

GAINS

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to bill but more gains fully taxable.	Short-term (less than year) gains and losses treated as ordinary income. Long-term gains tax not to exceed the lower of 25% or rate of taxpayer. Long-term capital losses deductible only from long-term capital gains, subject to three-year carry-back and eight-year carry-forward	Capital gains to be brought into income and taxed at personal rates; losses to be deductible from any income. (See exceptions). One-year carry-back and five-year carry-forward.
Similar to bill. Suggested safe haven rules to reduce valuation problems.	Cost basis of asset to be higher of original cost or fair market value on V-Day for determining both gains and losses. Suggested safe haven rules to reduce valuation problem.	V-Day to be announced near commencement of new system. Fair market value on V-Day will be the basis for calculating subsequent gains and losses. Exceptions for bonds, mortgages and agreements for sale.
Same as bill without farmer's option.	Lifetime exemption of $50,000 for principal residences and $75,000 for farms and orchards owned by farmers.	$1,000 exemption per year plus $150 (or actual cost) annual improvement allowance. Rollover for one year where sold in connection with a change in job.
Same as bill.	$5,000 minimum cost per item.	$500 minimum cost per item. Losses restricted to prior, current and immediately subsequent year.
Same as bill.	$5,000 minimum cost per item.	$500 minimum cost per item.
Similar to bill.	Reject principle of distinguishing between closely-held and widely-held corporations. Gains and losses on both taxed as provided under general rule and only when an asset is sold.	Full gain taxable on shares of closely-held corporations; full loss deductible. Half gain taxable on shares of widely-held corporations; half loss deductible. Gains and losses on shares of widely-held corporations accrued every five years.
Full gain taxable on bonds, mortgages and agreements for sale; losses fully deductible. Transitional rules for recovery of cost.	Same as general rule.	Full gain taxable on bonds, mortgages, debentures, agreements for sale. If proceeds on disposal less than cost or amortized cost on V-Day, recovery not taxable.
No comment.	No comment.	No change.
Similar to bill.	Rollover provisions should be broadened.	Similar to bill.
Similar to bill.	No deemed realization. Cost basis to donor plus gift tax thereon flows through to recipient.	Deemed realization at fair market value at date of gift.

ITEM	OLD LAW	NEW BILL
Bequests		No deemed realization for bequests to spouse. Deemed realization at death for other bequests. Special rule for depreciable property.
Arrivals and departures		Taxpayers moving to Canada will value their assets at that time for the purpose of calculating subsequent gains or losses. On leaving Canada, deemed realization except for assets on which a non-resident is taxable by Canada. First $5,000 exempt. Alternatively, taxpayer may elect to be taxed as if resident of Canada in year of actual disposal, provided reasonable security given at time of departure.
Averaging		Capital gains subject to general averaging and forward averaging provisions.
Estate taxes	No tax on first $50,000. Maximum rate of 50% reached at $300,000. No tax on transfers to spouse.	Federal estate and gift taxes eliminated.

GAINS

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to bill.	No deemed realization. Cost basis to deceased plus estate tax thereon flows through to heirs.	Transferred to heirs at cost plus death duties applicable to any accrued gains.
Suspend tax for temporary residence (three years or less). Departures should have option of deemed realization or to continue to be taxed as residents of Canada, with security given to ensure payment of tax.	No deemed realization on leaving Canada.	Base value of assets for capital gains measurement will be fair market value on arrival day. Taxpayer leaving Canada deemed to have sold assets at fair market value.
Same as bill. Capital gains may be averaged.	Similar to bill. Capital gains may be averaged.	Same as bill. Capital gains may be averaged.
Exempt first $150,000. Broaden rate bracket so that 50% rate applies at $800,000.	Abandon estate tax field to provinces.	No changes proposed.

ITEM	OLD LAW	NEW BILL
Rates of tax	21% on first $35,000 and 50% on balance, (plus temporary 3% surtax).	General rate 50% in 1972 reduced by one percentage point annually to 46% in 1976. If eligible for small business incentive, 25% on first $50,000 of business income (see below).
Ordinary dividends paid by Canadian corporations to resident individuals	Individual shareholders can deduct a tax credit of 20% of dividends.	Dividend tax credit increased to 33 1/3% and included in income.
Ordinary dividends paid by Canadian corporations to resident corporations	Dividends from one "taxable Canadian corporation" to another one generally tax-exempt.	Dividends remain generally exempt. However, dividends received by private corporations from non-subsidiaries are subject to a special tax of 33 1/3% which is refunded when dividends are paid to shareholders. For every $3 of dividends, $1 of tax is refunded.
Investment income of private corporations (other than dividends)	No special rules, assuming corporation is not a "personal corporation".	Taxed at general rate. Refund of 25 percentage points when dividends are paid to shareholders. For every $3 of dividends paid, $1 of tax refunded.
Special dividends by private corporations out of capital gains	No provision.	One-half of capital gains taxed as investment income and rules for refund of one-half of tax will apply. The other half may be distributed tax-free to shareholders as a special dividend.
Small business incentive	Rate of 21% on first $35,000 available to all corporations.	Rate of 25% on the first $50,000 of business income available only to Canadian-controlled private corporations. Low rate not available to the extent funds used for non-business purposes and low rate ends once $400,000 of before-tax earnings have been accumulated after 1971.
Other special distributions	Corporations can pay special taxes, generally at 15%, on portions of their undistributed income, and thereafter distribute the remaining 85% to their shareholders tax-free.	Corporations can pay a special tax at 15% on all or any part of their undistributed income on hand at the start of the new system. The remaining 85% can then be distributed to shareholders tax-free. This distribution would reduce the opening value of the shares for capital-gains tax purposes. Once the 15% tax has been paid on all pre-1972 undistributed income, capital gains that relate to 1971 and before can also be distributed tax-free to shareholders. This distribution will similarly reduce the opening value of the shares. The special taxes would not apply to post-1971 earnings.

AND SHAREHOLDERS

COMMONS REPORT	SENATE REPORT	WHITE PAPER
General rate 50%; low rate of tax should be replaced by new incentives for Canadian-controlled closely-held corporations.	General rate 50%, but the low rate of tax should be retained for the first $35,000 of business income of small business corporations.	All corporations pay tax at the rate of 50%.
Generally, all dividends would be subject to half integration.	Dividend tax credit retained, but modified. Credit would be 25% on the first $500 of dividends, 20% on the next $4,500 and 15% on the excess.	Shareholders would receive credit for all or half of corporation taxes paid, under a system of integrating the tax paid by corporations and shareholders.
General rule is that dividends between corporations should be taxable at the rate of 33 1/3% and should be subject to half integration. If a corporation has 25% or more ownership of another corporation, dividends should be tax-exempt.	Dividends from one corporation to another to be tax-exempt, with special rules to prevent undue accumulation of portfolio dividends.	Dividends from one corporation to another are taxable, and carry full or half credit for corporation taxes paid: full credit if the dividend is paid by a CHC and half credit if the dividend is paid by a WHC.
No special rules.	No special rules.	No special rules.
No special rules.	No special rules.	No special rules.
See rates of tax above.	See rates of tax above.	No special provisions.
Similar to bill.	Similar to bill.	Similar to bill.

ITEM	OLD LAW	NEW BILL
Exploration and Development		
Principal business taxpayers	Can deduct Canadian exploration and development expenses in the year incurred or in any subsequent year.	No change.
Non-principal business	Generally, are allowed to deduct exploration and development expenses only from mining and petroleum income, with an unlimited carry-forward.	These taxpayers will be allowed to accumulate Canadian exploration and development expenses in a separate asset class and to deduct annually the greater of: – income from mining or petroleum, including royalties and proceeds from mineral properties, or – 20% of the unclaimed balance.
Foreign exploration	Generally, no deduction for foreign exploration and development expenses, other than drilling expenses for certain foreign oil and gas wells.	Foreign exploration and development expenses will be accumulated in a separate asset class and all taxpayers will be able to deduct annually the greater of: – foreign income from mining or petroleum or – 10% of the unclaimed balance.
New mines		
Three-year tax exemption	Income exempt for first three years.	Existing exemption limited to income earned before Jan. 1, 1974.
Accelerated depreciation	No provision.	Assets related to a new mine (e.g. mine buildings, machinery and equipment, a refinery, and townsite facilities) may be included in a separate asset class and an annual deduction made equal to the greater of: – income from the new mine, or – 30% of unclaimed balance. This accelerated depreciation also applies to most assets related to the expansion of an existing mine where the milling capacity is increased by at least 25%.
Operators' Depletion	Most operators of mineral or petroleum resources are entitled to claim a depletion allowance of 33 1/3% of production profits. Special rates for coal and gold.	Present system of depletion continues until end of 1976. Thereafter, depletion will have to be earned at the rate of $1 for every $3 of eligible expenditures. Eligible expenditures include all Canadian exploration and development costs, capital assets (except townsite facilities) acquired after Nov. 7, 1969 related to a new mine or major expansion, new facilities acquired after Nov. 7, 1969 to process mineral ores to a stage beyond which they were previously processed in Canada. Depletion earned but unclaimed can be carried forward indefinitely in determining future depletion.

PETROLEUM

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Recommended an increase in the rate to 30% from 20%.	Same as bill.
No comment.	No comment.	No comment.
Same as bill.	Retain exemption but reduce it to 75% of earnings of first three years.	Same as bill.
Similar to bill, but recommended that expenditures on new mine be deductible from any mining income, not just income from new mine.	Similar to bill.	Similar to bill, but did not provide for townsite assets or refineries or for expansion of an existing mine.
Similar to bill.	Present rules should apply for 10 years for properties now owned and operated. Thereafter taxpayers should be allowed a basic 20% depletion allowance and the earned depletion concept would only apply in calculating the maximum depletion of 33 1/3%.	Same as bill, but no automatic depletion for properties acquired after Nov. 7, 1969.
Similar to bill.		Eligible expenditures limited to exploration and development in Canada and new mine assets.
Taxpayers should be allowed to establish a bank of earned depletion at the start of the new system, calculated by reference to past exploration and development expenses less depletion allowed.	Same as bill.	Same as bill.

ITEM	OLD LAW	NEW BILL
Non-operators' depletion	Non-operators receiving royalties or rentals computed by reference to production from mining or petroleum properties are entitled to a 25% depletion allowance.	Non-operators depletion at the rate of 25% continues until the end of 1976. Thereafter such rentals and royalties will be treated as production income and be eligible for 33 1/3% depletion, subject to the earned depletion rules.
Shareholders' depletion	Shareholders of certain mining and petroleum companies are allowed to exclude from income 10%, 15% or 20% of dividends received.	Repealed.
Purchase of mineral rights	No deduction.	Included with exploration and development expenses, but do not earn depletion.
Sale of mineral rights	Generally tax-exempt.	Proceeds taxable. For rights held at start of new system, 60% of proceeds taxable if sold in first year, 65% in second year, and so on until the ninth and subsequent years when full proceeds are taxable.
Prospectors and Grubstakers	Proceeds on sale of mining properties are exempt from tax.	Exemption from tax is withdrawn. Where property is sold to a corporation in exchange for shares of that corporation, prospectors or grubstakers may elect to pay no tax at that time; they are deemed to have a zero cost basis for the shares and to pay capital gains tax on the proceeds of disposal. The corporation it then deemed to acquire property at no cost.
Provincial tax abatement	Provincial tax abatement is now 10% and provincial mining taxes are deductible in computing taxable income.	After 1976, an extra tax abatement of 15% on mining income, and mining taxes will not be deductible.

PETROLEUM

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Same as White Paper.	Retain old law for interests held on Nov. 7, 1969.	Repealed.
Same as bill.	Same as bill.	Same as bill.
Same as bill except that these costs should earn depletion.	Same as bill except that properties acquired directly from the Crown should earn depletion.	Same as bill.
Same as bill except that certain tax-free transfers should be permitted between related companies.	All mineral rights owned on V-Day should be valued at that time and subsequent disposals subject to capital tax only.	Same as bill.
Continue exemption for prospectors.	Continue exemption for both.	Same as bill.
Same as bill.	No comment.	No comment.

ITEM	OLD LAW	NEW BILL
Interest on money borrowed to buy shares		
Corporations	Corporations are not allowed to deduct interest on money borrowed to buy shares in other corporations.	Corporations will be allowed full deduction for this interest.
Individuals	Individuals are allowed to deduct interest on money borrowed to buy shares in corporations.	Full deduction of interest is continued for individuals.
The "Nothings"	Certain expenditures, called "nothings" are not deductible in the year incurred because they are capital in nature; and they are not depreciable because they do not give rise to an asset that is listed in one of the capital cost allowance classes. Examples of these nothings are goodwill, franchises for unlimited periods and incorporation costs.	A new 10% capital cost allowance class is created for "nothings". One-half of the cost of these assets will be depreciable, in line with the one-half rule for taxing capital gains and deducting capital losses. This new class will only apply to costs incurred after the new system commences.
Sale of goodwill	Proceeds on sale of goodwill are generally tax-exempt.	Proceeds on sale of goodwill owned at the commencement of the new system will be included in income to the extent of 20% if sold in the first year, 22½% if sold in the second year, 25% if sold in the third year, and so on until the thirteenth and subsequent years when 50% of the proceeds will be included in income. One-half proceeds of sale of goodwill connected with a business acquired or commenced after start of new system credited to "nothings" class.
Entertainment and related expenses	Deduction allowed for reasonable entertainment expenses, membership costs and similar expenses provided they are incurred to earn income.	No deduction for social and recreational club fees, or costs of yachts, fishing camps and other recreational facilities. Deduction for entertainment and conventions similar to old law, except for geographical restriction on conventions.
Depreciation		
Gifts	A gift of depreciable property is deemed to be a sale at fair market value.	No change except that on gifts of depreciable property to a spouse, the spouse is deemed to acquire the property at its tax cost.
Bequests	On bequests of depreciable property, beneficiary is deemed to acquire property at fair market value for purposes of future depreciation. No recaptured depreciation to deceased.	On bequests to a spouse, beneficiary is deemed to acquire property at its tax basis. On bequests to other persons, deceased is deemed to have sold the property at tax basis plus one-half of any accrued gain and beneficiary to have acquired property for that amount.

PROPERTY INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Approved White Paper.	Similar to bill.	Interest allowed as a deduction to the extent of dividends received.
Approved White Paper.	Approved White Paper.	Interest allowed as a deduction to the extent of dividends received.
Similar to bill, except that all of cost would be depreciable.	Similar to bill except that all cost would be depreciable, with the proviso that the legislation be broad enough to allow the inclusion of all "nothings". Also, goodwill should not be treated as a "nothing", but should be treated in the same manner as land which is not depreciable.	Similar to bill except that all cost would be depreciable.
Should be no retroactive taxation of goodwill owned at commencement of new system. Minister of National Revenue should be prepared to approve changes in the valuation of goodwill included in existing sale agreements.	Goodwill should be valued on V-Day and when sold the gain or loss would be subject to the normal capital gains tax rules.	Similar to bill except that all proceeds would be taxable after the transition period.
Similar to bill.	Similar to bill.	More restrictive than bill; would have denied a deduction for entertainment and convention expenses.
No change from old law.	Recipient of gift should acquire property at its tax basis to donor plus any gift taxes paid.	No change from old law.
Deemed realization at death. Beneficiary depreciates property based on fair market value.	Same as White Paper except that the depreciation base should be increased by estate taxes on the property.	Beneficiary is deemed to have acquired property at its tax basis.

ITEM	OLD LAW	NEW BILL
Rental property	All rental buildings are included in one of two capital cost allowance classes, depending on the type of construction.	A separate class is created for each rental building costing $50,000 or more.
Termination of class	A terminal loss is deducted only when all assets of a particular class have been sold.	No change from old law.
Losses from holding property	Losses from holding property are fully deductible as long as property is held for the purpose of earning income.	No deduction from other income for loss incurred on real property held primarily to earn rental income if the loss resulted from depreciation. Also no deduction from other income for loss incurred on holding undeveloped real property (e.g. vacant land) as a capital investment, if loss resulted from interest and property taxes. The interest and property taxes can be added to the cost of the property.
Consolidated returns	No provision for consolidated returns.	No provision for consolidated returns.
Taxpayers in the professions	Individuals and corporations earning professional income are entitled to compute income according to the "cash basis".	Professional income will be computed under the accrual basis, except that work in process may be excluded. There are transitional rules to cover the deferred income at the start of the new system.
Farmers and fishermen		
Cash basis	Farmers and fishermen are entitled to compute their income on a cash basis.	No change.
Averaging	Farmers and fishermen are entitled to special income-averaging provisions.	No change.
Basic herd	Farmers are entitled to classify a herd of animals as a capital asset, "basic herd", and gains and losses are treated as capital gains and capital losses and are therefore tax-exempt.	Farmers will have an opportunity to establish a basic herd as at December 31, 1971. Basic herds will be valued on V-Day and any proceeds of disposal up to this value will be exempt from tax. Proceeds in excess of this value will be treated as farming income and eligible for the special forward averaging.
Straight-line depreciation	Farmers and fishermen may use straight-line depreciation instead of diminishing balance depreciation and thereby avoid recaptured depreciation. Gains on disposal of depreciable assets are treated as capital gains.	Straight-line depreciation phased out.

PROPERTY INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Increase limit from $50,000 to $100,000.	No change from old law.	Same as bill.
Similar to White Paper.	Similar to White Paper.	At any time taxpayers could write down the net book value of a class to the aggregate of the original costs of the assets on hand. This write down would have to be made in any year in which control of a corporation changes.
Similar to bill.	Similar to bill except that provisions should only apply to property acquired after new system starts and should then only apply to taxpayers who are not in the business of renting property.	No deductions from other income for a loss from holding property, if that loss resulted from deducting depreciation, interest or property taxes.
Consolidated returns should be permitted on payment of a tax premium.	Consolidated returns should be permitted without payment of a tax premium.	Partnership option permits consolidated returns in certain circumstances.
Similar to bill.	Cash basis should be retained.	Similar to bill except that work in process had to be included.
Same as bill.	Same as bill.	Same as bill.
Same as bill.	Same as bill.	Same as bill.
Retain "basic herd" provisions.	Approved White Paper.	Because of full taxation of capital gains, the "basic herd" provision is no longer required.
No comment.	Same as bill.	Same as bill.

ITEM	OLD LAW	NEW BILL
Hobby farmers	A taxpayer whose principal business is not farming may deduct only $5,000 of farming loss annually from other income.	Similar to old law except that property taxes and interest which are not allowed as operating losses can reduce subsequent capital gains on sale of farm, but would not be allowed to create a capital loss.
Trusts	Trusts taxed at same rates as individuals although no deductions allowed for personal exemptions.	No change for trusts created by will. For trusts established by living persons, retained income taxed at higher of 50% or personal rates. For trusts existing at start of system that do not receive additional property, retained investment income taxed at personal rates.
	Income received by a trust which is payable to beneficiaries in year received is taxable in the hands of the beneficiary, not the trust.	Former treatment continued, and certain beneficiaries may elect to treat a prescribed portion of the retained income as their personal income and not trusts' income.
	Income on which a trust has paid tax can usually be distributed to beneficiaries without additional tax.	No change.
		On trusts for spouse, deemed realization on death of spouse. Other trusts, deemed realization every 21 years. Special rules for valuing trust interests for capital gains tax purposes.
Partnerships Partnership income	Partner taxed on his share of partnership income.	Similar to old law, with changes in computing partner's share of depreciation.
Interest in a partnership		Sale of partnership interests will give rise to capital gains or losses; special rules for computing tax basis and V-Day value.
Investment corporations	Investment corporations pay 21% tax on all taxable income. Dividends paid to shareholders eligible for dividend tax credit.	Canadian dividends received are exempt. Investment income and full capital gains taxed at 25%. Dividends paid eligible for dividend tax credit. Special capital dividends occasion refund to corporation of capital gains tax paid and treated as capital gain to shareholders.
Incorporated open-end mutual funds	Can qualify as investment corporation, otherwise treated as ordinary corporation.	Can qualify as investment corporation. If not qualified, dividends received subject to 33 1/3% refundable tax; full capital gains taxed at 25%; other income taxed at 50%. Dividends paid eligible for dividend tax credit. Redemption of shares occasions refund to corporation of capital gains tax paid and treated as capital gains to shareholders.

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Same as bill.	Same as bill.	Same as bill.
No recommendations.	Retain old law.	Trusts which accumulate income taxed at a flat rate of 50% (with lower rates in special circumstances). Recommended further study.
No comment.	No comment.	No comment.
Similar to bill.	Similar to bill.	Most mutual funds will be WHCs and dividends received will be taxed in the same manner as receipts by other WHCs. Capital gains distributions will be permitted to shareholders to the extent of capital gains made by fund and these distributions will carry a 33 1/3% credit. This capital gain distribution would be half taxable to individual shareholders.
Similar to bill.	Similar to bill.	Taxed as above for investment corporations.

ITEM	OLD LAW	NEW BILL
Unincorporated mutual fund trusts	Same rules as for other trusts.	Similar to old law except realized capital gains may be allocated to unit holders. Unallocated capital gains taxed at 25%, tax refunded as units redeemed. Gains on redemption of units treated as capital gains to unit holders.
Co-operatives (including caisses populaires and credit unions)	New co-operatives exempt from tax for first three years.	Three-year tax exemption is withdrawn.
	Income for tax purposes reduced by patronage dividend with limit that taxable income must at least equal the excess of 3% of capital employed over interest paid, other than to banks or credit unions.	Patronage dividends can reduce income to 5%.
	Caisses populaires and credit unions are now exempt from tax.	Caisses populaires and credit unions to be taxed in way similar to co-operatives.
Investment income of clubs and other non-profit organizations	Certain non-profit organizations such as golf clubs, professional associations and trade and business associations, are now tax-exempt on all income.	Investment income in excess of $2,000 of certain social and recreational clubs will be taxable.

PROPERTY INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to bill.	Similar to bill.	Unincorporated mutual funds will be treated as CHCs or WHCs.
Approved White Paper proposal.	Recommended further study.	Withdraw three-year exemptions.
Half integration rules should apply to taxable patronage dividends paid out of taxed earnings. Small business incentives should apply to eligible co-operatives.		Increase interest rate to reasonable market level. Interest deductions for patronage dividend limitations include only interest on loans from members.
Similar to bill.		Caisses populaires and credit unions to be taxed as co-operatives.
Suggested further study.	Only net investment income in excess of $5,000 should be taxed. Complete exemption should be given for organizations that are better classified as charitable organizations.	Full taxation of investment income.

ITEM	OLD LAW	NEW BILL
FOREIGN-SOURCE INCOME OF CANADIANS		
Foreign tax credits	Foreign income taxes paid are deductible from Canadian tax up to the effective Canadian tax on the foreign income.	Similar to old law except that after 1975 foreign tax credit on investment income of individuals is limited to 15%. Excess over 15% will be a deductible expense.
	No provision.	If foreign taxes paid on business income exceed the foreign tax credit available, the excess can be carried forward for up to five years.
Taxes paid to political subdivisions	No provision.	Foreign income taxes paid to political subdivisions either deductible as an expense or included in foreign tax credit calculations, depending on circumstances.
Dividends from foreign affiliates	Dividends received by a Canadian corporation from a foreign affiliate are exempt from tax.	Dividends out of pre-1976 earnings exempt from tax.
		Dividends out of post-1975 earnings exempt if paid out of profits earned in a treaty country; if from non-treaty country, wholly or partially exempt depending on level of foreign taxes.
Grandfather clause		Non-exempt dividends received after 1975 may be treated as a return of capital to the extent of the cost basis of the shares of the foreign affiliate at the end of 1975.
		For projects undertaken by the end of 1975 relief will be given on dividends for taxes spared under incentive legislation of developing countries.
Passive income	No provision.	After 1972, Canadian shareholders of a foreign affiliate will be required to include in income their share of the affiliate's investment income and capital gains for the year.
Foreign business corporations	Exempt from tax.	Exemption reduced to 4/5 of taxable business income in 1972, 3/5 in 1973, and so on until eliminated in 1976 and subsequent years.
	Dividends paid by these corporations are not eligible for the dividend tax credit.	Dividends paid after 1971 are eligible for the revised dividend tax credit.
TAXATION OF NON-RESIDENTS		
Withholding Tax	Standard withholding tax on investment income paid to non-residents is 15%.	Beginning 1976 standard rate increased to 25%, lower rates by treaty.
	Dividends paid to non-residents by a corporation with a degree of Canadian ownership are subject to a 10% withholding tax.	Withholding tax rate continues to be 5% less than rate otherwise applicable.

INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to White Paper.	Retain old law.	Similar to bill.
Similar to bill.	Similar to bill.	Similar to bill.
Same as White Paper.	Same as White Paper.	To be covered by tax treaties on a reciprocal basis.
Similar to bill.	No change from old law.	Similar to bill except that the date was the end of 1973.
Similar to bill.		Similar to bill.
No provision.	No provision.	No provision.
Similar to bill.	No provision.	No provision.
Restrict passive income rules to diverted income.	Rejected White Paper proposal, but recommended that old law be applied more strictly to curb abuses. Should help Canadian exporters.	Similar to bill except that passive income included "trans-shipment profits".
Similar to bill.	Similar to bill.	Similar to bill.
Similar to bill.	Retain old law and eliminate withholding taxes on interest payments to arms-length foreign lenders.	Similar to bill except that January 1, 1974 suggested date for increase.
No comment.	Similar to bill.	No comment.

ITEM	OLD LAW	NEW BILL
Pension and similar payments	No withholding tax.	Subject to withholding tax. Exemption for $960 of old age security payments and up to $1290 annually of Canada or Quebec Pension Plan payments. Alternatively, non-resident may elect to pay tax on his Canadian income, other than investment income.
Canadian branch of foreign corporation	Pays a special 15% tax on after-tax branch profits, to the extent these are not re-invested in capital assets.	Beginning 1976, rate of tax 25% subject to treaty reduction. Allowance for reinvestment extended to working capital, made cumulative and subject to recapture.
Thin capitalization	No provision.	If the ratio of shareholders' equity to debt due to non-resident shareholders who have a 25% interest in the corporation is less than 1:3, part of the interest paid is not allowed as a deduction.
Non-resident owned investment corporations (NROs)	Taxed at 15%.	Income includes full capital gains that are taxable to non-residents, but not other gains. Beginning in 1976 tax increases to 25%.
	No withholding tax on dividends.	Dividends out of post-1971 earnings subject to normal withholding tax. The income taxes paid on earnings (only one-half of tax on capital gains) refunded to the corporation.
Capital gains	Capital gains are not taxable.	Non-residents are taxable on gains from Canadian real property, Canadian business assets, shares of Canadian private corporations and substantial interests of Canadian public corporations.

INCOME

COMMONS REPORT	SENATE REPORT	WHITE PAPER
Similar to bill without exemption.	Rate should be 15%.	Similar to bill without exemption.
Similar to bill.	Similar to bill.	Similar to bill.
Similar to bill.	Rate should continue at 15%.	Similar to bill.
Similar to bill.	Similar to bill.	Similar to bill.
Taxation of NROs should be equivalent to the tax paid by corporation's sharehol-ders if they had personally received the income.	Retain old law.	Similar to bill except that increase in rate would take place in 1974. Same as old law.
Similar to bill.	Capital gains realized by non-residents should be exempt from tax, unless gain is related to a business carried on in Canada.	Similar to bill.