# Account of the Cost of Selective Tax Measures

August 1985



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# Executive Summary

## Introduction

A number of provisions in federal tax law give special tax treatment to selected individuals and groups in society. In some cases, this treatment is tied to particular sources of income (for example, the pension income deduction). In other cases, the preferential tax treatment is provided in respect of particular uses to which taxpayers put their income (such as savings in registered retirement savings plans or purchases of goods exempt from sales tax). Finally, a number of tax measures are based on specific characteristics of taxpayers themselves (for example, the disability deduction). In all cases, then, these provisions are selective in their application and are thus referred to in this account as "selective tax measures".

Selective tax measures generally take the form of tax exemptions, deductions, credits, reduced tax rates or tax deferrals. They are a means by which the federal government can pursue public policy goals. They are used to encourage economic and social activities such as saving, investment, regional development, housing, resource exploration and development, and donations to charities. They provide aid to the disabled, the elderly and those with large medical expenses.

This account is a catalogue of selective measures that exist in the federal income and commodity tax systems. Its purpose is to provide an accessible and comprehensive information source on the value of selective tax measures. The published tables identify each tax measure and, where it can be reliably estimated, the approximate amount of tax revenue forgone.

Estimates are provided for the years 1979 to 1983 for personal and commodity tax measures and 1979 to 1982 for corporate income tax provisions. The figures provided in the tables are subject to a number of important caveats and qualifications. These are discussed in brief below and in more detail in the account.

This account covers changes to the tax system introduced up to and including the November 1984 Economic and Fiscal Statement. Changes announced in the May 1985 budget are not included. No values are included for the more recent measures given that estimates are provided only to 1983 for personal and commodity tax measures, and to 1982 for corporate tax provisions. A description of each of the changes since 1980 is provided in the appendices, and the question of how some of the major new items are to be included in the account is treated in the methodology section.

For the most part, this document is an update of the accounts published in 1979 and 1980. Although the basic approach to the identification and measurement of selective tax measures has been preserved from the previous accounts, there are nevertheless some important conceptual and methodological changes that have been incorporated into this account. These changes are summarized below and explored in greater detail in the main text of the account.

Accounts of the cost of selective tax measures have become quite common in recent years, both within Canada and internationally. Accounts are now published regularly in a number of countries, including the United States, the United Kingdom, West Germany, Spain, Austria, France, Australia, Portugal and Ireland. In addition, in Canada, provincial government accounts of selective tax measures have been published for Saskatchewan, Quebec, and British Columbia.

As emphasized in the 1979 and 1980 accounts, it is important to note that ***an accounting of selective tax measures is not an evaluation of government tax policy. The accounting does not question the desirability of the goals of the tax provisions nor their effectiveness in achieving the goals. It is not a list of tax loopholes or areas for tax reform. It is simply an accounting of the cost to the federal government of these tax measures.***

It should be noted that the selective tax measures identified in this account are confined to those tax measures provided through the federal individual and corporate income taxes, the sales and excise taxes, and the special oil and gas taxes. It does not cover any provisions that may be embodied in other federal legislation such as the customs tariff, social security taxes under the Canada Pension Plan or the unemployment insurance program, or those arising out of various Canadian tax treaties with other countries. Nor does it cover provincial tax measures or the provincial tax revenue forgone due to federal tax provisions.

## Defining Selective Tax Measures

The approach used to define selective tax measures, which is discussed in detail in the account, is generally as follows: first, a benchmark tax structure is formulated, based on certain general criteria; second, any deviations from this system are identified in the account.

The benchmark tax structure is mainly based on the concept of *neutrality*. Essentially, this criterion implies that under the benchmark tax structure no differential tax treatment is given on the basis of any special circumstances applicable only to a particular group of taxpayers. As applied to income tax, this criterion is basically analogous to the concept of horizontal equity – that is, that taxpayers in similar circumstances should pay the same amount of tax. In the case of commodity taxes, the neutrality criterion implies that under the benchmark system, all consumers face the same rate of tax on all purchases of final goods.

In certain cases, the strict application of the neutrality criterion would imply a benchmark system that departs dramatically from the present system. The information on selective tax measures identified using such a benchmark would therefore not be useful in policy analysis. In these cases, on grounds of *pragmatism*, the benchmark structure is assumed to resemble the current system.

In general, *partial or ad hoc* provisions are regarded as selective tax measures. So too are provisions that are clearly *functionally equivalent* to direct spending programs, even though they may be neutral for all taxpayers. The main example here is the abatement of personal and corporate income taxes to the provinces as part of a system of transfers to finance social policies. Finally, where there is uncertainty over the appropriate treatment of a tax provision, the item is included in the account, either as a selective tax measure or as a separate item in an annex to the main table (called the memorandum items section of the account). This section includes items that are not selective tax measures but whose inclusion is warranted for informational purposes.

Although the basic approach used in this account to identify selective tax measures is unchanged from the 1979 and 1980 accounts, there are a few noteworthy revisions. Of particular note is the change in the treatment of certain provisions that are intended to provide for a degree of integration between the personal and corporate income tax systems. These include the dividend gross-up and tax credit, the refund of tax on investment income flowed through private corporations, and the various deductions and refunds provided to investment corporations. Since the purpose of these provisions is to integrate the personal and corporate tax systems, and hence to enhance the neutrality of the tax system as a whole, these measures are not regarded as selective tax measures in this account. Nevertheless, for purposes of information, their values are included as memorandum items in the tables.

A second significant change from prior accounts concerns the non-taxation of imputed income from owner-occupied homes. The previous accounts took the position that the non-taxation of this imputed income constituted a deviation from neutrality, and hence, a selective tax measure. However, such imputed income is universally viewed as not being a source of funds that should or could feasibly be subject to tax. Thus, in this account, the non-taxation of imputed rent is considered to be part of the benchmark tax structure and not a selective tax measure. It may be noted that, for the same reasons, this item is not included in the United States' account.

Finally, changes have been made in this account in the treatment of unemployment insurance premiums and Canada and Quebec Pension Plan contributions. In the 1979 and 1980 accounts, these were treated as selective tax measures. In this latest account, they are regarded as part of the benchmark tax structure, although information on revenue forgone due to these deductions is included in the memorandum items section of Table 1.

## Estimating Selective Tax Measures

The account incorporates a number of significant methodological changes in the computation of selective tax measures. First, the development of a corporate tax microsimulation model has permitted a much more rigorous and detailed analysis of the selective tax measures available to corporations. Second, changes have been made to the estimating methodologies used in computing several personal income tax items, including the non-taxation of capital gains on principal residences and the tax advantage of savings in registered pension plans (RPPs) and registered retirement savings plans (RRSPs). Finally, significant improvements have been made in the computation techniques and data sources used in evaluating many of the commodity tax exemptions. As a result, the values for several selective tax measures have been substantially revised from those in previous accounts.

The increased information on corporate income tax measures has also enabled the breakdown of these items by industry. As well, additional information on the use of selective tax measures by corporations that have current year tax losses has permitted the presentation of "lower bound" and "upper bound" values. Both the lower bound and upper bound values include the current year federal tax savings for the firm from the use of selective tax measures together with those tax savings resulting from the carry-back to previous years of losses that arise from selective tax measures. However, the lower bound estimate attributes no value to losses that are available to be carried forward to future years. On the other hand, the upper bound value assumes that such carry-forwards are fully utilized in the future. Given that, in fact, some firms will have sufficient taxable income in the future to make full use of their carry-forwards while others will not, the lower bound value tends to underestimate the tax revenue forgone due to the use of each selective tax measure, while the upper bound value tends to overestimate it.

With respect to the estimation technique used in the account, one important aspect is that each selective tax measure is estimated at the margin – that is, assuming that all other provisions remain in effect. The selective tax measure is assumed not to exist and the resulting extra taxes are determined using the applicable marginal tax rate of the individual or corporation. This "marginal" approach is appropriate when information is being sought about the federal revenue value of a particular item. But it is important to note that the approach may yield different estimates of revenue forgone if it is assumed that two or more selective tax measures are removed simultaneously.

For example, in the personal income tax system, a tax filer typically will claim a number of tax exemptions and deductions. The overall effect of claiming all of these deductions can be to push the taxpayer into a lower tax bracket than would have been the case had none of the deductions existed. Under the marginal approach, each measure is valued at the marginal tax rate the taxpayer faces when all other tax provisions are in effect (i.e., at the lower tax rate). However, in estimating the total impact of all selective tax measures taken together, it would be necessary to take into consideration that, without any of the tax exemptions or deductions, the individual could be in a higher tax bracket. For this reason, the total effect of all the selective tax measures in the personal income tax system taken together will be greater than the sum of the estimates for the individual items presented in the account.

## Using the Tables: Cautions and Caveats

***The quantitative estimates of federal selective tax measures in the tables should be used with caution.*** The reasons for this are summarized in the following points.

First, the estimates are based on the assumption that the removal of a provision would not affect taxpayer behaviour. Often, the removal of a selective tax measure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay. This would result in smaller increases in revenue than are implied by the estimates given in the tables.

Second, the estimates of the value of a provision do not take into account the effect on the overall level of economic activity of removing a selective tax measure. This could be quite significant in the case of a major tax provision. If the removal of a selective tax measure entailed a negative impact on output and incomes in the economy, the federal tax revenue effect would be smaller than otherwise. In this respect, the estimates in the account may be overstated.

Third, for many items, significant data constraints, particularly with regard to the most recent years, prevent the accurate estimation of the revenue forgone as a result of the provision. Where possible, values have been estimated based on the available information, but, in these cases, it should be noted that the estimates are subject to wide margins of error. In addition, there are a number of items for which the available data were not sufficient to permit any reasonably accurate estimation of the selective tax measure. Although many of the omitted amounts are likely relatively small in value, there may be cases where the non-quantified items are quite significant (for example, cash accounting for farmers).

Fourth, the individual selective tax measure values cannot be added together to produce a meaningful value representing the total value of all selective tax measures in the Canadian tax system, or those given to one sector. This results from:

- the fact that the estimating technique used in valuing selective tax measures does not reflect the additional revenue forgone due to the interaction of provisions, as described above;
- the wide margins of error of some estimates (which could be all biased in the same direction);
- the non-availability of estimates for several items, some of which could be very significant; and
- the fact that the simultaneous elimination of all selective tax measures would likely have significant macroeconomic implications which would have an additional impact on government revenue collections.

In addition to these points, ***it must be emphasized that the definition of the benchmark tax structure, and hence the identification of selective tax measures, is in many instances an arbitrary exercise.*** There are several examples where provisions are included in the account for reasons of comprehensiveness where their categorization as selective tax measures may be debatable. The inclusion of each of these "debatable" items in the account is supportable given the informational intent of the account, and on an item-by-item basis readers may choose to reject or accept the arguments put forth for their inclusion as selective tax measures. However, given the somewhat arbitrary nature of the benchmark system in these areas, any value representing the grand total of all selective tax measures would not be meaningful.

Fifth, in considering the value of any particular item, it is important to note that the value to the taxpayer of a dollar of tax preference is often worth substantially more than a dollar of direct spending. This results from the fact that, while all selective tax measures directly increase after-tax income of taxpayers by the amount of revenue forgone, government grants are generally taxable to the recipients or reduce the value of a deductible expense. Thus, the value to the taxpayer of a dollar of tax reduction may be one and one-half to two times the value of a dollar of direct spending.

Sixth, it is important to note that the values in the tables refer to *federal* revenue costs from selective tax measures. Due to the federal-provincial tax collection agreements, there is typically an associated amount of provincial revenue forgone in the case of individual and corporate income tax provisions.

Given the above-mentioned qualifications and caveats, it is nevertheless clear from the tables that there are a significant number of selective tax measures and their estimated values are, in some instances, quite large.

It is also apparent that the values of many selective tax measures have been growing in amount. This growth can be attributed in large measure to the growth in the taxpayer population and in economic activity. At the same time, values have declined for a number of selective tax measures, particularly in the corporate income tax system. This is primarily due to the downturn in the Canadian economy in 1981 and 1982 and, hence, the inability of corporations to make use of the available deductions.

During the period covered by the tables, there were a number of changes to the Canadian tax system that have had an impact on the values of selective tax measures. In particular, effective from 1982, the schedule of personal marginal tax rates was reduced, particularly at higher income levels. This general change to the tax structure had the effect of reducing the value of personal income tax exemptions and deductions.

Amendments were also made to a number of selective tax measures. These include, among others, the modification of the treatment of interest-free loans provided to employees, the elimination of income-averaging annuity contracts (IAACs) and the phasing-out of multiple unit residential buildings (MURBs). The changes to each of the selective tax measures are discussed individually in the appendices of the account.

The selective tax measures have been grouped in the tables according to the functional categories that are used in the Public Accounts of Canada. Corporate income tax provisions, the majority of which fall under the economic development and support category, are grouped by industry.

As an example of the use of the account, consider the following item from the table on selective tax measures under the personal income tax system:

> In Table 1, under the health and welfare category, is an item entitled, "Tax advantage on savings in registered pension plans (RPPs) and registered retirement savings plans (RRSPs)." The value of this item rose from $2.95 billion in 1979 to $4.9 billion in 1983.
>
> The description of this selective tax measure in Appendix 1 notes that both individuals and employers on their behalf can make tax-deductible contributions to RPPs. In addition, employees and self-employed persons can make tax-deductible contributions to RRSPs. Such deductions are generally subject to annual limits. The income earned in these plans accumulates free of tax until paid out of the plans. These arrangements allow a deferral of income tax equivalent to an interest-free loan to the taxpayer.
>
> If this item did not exist, the federal government would have obtained another $4.9 billion in individual income tax revenue in 1983 if the following conditions were met: taxpayer savings behaviour was no different; the economy was unaffected; and all other tax provisions remained in place. To the extent that some of these conditions would not be met, a different amount of extra tax revenue could have been collected.

# I. Introduction

A number of provisions in federal tax law give special tax treatment to selected individuals and groups in society. In some cases, this treatment is tied to particular sources of income (for example, the pension income deduction). In other cases, the preferential tax treatment is provided in respect of particular uses to which taxpayers put their income (such as savings in registered retirement savings plans or purchases of goods exempt from sales tax). Finally, a number of tax measures are based on specific characteristics of taxpayers themselves (for example, the disability deduction). In all cases, then, these provisions are selective in their application and are thus referred to in this account as "selective tax measures".

Selective tax measures generally take the form of tax exemptions, deductions, credits, reduced tax rates or tax deferrals. They are a means by which the federal government can pursue public policy goals. They are used to encourage economic and social activities such as saving, investment, regional development, housing, resource exploration and development, and donations to charities. They provide aid to the disabled, the elderly and those with large medical expenses.

This account is a catalogue of selective tax measures that exist in the federal income and commodity tax systems. Its purpose is to provide an accessible and comprehensive information source on selective tax measures. It provides the most recent estimates of the revenue cost of selective tax measures. Values are provided for the years 1979 to 1983 for the personal and commodity tax systems and 1979 to 1982 for the corporate income tax items. The figures provided in the tables are subject to a number of important caveats and qualifications. These are discussed in Section 4 of the text.

The basic framework for identifying and measuring selective tax measures that was used in the 1979 and 1980 accounts[1] has been retained in the preparation of this account. However, there have been some important changes both in the approach employed to identify selective tax measures and in the methodologies used in estimating the value of the tax provisions.

With regard to the identification of selective tax measures, there are a few changes in the treatment of certain items from the approach used in the 1979 and 1980 accounts. Specifically, the dividend tax credit, the refund of tax on the investment income of private corporations, and the deductibility of unemployment insurance premiums and Canada and Quebec Pension Plan contributions are not regarded as selective tax measures in this account. However, for informational purposes, the values of these provisions are included as memorandum items in separate annexes to the main tables. In addition, for informational purposes, the revenue cost of certain provisions not covered in previous accounts is included in the memorandum items section.

With respect to the methodologies used in estimating the values of selective tax measures, a number of significant changes have been incorporated into this account. First, the development of a corporate tax microsimulation model has permitted a much more rigorous and detailed analysis of the selective measures available to the corporate sector. Second, changes have been made to the estimating methodologies used in computing values for several personal income tax items, including the non-taxation of capital gains on principal residences and the tax advantage of savings in registered pension plans (RPPs) and registered retirement savings plans (RRSPs). Finally, significant improvements have been made in the computation techniques and data sources used in evaluating many of the commodity tax exemptions. Where the value for a selective tax measure has been significantly altered by a change in the estimating procedure, the new methodology is outlined in the description of the specific item in the appendices.

The account also describes the changes to the tax system that have been implemented since the publication of the last account and discusses how these provisions should be incorporated into the analysis of selective tax measures. The changes to the tax system since 1980, up to and including the November 1984 Economic and Fiscal Statement, are contained in this account. The more recent measures, of course, do not have a revenue impact for the years for which estimates are provided in the account.

Most of the changes to the tax system that have been announced since the publication of the last account have involved fairly straightforward modifications to existing tax provisions. Any such changes are described separately for each item in the appendices to the account. However, a number of the recently introduced tax changes are more fundamental in nature, consisting either of new provisions or significant qualitative changes to the scope of the provision. In these cases, the question of how these items should be incorporated into the account (i.e., as part of or as changes to the benchmark structure or as selective tax measures) is addressed in Section 3 of the text, which discusses the benchmark tax structures for the personal, corporate and commodity tax systems.

Accounts of the cost of selective tax measures have become quite common in recent years, both within Canada and internationally. Accounts are now published regularly in a number of countries, including the United States, the United Kingdom, West Germany, Spain, Austria, France, Australia, Portugal and Ireland. In addition, in Canada, provincial government accounts of selective tax measures have been published for Saskatchewan, Quebec, and British Columbia.

As emphasized in previous accounts, it is important to note that ***an accounting of selective tax measures is not an evaluation of government tax policy. The accounting does not question the desirability of the goals of the tax provisions nor their effectiveness in achieving the goals. It is not a list of tax loopholes or areas for tax reform. It is simply an accounting of the cost to the federal government of these tax measures.***

This account is confined to selective tax measures provided through the federal individual and corporate income taxes, sales and excise taxes, and the special oil and gas taxes. It does not cover any tax provisions that are embodied in other federal legislation such as the customs tariff, social security taxes under the Canada Pension Plan or the unemployment insurance program, or those arising out of various Canadian tax treaties with other countries. Nor does it cover provincial tax measures or the provincial tax revenues forgone due to federal tax provisions.

# II. General Criteria for Defining Selective Tax Measures

The identification of selective tax measures requires the definition of a benchmark or normal tax structure, deviations from which are classified as selective tax measures.

The criteria used in defining the benchmark tax structures and identifying selective tax measures are briefly described below. These criteria are the same as those used for the 1979 and 1980 accounts.

(i) The principal criterion used in the analysis is *neutrality*. Essentially, this criterion implies that under the benchmark tax structure no differential tax treatment is given on the basis of any special circumstances applicable only to a particular group of taxpayers. As applied to income tax, this criterion is basically analogous to the concept of horizontal equity – that is, that taxpayers in similar circumstances should pay the same amount of tax. The variation in tax rates from lower to higher incomes to achieve vertical equity is, however, considered to be part of the benchmark system.

In the case of commodity taxes, the neutrality criterion implies that under the benchmark system, all consumers face the same rate of tax on all final purchases of goods.

(ii) In certain cases, the strict application of the neutrality criterion may imply a benchmark system which departs dramatically from the present system. The information on selective tax measures that were identified on the basis of such a benchmark would therefore not be useful in policy analysis. In these cases, on grounds of *pragmatism*, the benchmark structure is assumed to resemble the current system even though this might not completely satisfy the neutrality criterion.

(iii) In relation to the above, *partial or ad hoc provisions* are included in the account even if their objective may be to make the present system more neutral.

(iv) A tax provision that is clearly *functionally equivalent* to a direct spending program is classified as a selective tax measure even though it may be neutral for all taxpayers. The main example here is the abatement of personal and corporate income taxes to the provinces in lieu of federal grants for cost-shared programs.

(v) Finally, for a number of tax provisions there is a significant degree of uncertainty over whether the specific item should or should not be regarded as a selective tax measure. In these cases, given that the intent of the account is to provide information on the operation of the tax system, the analysis errs on the side of *comprehensiveness* and includes the item in the account, either as a selective tax measure or, in some instances, as a memorandum item.

These criteria are similar to those used in other countries. For example, the United States' studies define tax expenditures as deviations from a "generally accepted structure of an income tax". Although this criterion usually coincides with the criteria of neutrality and pragmatism which dominate our analysis, some differences do arise. For example, the exemption for dependent children is classified as a selective tax measure in Canada on the grounds of non-neutrality but is considered in the U.S. analysis as part of their "generally accepted tax structure". Nevertheless, while there are some variations in the definitions and concepts used in other countries' analyses, the overall approaches employed are quite similar.

# III. Definition of Benchmark Tax Structures

A number of important conceptual issues arise in the process of defining the benchmark tax structures by applying these general criteria to specific tax provisions. These issues, and those that have arisen in incorporating new tax measures into this analysis, are reviewed in this section. First, general issues dealing with more than one of the personal, corporate, and commodity tax benchmark systems are outlined. Subsequently, features specific to each of the three benchmark systems are set out separately.

## A. General Issues

### 1. Treatment of Integration of Personal and Corporate Income Taxes

One major conceptual issue that arises in the identification of selective tax measures concerns the integration of the personal and corporate income tax systems. This issue is really an element of the general question of the definition of the tax unit – that is, whether corporations and individuals should be viewed as separate tax units under the benchmark system.

It may be argued that the strict application of the neutrality criterion would imply that corporate source income should be allocated to individual shareholders and taxed in their hands at the same rates as income from other sources. Under this view, the benchmark tax structure would assume the full integration of the corporate and individual income tax systems.

However, under the current tax and accounting systems, corporations and individuals are basically treated as distinct entities. For this reason, a fully integrated benchmark system would depart considerably from the current tax structure, and the selective tax measures delineated under such a benchmark would be both limited in their usefulness and very difficult to estimate reliably.

On the other hand, the assumption of complete separation of the personal and corporate systems for purposes of the benchmark tax structure would also give rise to anomalous results. For example, under this approach, any measures providing tax relief at the individual level for corporate taxes paid, such as the dividend gross-up and tax credit, and the refund of Part I tax on the investment income of private corporations, would be regarded as selective tax measures, even though they may serve to enhance the neutrality of the tax system as a whole.

In previous accounts, on grounds of pragmatism, the complete separation of the personal and corporate tax systems was chosen as the benchmark and, hence, provisions such as the dividend tax credit were regarded as selective tax measures.

In contrast, this account assumes that provisions which provide for integration are part of the benchmark tax structure. Consequently, the dividend gross-up and tax credit, the refund of tax on investment income flowed through private corporations and the various deductions and refunds provided to investment corporations are not regarded as selective tax measures in this account.(2) Nevertheless, for informational purposes, the values of these provisions are included as memorandum items in the account.

One significant development in this area since the publication of the last account has been the introduction of the dividend distribution tax. This tax serves to bring the amount of taxes paid by small corporations into line with the value of the dividend tax credit claimed by their shareholders. With regard to the incorporation of this item into the account, as the dividend distribution tax is effectively a mechanism of integration, it should be treated in a fashion similar to the dividend tax credit. Consequently, in future accounts, the revenues collected under the dividend distribution tax will be included as a memorandum item in the table of corporate tax measures. Since estimates for corporate tax measures are provided only to 1982, and the dividend distribution tax became effective only in 1983, values for this tax are not included in this account.

## 2. Annual Accounting Period

As in past accounts, this account assumes an annual accounting period. As a result, any reductions in tax revenues due to deferral or averaging provisions are considered to be selective tax measures.

A question arises concerning the appropriate treatment of the forward averaging provision. In past accounts, the former general averaging provision was considered to be a selective tax measure because it constituted a departure from the annual accounting period and because it provided preferential treatment to a particular group of taxpayers, that is, those with rapidly increasing incomes. The treatment of the forward averaging provision presents certain difficulties. On the one hand forward averaging can be viewed as a selective tax measure in that it departs from the annual accounting benchmark, is discretionary in nature, and benefits a particular group of taxpayers (those with fluctuating incomes). On the other hand, the forward averaging provision in many cases enhances neutrality over the longer run and can be viewed as a necessary complement to the choice of an annual accounting period in the benchmark tax structure. Nevertheless, on grounds of comprehensiveness, the forward averaging provision is considered to be a selective tax measure.

## 3. Treatment of Inflation

The neutrality criterion implies that the tax base of the benchmark tax system should ideally be real income. For example, the portion of the nominal return on an investment which represents a compensation for the inflation-caused decline in the real value of an asset does not add to an individual recipient's command over resources and should not therefore be included as income under the benchmark tax structure. However, the individual and corporate income tax systems have historically been based on nominal income. For pragmatic purposes, in order not to depart too dramatically from the public perception of the current tax system, the individual and corporate income tax bases under the respective benchmark tax structures are considered to be nominal, rather than real, income.

There are a number of provisions which are intended to adjust for the effects of inflation on the tax system. The most prominent of these is the indexing of personal exemptions and income tax brackets. Where the indexing adjustment is applied to exemptions that are classified as selective tax measures, such as the marital exemption, indexing simply increases the values of the relevant tax measures included in the account. With respect to the indexing of the brackets, such adjustments alter the threshold levels at which the various marginal tax rates become effective. As the tax brackets and rates are part of the benchmark system, the indexing of the brackets does not represent a selective tax measure. Following this reasoning, the value of indexation does not appear as a separate item in this account.

Other mechanisms which are intended to adjust for the effects of inflation on the tax system include the inventory valuation adjustment, the $1,000 investment income deduction, and the indexed securities investment plan (ISIP). While the purpose of these measures is to adjust for inflation (and thereby enhance neutrality), these provisions generally attempt to redefine income for tax purposes on an *ad hoc* basis rather than systematically adjusting the basic tax structure. As such, these items are classified as selective tax measures in the account.

## 4. Federal-Provincial Fiscal Arrangements

In a number of instances, federal direct expenditures on certain cost-shared programs with the provincial governments have been partially replaced by federal income tax abatements to the provinces.

The main item of note in this regard concerns the transfers of tax points to all the provinces which took effect in 1967 to replace federal payments to provinces for post-secondary education, and then again in 1977 in lieu of federal payments for hospital insurance and medical care. In addition to these general tax transfers to the provinces, there is a special federal income tax abatement for Quebec residents which is provided as a substitute for direct federal contributions under various shared-cost programs. Both these tax point transfers are functionally equivalent to direct spending and therefore are classified as selective tax measures under the functional equivalence criterion.

One further point concerning federal-provincial fiscal arrangements is that the provinces that have signed tax collection agreements with the federal government define their individual and corporate income tax in terms of federal income tax payable. (Quebec does not participate in the agreements for either the individual or the corporate income tax while Ontario and Alberta do not participate in the agreements for the corporate income tax.) As a result, most federal income tax provisions automatically result in revenue changes for those provinces party to the tax collection agreements. It is important to note that the dollar values of the various selective tax measures shown in the account refer to *federal* revenue costs only. The total savings to taxpayers from the selective tax measures are typically from 40 to 60 per cent higher for individuals and about one-third higher for corporations, depending on the province of residence of the taxpayer.

## 5. Treatment of Losses

As noted in past accounts, the income tax treatment of losses under the benchmark tax structure raises some fundamental conceptual questions. Although the present carry-forward and carry-back provisions do not provide for complete neutrality among taxpayers, they are, for pragmatic reasons, assumed to be part of the benchmark tax system.

A number of significant changes in the treatment of corporations with losses were introduced in the April 1983 budget. First, the general carry-back and carry-forward time limits were lengthened to three years and seven years respectively. Given that the carry-over of losses is allowed under the benchmark system, this modification to the limits is treated merely as a change in the benchmark tax structure and does not constitute a selective tax measure.

Second, the April 1983 budget introduced a number of changes concerning the carry-back, refundability, and flow-through to investors (through share purchase tax credits) of the investment tax credit (ITC). These changes are discussed in the description of the ITC provision in the appendix. Since the full amount of the ITC is considered to be a selective tax measure, these changes, which permit greater use of the credit by firms with losses, are treated simply as an increase in the revenue cost of the provision.

Third, the introduction of scientific research tax credits (SRTCs) permitted the flow-through of tax benefits to investors in firms which engaged in scientific research. These credits are of primary benefit to investors in corporations which do not currently have taxable income. Under this provision, firms were allowed to forgo deducting R&D expenses and claiming R&D tax credits and, instead, transfer the tax incentives to investors in the form of a tax credit. Given that corporations and shareholders are treated as separate entities under the benchmark tax system, the entire SRTC is considered to constitute a selective tax measure to shareholders, notwithstanding that only a portion of the fast write-off of R&D expenses, which the SRTC is provided in lieu of, would be treated as a selective tax measure at the corporation level.[(3)] More recently, a moratorium on certain quick-flip transactions was imposed in October 1984 and subsequently SRTCs were eliminated in the May 1985 budget.

## 6. Other Taxes

In addition to the personal and corporate income taxes and the federal sales and excise taxes, the Government of Canada also levies a number of other specific taxes. One area of note in this regard concerns the range of taxes levied on the oil and gas sector. The National Energy Program involved the introduction of a number of new taxes including the Natural Gas and Gas Liquids Tax (NGGLT), the Petroleum and Gas Revenue Tax (PGRT) and the Canadian Ownership Special Charge (COSC). Subsequent energy agreements with the provinces provided for the introduction of the Incremental Oil Revenue Tax (IORT). Each of these taxes has been modified from time to time over the period covered by this account, and more recently, these taxes have been ended or are being phased out.

The treatment of these taxes in the account presents certain conceptual difficulties. These taxes can be viewed as entirely separate from the income and commodity tax systems each with its own benchmark structure. As such, any exclusions from the general application of each of these energy taxes – for example, preferences for certain affected groups or particular kinds of production – could be considered to be selective tax measures. Alternatively, some of these taxes could be viewed as measures to offset or limit the revenue cost of other tax incentives provided to the energy sector. For example, the Incremental Oil Revenue Tax has the effect of limiting the deduction of incentive write-offs against a part of incremental revenue derived by the oil producers from higher prices. Under this scenario, the value of the other selective tax measures would be reduced by these taxes. Finally, these taxes can simply be considered to be deviations from the benchmark tax structure, as they apply to only one sector of the economy, and thus constitute tax penalties.

Since the purpose of the account is foremost to provide information, estimates are provided in the memorandum section of the account of the values of the revenues collected under these taxes, and the value of the exclusions from these taxes. Descriptions of each of these provisions are included in the appendices.

A second issue regarding the treatment of other taxes in the account concerns the appropriate rate of withholding tax on payments to non-residents. In the majority of cases, the withholding tax rates are specified in tax treaties with foreign countries. Because this account does not attempt to identify any selective measures embodied in any tax treaties with other countries, the withholding tax rate determined in the treaty is considered in such instances to be the benchmark rate. In other cases, the basic withholding tax rate of 25 per cent applies. Under this definition of the benchmark system, selective tax measures arise where there have been unilateral reductions in the rate of withholding tax, not pursuant to any treaty. Examples include the exemption for interest on long-term corporate debt and foreign currency deposits.

## B. Individual Income Tax

This section describes certain features that specifically relate to the benchmark tax structure for the individual income tax. It covers issues relating to the tax base and the tax unit and the treatment of various credits and marginal tax rate reductions under the benchmark structure.

## 1. Tax Base

Since the personal income tax is imposed on income, the neutrality criterion implies the use of a comprehensive income tax base under the benchmark system that does not discriminate among taxpayers with differing sources of income. Provisions which allow for the exclusion of certain kinds of income or special deductions from income are therefore classified as selective tax measures. It is important to note that the comprehensive individual income tax base refers to net, rather than gross, income. Thus, no selective tax measures are deemed to arise in respect of deductions for costs of earning income.

Deviations from the comprehensive income tax base are the source of a substantial number of selective tax measures. Some of the more obvious ones over the period of this study include: the exemption of one-half of capital gains, the non-taxation of capital gains on owner-occupied dwellings, the exclusion of the first $1,000 of investment and pension income, and the deductibility of charitable and medical expenses and contributions to registered home ownership savings plans (RHOSPs).

One significant change that has been incorporated in this account relates to the non-taxation of imputed income from owner-occupied homes. The previous accounts took the position that the non-taxation of this imputed income constituted a deviation from neutrality, and hence a selective tax measure. However, such imputed income is universally viewed as not being a source of funds that should or could feasibly be subject to tax. Thus, in this account, for pragmatic purposes, the non-taxation of imputed rent is considered to be part of the benchmark tax structure and not a selective tax measure. It is of note that in the U.S. the non-taxation of imputed income on owner-occupied homes is not included in the U.S. government's tax expenditure accounting for the same reasons.

The treatment of gifts and bequests in the account presents some difficulties. As noted in previous accounts, gifts can be treated either as deductible to the donor and taxable to the recipient, as non-deductible to the donor but included in the income of the recipient, or, as neither deductible to the donor nor taxable to the recipient. For pragmatic reasons, this last approach is the one taken in the account.

Conceptual issues also arise in considering the appropriate benchmark treatment of the unemployment insurance program. The program can be viewed as either an insurance plan or as a government transfer program financed by a payroll tax. The 1979 and 1980 accounts noted that under the insurance plan approach, the present system of taxing benefits and allowing the deduction of contributions would not be viewed as a selective tax measure. However, given that participation in the program is mandatory and the link between contributions and program benefits is weak, the account adopted the payroll tax-government transfer characterization of the program. It noted that under this approach, employee contributions would not be deductible as is the case for other taxes, and employer contributions would be treated as taxable benefits. Following this reasoning, the accounts included the deductibility of employee premiums and the non-taxation of employer premiums as a selective tax measure.

Since the publication of the last account, this question has been further examined and the possibility has been raised that under the benchmark system, such payroll taxes would be nonetheless deductible from employees' incomes as legitimate expenses to earn income. This would imply that, as in the approach which treated unemployment insurance as an insurance plan, here too, the current treatment of unemployment insurance contributions and benefits does not constitute a selective tax measure. This account adopts this approach and, accordingly, the current treatment of unemployment insurance contributions is no longer included as a selective tax measure. Nevertheless, for information purposes this item is entered as a memorandum item in the account.

Similar conceptual issues arise in the treatment of Canada Pension and Quebec Pension Plans. These plans can be characterized in two different ways. Under one view, these plans can be regarded as savings plans similar to registered pension plans combined with a transfer element to the extent that at present the benefits paid to retired persons are in excess of their accumulated contributions plus interest earnings. Under this approach, the current system gives rise to a selective tax measure because income tax liability is deferred in respect of the savings element of the plans.

Alternatively, one can take the position that these plans essentially constitute intergenerational transfer programs that produce transfers in each time period from one generation to another. Under this view, whereby CPP and QPP contributions are seen as payroll taxes to pay for current pensions to the elderly, the same issues arise that were raised concerning the treatment of UI premiums, i.e., whether under the benchmark structure these payroll taxes would be non-deductible, as are other taxes, or deductible as a necessary expense to earn employment income.

The appropriate characterization of CPP and QPP raises significant difficulties. First, these plans are generally perceived to be savings vehicles, and indeed it was this viewpoint that past accounts adopted in classifying this item. However, there are features of these plans that make their direct comparison to private pension plans somewhat tenuous. As noted, at present, benefit payments to retired persons are in excess of those that could be funded out of their previous contributions. Thus, in effect, the benefit payments include a transfer element. However, the CPP and QPP funds are not accounted for on this basis. The entire amount of the benefit payment, including this apparent transfer component, is taken from the CPP and QPP funds. (If this transfer element had been taken from the consolidated revenue fund, the CPP and QPP funds would, of course, be much larger.) In these respects, the CPP and QPP more closely fall into the intergenerational tax-transfer characterization.

For these reasons, it is the tax-transfer approach that is taken in this account. As in the case of unemployment insurance, in this account the tax advantages for CPP and QPP contributions are no longer treated as a selective tax measure. However, for informational purposes, the value of the deduction for CPP and QPP contributions is included in the memorandum items section of Table 1.

## 2. Tax Unit

The major question that arises here is whether the individual or the family should be taken as the benchmark tax unit. Although the present system contains elements of both an individual- and a family-based structure, it seems more reasonable to characterize it as fundamentally an individual-based scheme with certain exceptions which provide for family-related factors. To maintain a point of reference to the present system, on grounds of pragmatism, the individual is taken as the benchmark tax unit. Given this choice, the neutrality criterion leads to the classification of the various dependant-related provisions, e.g., exemptions for spouse and dependent children, child tax credit, as selective tax measures.(4)

The appropriate treatment of the child care expense deduction raises certain conceptual issues. On the one hand, this deduction could be viewed as an expense to earn income and therefore deductible under the benchmark structure. On the other hand, child care expenses can be viewed as a personal expenditure for which no deduction would be allowed. Given that the medical expense deduction, which can include similar expenditures such as payments for home care for an invalid dependant, is regarded as a selective tax measure, for consistency, the child care expense deduction is viewed in this account as a selective tax measure as well.(5)

## 3. Tax Rates, Credits, and General Tax Reductions

The neutrality criterion could be taken to imply a uniform tax rate for the benchmark tax system (using, for example, the average rate of tax as the benchmark tax rate). However, this would be such a radical departure from the present system that it is ruled out on grounds of pragmatism. Thus, as in past accounts, the existing tax rate regime is taken as part of the benchmark system. In this regard, the reductions in the marginal tax rates that became effective in 1982 are taken to be merely a change in the benchmark system and do not constitute a selective tax measure.(6)

The basic personal exemption is also treated as part of the benchmark tax structure. This exemption is provided to all filers and can be viewed as an initial level of income which bears a zero rate of tax, and thereby as constituting part of the existing structure of marginal tax rates.

Any broadly-based tax cuts and credits that do not discriminate among taxpayers except on the basis of income level are also assumed to constitute part of the benchmark system. The most obvious example of such a provision is the federal tax reduction. Prior to 1982, the tax reduction was set at 9 per cent of federal taxes payable with a minimum of $200 and a maximum of $500. Since this was a general tax cut, it was considered to form part of the benchmark tax structure. Commencing in 1982, the tax reduction was set at a flat amount of $200 per taxpayer. This flat-rate credit is similarly incorporated into the benchmark system. Under the modified provision, however, any amount of the credit unused by one spouse in a family can be used by the other spouse to reduce his or her tax. Given the choice of the individual as the benchmark tax unit, this transferability option is not neutral and therefore constitutes a selective tax measure. The reduction and phase-out of the tax cut for higher income individuals beginning in 1984 is merely a change in the benchmark structure and does not give rise to a selective tax provision. For information purposes, however, the full value of this tax reduction is shown as a memorandum item.

## C. Corporate Income Tax

This section discusses certain basic issues relating to the development of the benchmark system for the corporate income tax. The details of the treatment of each selective tax measure are contained in Appendix 2.

### 1. Tax Base

As in the case of the benchmark individual income tax system, the neutrality criterion would imply that the tax base under the corporate income tax benchmark would be a comprehensive measure of income.

For corporations, the comprehensive income tax base would imply the inclusion in income of the total value of all receipts or receivables of the firm, less the total amount of current costs associated with earning that income and an amount representing the value of the physical depreciation of the corporation's productive assets.

The present tax system departs from this benchmark in the following general respects. First, capital cost allowance rates for tax purposes are generally higher than the rate used for normal accounting purposes or the rate at which depreciation actually occurs. In specific cases (e.g., machinery and equipment used in manufacturing and processing), the capital cost allowance rates are set deliberately high to stimulate investment in these assets. Second, certain forms of income are excluded in part (e.g., one-half of capital gains). Third, deductions are permitted for certain expenses unrelated to the business activity of the corporation (e.g., charitable donations) or in excess of actual costs (e.g., the 50-per-cent allowance for incremental R&D expenses provided until 1983). Lastly, immediate deductions are permitted for certain expenses which relate to business activity in a subsequent period (e.g., certain prepaid expenses).

Another issue that arises in defining the corporate income tax base concerns the exemptions granted to certain non-profit entities and government corporations. The non-taxation of income from commercial activities of such entities constitutes a selective tax measure.

Finally, as noted in the discussion on the treatment of inflation in the account, the ideal corporate income base would be defined in real rather than nominal terms. However, the use of a real income corporate tax base would depart radically from the existing tax structure and current accounting practices and can be questioned on the grounds of pragmatism. Moreover, there is no universally accepted procedure for translating the existing system into one based on real income. For these reasons, the benchmark corporate income tax base is assumed to be nominal rather than real income. Consequently, the 3-per-cent inventory valuation allowance, which is an *ad hoc* measure to adjust for inflation, is regarded as a selective tax measure.

## 2. Tax Unit

The choice of the appropriate tax unit for purposes of the corporate income tax benchmark system raises a number of conceptual issues that were discussed in the 1979 account. In short, there is a range of possible tax units including the establishment or activity unit within a corporation, the single legal corporate entity, the consolidated group of related corporations, and the whole of the Canadian corporate sector. The present system embodies elements of all four approaches. For example, the view that the single legal corporate entity is the relevant corporate tax unit in the current structure is supported by the observation that losses from one part of a business can be offset against other business income within the same corporation, but losses by one corporation in a consolidated group cannot generally be used against the income of another corporation in the group. On the other hand, in the case of certain provisions such as the exemption of intercorporate dividends, the whole of the corporate sector is treated as the corporate tax unit in the existing system, in that the exemption is designed to ensure that income already taxed in one corporation is not taxed again on receipt of a dividend by another corporation.

As noted in the 1979 account, on balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single corporation is adopted as the benchmark tax unit. However, to maintain a point of reference with the current system, the exemption for intercorporate dividends and the general loss flow-through provisions relating to corporate reorganizations are treated as part of the benchmark tax structure.

## 3. Tax Rates and Credits

Certain issues arise in considering the benchmark structure of corporate tax rates and credits. First, with respect to the general structure of corporate tax rates, the basic federal tax rate applicable to non-manufacturing corporations is 36 per cent after all abatements. Provisions which reduce this tax rate for certain kinds of corporations or activities (e.g., manufacturing and processing) are regarded as selective tax measures. One new development in this area is the modification introduced in the February 1984 budget to the rules providing for a lower corporate tax rate for small businesses; commencing in 1984, the first $200,000 of active business income earned by all Canadian-controlled private corporations (CCPCs), regardless of their total income, is now subject to this lower rate. This provides preferential treatment to CCPCs over public corporations and the benefits are focused on small firms. Thus, the provision is still classified as a tax incentive to small businesses.

Second, tax credits such as the investment tax credit, the employment tax credit, and the political contribution tax credit are considered to be selective tax measures. The foreign tax credit is not included in the account since it is essentially a device to avoid international double taxation by providing a deduction against Canadian tax in respect of foreign taxes paid on foreign source income.

## D. Commodity Taxes

Applied to commodity taxes, the neutrality criterion implies that a benchmark commodity tax system should provide no preferential treatment to taxpayers on the basis of consumption patterns or special characteristics of the consumer.

The main federal commodity tax is, of course, the manufacturer's sales tax. Two important issues are raised in defining the benchmark system for this tax. The first issue concerns the scope of the tax. The tax is designed strictly as a tax on manufactured goods. Although it is clearly non-neutral, in that it generally favours the consumption of services over goods, the benchmark structure assumes, on grounds of pragmatism, that the tax applies only to manufactured or produced goods and not to consumer services. Nevertheless, for information purposes, the non-taxation of services is included as a memorandum item.

Another question relating to the scope of the sales tax concerns the treatment of intermediate goods under the benchmark tax structure. Under the current law, partly finished inputs purchased by manufacturers for further processing and all machinery and apparatus used directly in the production process are exempt. The benchmark tax structure incorporates this treatment of intermediate goods. Consequently, exemptions for goods such as processing equipment purchased by manufacturers, farming machinery and fishing boats are not viewed as selective tax measures.

Conceptually, one could take the position that under the benchmark system, all goods purchased by a manufacturer should be exempt from sales tax, no matter how indirectly they enter into the production process. Under this scenario, tax penalties would arise to the extent that tax is imposed on goods such as building materials used in the construction of the manufacturer's plant, computers, office equipment and furnishings, and corporate aircraft used by executives. This, however, would constitute a significant departure from the general perception of the sales tax and thus on pragmatic grounds, as noted above, the benchmark structure is assumed to follow the current practice.

The second issue that arises in the definition of the commodity benchmark tax structure concerns the trade level at which it is imposed. In its present form the tax is generally levied on the manufacturer's sale price in the case of a domestic good, or on the duty-paid value in the case of an imported good. The imposition of the tax at this early trade level gives rise to certain non-neutralities in that, as a result of differences in the marketing chains, the effective rate of tax as a proportion of the final sale price to consumers can differ substantially from product to product. Nevertheless, again for purposes of maintaining a point of reference to the present system, the trade level at which the tax is actually levied is assumed to be the appropriate level for the benchmark tax.

For some commodities, the tax is levied, not on the sale price to the wholesaler, but rather on the price to the retailer. In certain cases, notably the cosmetics, motor fuel and automobile industries, this is effected through provisions in the *Excise Tax Act.* In other cases, it arises because no wholesale trade level exists for that product. These are assumed to be part of the benchmark structure and do not constitute selective tax measures. It should also be noted that in a number of industries, some manufacturers are in direct competition with wholesalers in selling to retailers. In these cases, for purposes of computing sales tax, the manufacturers' prices are administratively reduced to exclude the wholesaling component of the sale price. In the above cases, neither positive nor negative selective tax measures are deemed to arise.

Using the above definition of the commodity benchmark tax system, many exemptions of goods are classified as selective tax measures. These include the exemptions for food, clothing, drugs, heating fuels, electricity, transportation and construction equipment and a range of other commodities.

Finally, the sales tax on alcohol and tobacco products at a rate three percentage points higher than the general rate could be viewed as a tax penalty. However, this raises the further issue of the status of the special excise taxes on alcohol and tobacco, gasoline, jewellery and a range of other goods under the benchmark tax structure. The revenues from these special taxes (including the differential sales tax rate for alcohol and tobacco products) are included in the memorandum items section of the account.

# IV. Quantitative Estimates of Selective Tax Measures

Tables 1 to 3 provide quantitative estimates of federal selective tax measures in the individual, corporate and commodity tax systems respectively for the years 1979 to 1983 (Table 2 provides estimates of corporate tax measures only up to 1982). The tax provisions have generally been grouped using the functional categories that are used in the Public Accounts of Canada. Corporate income tax items, the majority of which fall under the economic development and support category, are grouped by industry.

Readers will note a number of changes from the previous accounts in the presentational format and values of the selective tax measures. First, the estimates for the individual, corporate and commodity tax provisions are now provided in three separate tables rather than in one consolidated table as was the practice in previous accounts. This has been done largely to facilitate the presentation of the increased information available on corporate income tax measures, that is, the breakdown of these items by industry and the separation of the values into "lower bound" and "upper bound" estimates, as described later in this section.

The second important difference is the number of significant changes in the values of selective tax measures from those in previous accounts. In many cases, these changes are merely the result of improved and more recent data. Most of the 1979 and 1980 estimates in the 1980 account were based on forecasts or preliminary values for the key estimating variables. However, in a number of cases, major revisions have been made to the estimating methodologies. Also, new methodologies have been developed in some instances to produce values for items for which estimates were previously not available.

In the first part of this section, the most significant developments in the presentation of the estimates and their underlying computational methodologies are discussed. These include: (i) the implications of evaluating each selective tax measure as if only that item is changed (i.e., the use of the "marginal approach" in estimating selective tax measures), (ii) the evaluation of selective tax measures for non-taxpaying corporations, (iii) the changes in the approach used in the evaluation of tax deferrals, and (iv) the changes in the estimating methodology for the non-taxation of capital gains on principal residences. The other changes in the estimating techniques are described for each item individually in the appendices. In the second part of this section, a number of caveats regarding the interpretation of the values for the selective tax measures are noted. The section concludes with some brief comments on the general magnitude and historical trends in the values of selective tax measures.

## A. Major Changes to Estimating Methodologies

### 1. The Marginal Approach for Estimating Selective Tax Measures

There are a number of situations in the personal, corporate and commodity tax systems where the amount of tax collected on a taxpayer's income or on the sale of a particular good is affected by the concurrent application of more than one selective tax provision. In these instances, the value computed for each measure may differ depending on the order in which the items are evaluated.

In this account, each selective tax measure is estimated at the margin, i.e., each item is estimated separately, assuming all other provisions remain in effect. (In fact, as will be discussed in the following section on the treatment of tax deferrals in the account, each provision is evaluated as if it had never existed.) This "marginal" approach is appropriate when information is being sought about the federal revenue cost of a particular tax provision. It is important to note, however, that the revenue estimates found in this account cannot be summed to determine the aggregate amount of selective tax measures for a particular sector or for the tax system as a whole. The specific implications of the use of the marginal approach for the estimation of the tax measures in each of the personal, corporate and commodity tax systems are discussed in the following sections.

#### (a) Personal Income Tax System

The marginal approach has very significant implications in the evaluation of personal income tax measures. The first of these arises as a result of the progressive structure of marginal tax rates. Typically, a tax filer will claim a variety of tax exemptions and deductions. The overall effect of claiming all of these deductions can be to push the taxpayer into a lower tax bracket than would have applied had none of the deductions existed. Using the marginal approach, each selective tax measure is valued at the marginal tax rate the taxpayer faces after claiming all other tax deductions (i.e., at the lower tax rate). However, in estimating the total impact of all selective tax measures taken together, it would be necessary to take into consideration that, without any of the tax exemptions or deductions, the individual could be in a higher tax bracket. For this reason, the total effect of all the selective tax measures in the personal income tax system taken together will be greater than the sum of the individual estimates presented here.

A second implication of the use of the marginal approach is that some portion of certain selective tax measures may not be evaluated at all under this approach. Consider, for example, the non-taxation of capital gains on principal residences. In the absence of this provision, only one-half of the gain would be taxable upon realization, as is the case for other capital gains. In evaluating the selective tax measure relating to the half-taxation of other capital gains, under the marginal approach, the capital gain on owner-occupied housing would have already been exempted and, hence, not covered in the calculation of the general capital gains provision. Thus, one-half of the capital gains on principal residences would not be evaluated in computing either the specific exemption for housing or the general provision relating to all capital gains. This further illustrates that the addition of the individual tax measure estimates obtained using the marginal approach would be inappropriate.[7]

### (b) Corporate Income Tax System

The use of the marginal approach has significant implications for the estimation of corporate tax provisions. One such implication arises in cases where firms benefit from selective tax measures in the form of both deductions and preferential tax rates (e.g., for manufacturers or small businesses). In these situations, under the marginal approach, each tax deduction is valued at the preferential tax rate faced by the firm. At the same time, the benefit of the lower corporate tax rate is measured as the difference between the taxes currently payable and the amount that would be charged if the statutory corporate tax rate were to apply, assuming all the other deductions remained in effect. Under the marginal approach, therefore, the reduction in taxes resulting from the interaction of the lower tax rate and the individual deductions is not included in the calculation of revenue estimates for either the lower tax rate or the deductions. For this reason, the sum of the values of the individual measures is significantly less than the total effect of the provisions taken together.

A second implication of the marginal approach in evaluating corporate tax measures arises in the case of financially profitable firms which, by the use of a number of tax incentives available to them, put themselves in a loss position for tax purposes. In these situations, the marginal tax rate facing the firm will be zero for tax deductions up to the amount of the tax loss, after which the applicable corporate tax rate becomes relevant. In the extreme, if each of several tax deductions is less than the loss for tax purposes, they will all be given nil values, even though the tax savings in total for the firm from the use of all the deductions may be quite significant. In this case as well, the sum of the individual revenue estimates computed using the marginal approach understates the total tax savings arising from the existence of all the selective tax measures taken together.

Further conceptual and practical difficulties that are distinct from those that stem from the use of the marginal approach, arise in the computation of selective tax measures for non-taxable firms. These issues, and the methodology used in estimating the revenue cost of tax provisions for these corporations, are described in the discussion on the treatment of selective tax measures for non-taxpaying corporations.

### (c) Commodity Tax System

In the case of commodity taxes, situations also arise where more than one exemption can potentially apply to the same group of goods. For example, all pharmaceuticals are unconditionally exempt from sales tax; purchases of all goods by public hospitals are also exempt. Pharmaceuticals can, therefore, be bought by hospitals exempt under either provision. Under the marginal approach, in evaluating the cost of either the general exemption for pharmaceuticals, or the exemption for hospitals, the taxes forgone on purchases of pharmaceuticals by hospitals would not be included. The sum of the revenue estimates for each of the two exemptions therefore understates the total tax savings of the two provisions taken together.

Other examples of goods which can qualify for preferential treatment under more than one provision include: food, clothing, and certain medical instruments and apparatus purchased by hospitals; insulation materials; certain transportation and construction equipment purchased by municipalities; and building materials used in the construction of libraries, schools, and hospitals. Again, in each of these cases, the mere addition of the individual tax revenue cost estimates obtained under the marginal approach will understate the total value of tax savings from the commodity tax provisions.

## 2. Computation of the Value of Selective Tax Measures for Non-Taxpaying Corporations

As noted in the previous section, certain difficulties, conceptually distinct from those relating to the use of the marginal approach in estimating selective tax measures, arise in the case of non-taxpaying corporations. The first of these concerns the treatment of discretionary deductions available to firms. Of particular importance in the Canadian corporate tax system are the discretionary provisions within the tax depreciation system. Where the deduction of capital cost allowance by a non-taxable firm will not result in an immediate reduction of taxes payable in a prior year (through a loss carry-back), and there is uncertainty over it having sufficient taxable income in future years to use up all losses in the required time period, the firm may elect to forgo deducting capital cost allowances in the current year, choosing instead to keep the deductions for future years. This is particularly likely in the case of fast write-offs, such as those for manufacturing and processing equipment. The issue arises, however, that in evaluating tax measures in such a case, it would be unreasonable to assume that if another provision were eliminated, thus putting the firm in a taxable position, the firm would not use a sufficient amount of its unused deductions to reduce its tax payable to nil. For this reason, in estimating the revenue cost of all of the other selective tax measures, in this account the amount of capital cost allowance claimed by the firm is adjusted to be the maximum claimable. In this way, the actual impact on non-taxable firms of removing a non-discretionary deduction, such as the inventory valuation allowance, is better simulated.

The second issue that arises in the case of non-taxable firms concerns the treatment of selective tax measures that result in losses which may be carried over to reduce tax liabilities in other years.

The account employs a cash flow approach in computing and presenting the revenue estimates of selective tax measures. This approach is elaborated upon in the next section dealing with deferrals. Under this approach, values of tax measures are computed by comparing the flow of tax revenues in each year with and without the existence of the tax provision. Applied to corporate tax measures, the cash flow approach implies that the value of a selective tax measure in a given year is the sum of: (1) the value of the deduction in the current year for taxable firms, (2) the value of the loss created by the tax measure and carried back to prior years, and (3) the value of prior-year losses created by tax measures which are carried forward to reduce taxes in the current year.

Unfortunately, this approach entails significant computational problems. Sufficient information is available to attribute the tax savings from loss carry-backs to the specific tax provisions which give rise to the loss for tax purposes. However, in the case of losses carried forward into the year, no data exist whereby the tax savings in the year from the loss carry-forward can be attributed to the specific tax measures which created the loss in the prior year. Consequently, the calculation of the revenue cost estimates under the strict application of the cash flow approach is not possible.

On the other hand, there is information on the selective tax measures component of losses incurred in the year which are available to be carried forward. Although the value of loss carry-overs to future years does not strictly fit into the cash flow measure of current year estimates of selective tax measures, some additional information can be obtained from the examination of these loss carry-forwards. However, given that no information is available in the current year on the future utilization of loss carry-forwards, an assumption has to be made regarding the extent to which losses created by selective tax measures will reduce future taxes.

The problems relating to loss carry-backs and carry-forwards for estimation purposes are addressed in the account through the dual presentation of corporate tax measure estimates. The "lower bound" values represent the tax savings in the year that are readily identifiable with the use of the tax provision (i.e., they are the sum of the direct tax savings in the current year, and savings resulting from the carry-back of the loss created by the tax measure). The lower bound estimate diverges from the cash flow approach in that it does not value prior year losses carried into the year. This underestimates the tax revenue forgone in the year due to the existence of a selective tax measure.

The "upper bound" value also includes the value of current year tax savings from the use of a selective tax measure and those savings from the carry-back to previous years of losses arising from the use of selective tax measures. However, in addition, the upper bound estimate assumes that corporations which have losses for tax purposes will have sufficient taxable income in future years to take full advantage of their carry-forwards.(8) The upper bound estimate essentially gives the value of the deduction claimed, valued at the firm's relevant corporate tax rate.

## 3. Treatment of Tax Deferrals

Another important area that deserves further elaboration concerns the interpretation of the estimates for tax deferral provisions. The tax deferrals identified in the account fall under two main headings. The first category consists of a variety of savings vehicles such as registered pension plans (RPPs) and registered retirement savings plans (RRSPs), income-averaging annuity contracts (IAACs – discontinued in 1981) and deferred profit-sharing plans (DPSPs). The second category involves the provision of accelerated depreciation for business assets. Included in this group are the fast write-offs for manufacturing and processing equipment, research and development, certified films, MURBs, exploration expenses, and the general excess of capital cost allowance over book depreciation.

In past accounts, most of the tax deferral provisions were evaluated using a cash flow approach. This approach looks at the total impact of the existence of the selective tax measure on federal revenues during a year. For example, with regard to the excess of capital cost allowance (CCA) over book depreciation, the value of the selective tax measure was computed as the difference between the CCA claimed and the book depreciation recorded in the year, multiplied by the relevant tax rates.

While the cash flow approach was used for most deferral tax provisions, two of the major deferrals, those relating to RPPs and RRSPs and the Canada and Quebec Pension Plans, were estimated using an entirely different technique, viz., estimating the interest value of the deferral. This approach compares the tax deferral to an interest-free loan in the amount of the tax outstanding. Using this approach, values for these items were computed by multiplying the stock of savings in these funds by the marginal tax rate of contributors and then further multiplying this value by the interest rate in the year.

In quantifying tax deferrals, however, it is important that the methodologies employed be consistent with each other and generate values which are comparable to other selective tax measures which are not deferrals. A common approach to the evaluation of tax deferrals is therefore required.

In this account, all deferral tax provisions have been calculated using the cash flow rather than the interest value of deferral approach. Generally, information is more readily available to make these computations than is the case for the interest value of deferral approach. Also, compilations of direct expenditure outlays, such as the Public Accounts, employ a cash flow approach and therefore, for comparability purposes, so too should this account. More importantly, values for selective tax measures computed using the interest value of deferral approach are not very responsive to changes in the flow variables which can have very significant implications for government revenues in a particular year. For example, an increase of, say, $1 billion in contributions to RRSPs in a year would reduce federal revenues in that year by about $200 million dollars. But because only the interest cost of this increment to the total stock of RRSP savings would be valued under the interest value of deferral method, the increase in the value of the tax measure computed under this method would be considerably smaller, around $20 million. In addition, the interest value of deferral approach is not very useful for purposes of policy analysis. The estimates obtained under this approach do not seem to represent the additional revenue that would arise from any possible policy decision to change the tax provision.

In developing estimating techniques for each selective tax measure under the cash flow approach, however, the question arises as to whether the account should try to estimate each item (1) as if the provision were removed effective from the beginning of the year for which the value is being computed, or (2) as if the provision had never existed.

In assessing the advantages and disadvantages of each approach, it is evident that, generally, the estimation of the revenue cost of selective tax measures under approach (1) is a more straightforward calculation than that required in determining the extra revenues that the government would collect if the provision had never existed, as in approach (2). In addition, approach (1) is very policy-oriented in that it gives a value which is quite tangible (i.e., what would be the revenue impact of changing this tax provision in this year). The value computed under approach (2) is less policy-oriented because one clearly cannot in practice rewrite the history of the tax system.

Nevertheless, there are reasons for calculating the value of a selective tax measure under the assumption that the provision never existed. First, while approach (1) gives accurate values for the first year impact, the estimates computed in this way are overestimates of the long-run annual costs of the provision. For example, in the case of an immediate write-off of depreciable property, this estimating technique would not consider the extra depreciation that would be available to be claimed in later years in the absence of the selective tax measure.

Second, the revenue cost values for each year computed under approach (1) are not additive over the years. The reason for this is that, under this technique, the value computed for each year is dependent upon the outstanding tax not having been collected in the previous years. If in fact the tax were collected in a particular year, the amount available to be collected in later years would be reduced. Thus, adding up the revenue cost values computed under approach (1) over a number of years would give an overestimate of the true benefits during the period. Under approach (2), where the estimates are computed as if the provision had never existed, this problem does not arise and values can be added over time. For these reasons, in this account, deferral tax provisions are evaluated by comparing the revenues the federal government currently receives to those that would have been received had the provision never existed.

As a final point, it should be noted that, in considering alternative general approaches to evaluation, such as the cash flow or interest value of deferral methods, a third possibility, not used in prior accounts, is the present value approach. This approach estimates the net present value of all future tax benefits or costs arising from an action taken in the year. In the case of the registered pension plan (RPP) tax provision, for example, the value of the selective tax measure would be equal to the difference between the retirement funds that would arise from the current year's pension contributions under the present tax structure and the funds that would be generated without the RPP tax provision (expressed in present value terms). For this approach, assumptions and estimates must be made regarding future flows and parameter values such as the average length of time the contributions would remain in the pension plan, their future earnings rates, future tax rates and the discount rate. These projections, of course, introduce a substantial element of uncertainty into the estimates and make this method difficult to implement.

The thrust of the present value approach is to provide a measure in today's dollars of the sum of all future costs associated with continuing the provision for the year. In this respect, the present value approach is a very useful decision-making tool in evaluating the long-run tax revenue consequences of changes to a deferral provision. This accounting of selective tax measures is, however, oriented to giving an historical picture of the tax revenue consequences in past years of tax provisions. Hence, the cash flow method of presenting revenue estimates for tax deferral provisions seems the most appropriate.

### 4. Non-Taxation of Capital Gains on Principal Residences

One of the largest items in past accounts was the non-taxation of capital gains on principal residences. This account incorporates major changes in the methodology used in estimating this item.

First, as noted in the discussion of the impact of the use of the marginal approach in this account, this selective tax measure is estimated assuming that in its absence, only one-half of capital gains accrued since 1971 would be taxable upon realization. In past accounts, the values for this item assumed the full taxation of these gains. Second, this account incorporates an improved data base on homeowners with respect to the year of purchase of their homes and their duration of occupancy, permitting new estimates of the turnover rates of houses and average capital gains of homeowners. As a result of these changes, the estimates for this item are greatly reduced from those in previous accounts. A complete description of the methodology used in estimating this item is provided in Appendix 1.

## B. General Caveats

The estimated values of selective tax measures in the tables are subject to a number of caveats. These are summarized below.

First, the revenue cost estimates are based on the assumption that the removal of a selective tax measure would not affect taxpayer behaviour. Often, such a change would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay. This would result in smaller increases in revenue than is implied by the estimates given in the tables.

Second, the estimates of forgone revenue do not take into account the effect on the overall level of economic activity of removing a selective tax measure. This could be quite significant in the case of a major tax provision. If the removal of a tax measure entailed a negative impact on output and incomes in the economy, federal tax revenues could be reduced. In this respect as well, the selective tax measure estimates in the account could be overstated.

Third, for many items, significant data constraints, particularly with regard to the most recent years, prevent the accurate estimation of the revenue forgone as a result of the provision. Where possible, values have been computed based on the available information, but, in these cases, it should be noted that the estimates are subject to wide margins of error. In addition, there are a number of items for which the data availability was not sufficient to permit any reasonably accurate estimation of the forgone revenue. Although many of the omitted amounts are likely relatively small in value, there may be cases where the non-quantified items are very significant.

Fourth, the individual estimates cannot be added together to produce a meaningful value representing the total value of all selective tax measures in the Canadian tax system, or those given to one sector. This results from: (1) the fact that the estimating technique used in evaluating a selective tax measure does not capture the additional revenue forgone due to the interaction of other tax provisions (which one would want to include in any estimate of the total value of all selective tax measures); (2) the wide margins of error of some estimates (which could be all biased in the same direction); (3) the non-availability of estimates for several items, many of which could be very significant; and (4) the fact that the simultaneous elimination of all selective tax measures would likely have significant macroeconomic implications which would have an additional impact on government revenue collections and likely require offsetting tax changes, for budget policy reasons.

In addition to these points, ***it must be emphasized that the definition of the benchmark tax structure, and hence the identification of selective tax measures, is in many instances an arbitrary exercise.***

There are several examples where provisions are included in the account for reasons of comprehensiveness where their categorization as selective tax measures may be debatable. The inclusion of each of these debatable measures in the account is supportable, given the informational intent of the account, and on an item-by-item basis readers may choose to reject or accept the arguments put forth for their inclusion as selective tax measures. However, given the somewhat arbitrary nature of the benchmark system in these areas, any value representing the grand total of all selective tax measures would not be very meaningful.

Fifth, in considering the value of any particular item, it is important to note that the value to the taxpayer of a dollar of tax preference is often worth substantially more than a dollar of direct spending. This results from the fact that, while tax measures directly increase the after-tax income of taxpayers by the amount of their tax savings, government grants are generally taxable to the recipients. Thus, the value to the taxpayer of a dollar's tax preference may be one and one-half to two times the value of a dollar of direct spending.

Sixth, it is important to note that the values in the tables refer to *federal* revenue costs of selective tax measures. As a result of the federal-provincial tax collection agreements, there is typically an associated amount of provincial revenue forgone in the case of individual and corporate income tax measures.

## C. General Observations

Given the above qualifications and caveats, it is nevertheless clear from the tables that there are a significant number of selective tax measures and their estimated values are, in some instances, large.

It is also apparent that the values of many selective tax measures have been growing, due in large measure to the growth in the taxpayer population and to the increase in economic activity. At the same time, values for several tax provisions have declined, particularly in the corporate income tax system. This is primarily due to the downturn in the Canadian economy in 1981 and 1982 and hence the inability of corporations to make use of the available deductions. Lastly, during the period covered by the tables, there were a number of changes to the Canadian tax system that have had an impact on the values of tax measures. In particular, effective from 1982, the schedule of personal marginal tax rates was reduced, particularly at the higher income levels. This general change to the tax structure had the effect of reducing the value of selective tax measures in the personal income tax system. In addition to this broad change, amendments were made to a number of individual tax provisions. These include, among others, the modification of the treatment of interest-free loans provided to employees, the elimination of income averaging annuity contracts (IAACs) and the phasing out of multiple unit residential buildings (MURBs) to name a few. The changes to each of the selective tax measures are discussed individually in the appendices.

# V. Summary

This account is a catalogue of the selective tax measures in the federal income and commodity tax systems. These measures are identified and, where possible, estimated values of forgone revenue are provided.

The basic approach employed to identify selective tax measures is similar to that used in the 1979 and 1980 accounts: a benchmark tax structure is formulated based on certain general criteria; deviations from this structure are then identified as selective tax measures.

Although the basic approach to the identification and measurement of selective tax measures is unchanged from previous accounts, there are nevertheless some important conceptual and methodological changes that have been incorporated into this account. For example, certain provisions, such as the dividend gross-up and tax credit, the deductibility of unemployment insurance and Canada and Quebec Pension Plan premiums and the non-taxation of imputed income on owner-occupied dwellings are not regarded as selective tax measures in this account. In addition, for a number of items, major changes have been made in the estimating techniques used in computing the revenue cost estimates. As a result, the values for several selective tax measures have been substantially revised from those in previous accounts.

Finally, it is emphasized that the estimated values for selective tax measures published in the tables are subject to a number of caveats and should be used with caution.

## Footnotes

(1) *Government of Canada Tax Expenditure Account*, Department of Finance, December 1979.

*Government of Canada Tax Expenditure Account*, Department of Finance, December 1980.

(2) Part IV tax, which applies to dividend income of Canadian-controlled private corporations and is refundable when dividends are in turn paid out, is not considered to be a selective tax measure. This tax is imposed mainly to reduce the tax deferral advantages to high-income individuals of accumulating income inside a corporation.

(3) This account provides an estimate for SRTCs claimed by individuals in 1983. However, given that the SRTC measure was implemented in 1983, SRTCs are not included in Table 2 which contains corporate tax measure estimates only to 1982.

(4) As assistance for dependants can also be delivered through direct expenditure programs, such as family allowances, the functional equivalence criterion also implies the classification of these provisions as selective tax measures.

(5) Readers may note that in past accounts, the child care expense deduction was included as a memorandum item.

(6) However, the tax rate reductions do have the effect of reducing the calculated value of other selective tax measures to the extent that the marginal tax rates applicable to a particular deduction are reduced.

(7) In the case of capital gains on principal residences, given the informational intent of the account, estimates are provided for both the half taxation and the full taxation of these gains.

(8) It must be noted that in this calculation, only non-taxable firms with positive income on their financial statements are considered to be able to make full use of their losses in the future. Non-taxable firms that have negative book income can increase their loss carry-overs through the use of selective tax measures, and conceptually if these firms have sufficient taxable income in the future to write off the total amount of their losses, the portion of the tax loss arising from the use of selective tax measures should be valued fully. However, for purposes of computing an upper bound estimate, it would be unrealistic to include the full value of the tax measure-created loss for those firms as well. It should also be noted that the impact of loss carry-backs is computed only for non-taxable firms that are profitable.

Table 1

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | | | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|---|
| | | | | | ($ millions) | | |
| **I.** | **General Government Services** | | | | | | |
| | 1. | Political contribution tax credit | 6 | 6 | 5 | 6 | 8 |
| | 2. | Non-taxability of income from the Office of Governor General | S | S | S | S | S |
| | 3. | Non-taxation of RCMP pension or compensation for injury, disability or death | S | S | S | S | S |
| | 4. | Non-taxation of certain allowances to volunteer firemen | S | S | S | S | S |
| **II.** | **Foreign Affairs** | | | | | | |
| | 1. | Non-taxation of special allowance for diplomats and other government employees posted abroad | 5 | 6 | 5 | 7 | 8 |
| | 2. | Overseas employment exemption | – | – | – | n.a. | 17 |
| **III.** | **Defence** | | | | | | |
| | 1. | Non-taxation of veterans allowances, civilian war pensions and other service pensions | 50 | 60 | 65 | 75 | 85 |
| | 2. | Non-taxation of service pensions from another country | S | S | S | S | S |
| | 3. | Non-taxation of income from War Savings Certificates | S | S | S | S | S |

Symbols: n.a. : Estimates not available.
– : Not applicable.
s : Revenue impact expected to be small, less than $5 million.
* : Value included elsewhere.

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **IV. Transportation and Communications** | | | | | |
| No selective measures under this category | | | | | |
| **V. Economic Development and Support** | | | | | |
| **A. Farming and Fishing** | | | | | |
| 1. Five-year block averaging for farmers and fishermen | | | | | |
| 2. Cash basis accounting | | | | | |
| 3. Flexibility in inventory accounting | n.a. | n.a. | n.a. | n.a. | n.a. |
| 4. Deferral of tax on capital gains on intergenerational rollovers of family farms | | | | | |
| 5. Deferral of income on grain sold through deferred cash tickets | 15 | 60 | 45 | -30 | 30 |
| 6. Deferral of income on destruction of livestock | n.a. | n.a. | n.a. | n.a. | n.a. |
| 7. Expensing of certain capital expenditures | n.a. | n.a. | n.a. | n.a. | n.a. |
| 8. Exemption from requirement to make quarterly instalments of tax payments | S | S | S | S | S |
| 9. Deduction of one-quarter of all farm home expenses and two-thirds of automobile expenses without proof of use for business purposes | n.a. | n.a. | n.a. | n.a. | n.a. |
| 10. Investment tax credit on farming and fishing investments | 80 | 100 | 140 | 130 | 100 |
| 11. Excess of tax depreciation over book depreciation, general | S | S | S | S | S |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **B. Resource Sector** | | | | | |
| 1. Drilling funds, flow-through shares, and other resource-related deductions | 70 | 70 | 55 | 40 | 45 |
| 2. Capital gains treatment for prospectors and grubstakers | S | S | S | S | S |
| **C. Regional Development** | | | | | |
| 1. Portion of investment tax credit | * | * | * | * | * |
| 2. Portion of employment tax credit | * | * | * | * | * |
| **D. Energy Conservation** | | | | | |
| 1. Non-taxation of home insulation grants in Nova Scotia and Prince Edward Island | S | S | S | – | – |
| **E. Manufacturing Sector** | | | | | |
| No selective measures under this category | | | | | |
| **F. Research and Development** | | | | | |
| 1. Immediate write-off of R&D expenditures | S | S | S | S | S |
| 2. Scientific research tax credit | – | – | – | – | 85 |
| **G. Small Business** | | | | | |
| 1. Deferral of up to $200,000 of capital gains on intergenerational transfers of small businesses | – | n.a. | n.a. | n.a. | n.a. |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| 2. Special tax treatment of certain stock options issued to employees of private corporations | n.a. | n.a. | n.a. | n.a. | n.a. |
| 3. Full offset of capital losses on private company shares and debt obligations | n.a. | n.a. | n.a. | n.a. | 50 |
| 4. Non-taxation of provincial assistance for venture investments | – | – | – | n.a. | n.a. |
| **H. Labour Force** | | | | | |
| 1. Employment tax credit | S | S | S | S | S |
| 2. Non-taxation of employee benefits in the form of subsidized loans (including housing loans within prescribed limits) | n.a. | n.a. | n.a. | n.a. | n.a. |
| 3. Non-taxation of employer-paid premiums for private health insurance, and group term life insurance of up to $25,000 | 190 | 225 | 300 | 350 | 400 |
| 4. Non-taxation of other non-monetary benefits of employment (e.g., employee discounts) | n.a. | n.a. | n.a. | n.a. | n.a. |
| 5. Tax advantage of employer contributions to employee benefit plans | n.a. | n.a. | n.a. | n.a. | n.a. |
| 6. Non-taxation of vacation-with-pay trusts | – | S | S | S | S |
| 7. Non-taxation of strike pay | 6 | 7 | 8 | 5 | 4 |
| 8. Non-taxation of northern allowances | n.a. | n.a. | n.a. | n.a. | 25 |
| **I. General Business and Investment Incentives** | | | | | |
| 1. Investment tax credit for individuals not included elsewhere | 17 | 24 | 27 | 28 | 24 |
| 2. Non-taxation of one-half capital gains income realized after 1971 | 570 | 750 | 570 | 265 | 440 |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| 3. Non-taxation of realized capital gains income accrued prior to 1972 | | | | | |
| 4. Flow-through of capital gains for private corporations | n.a. | n.a. | n.a. | n.a. | n.a. |
| 5. Special treatment of stock dividends of public corporations | | | | | |
| 6. $1,000 capital gains exemption for personal use property transactions | S | S | S | S | S |
| 7. $200 capital gains exemption on foreign exchange transactions | S | S | S | S | S |
| 8. Deferral of capital gains income through various rollover provisions | n.a. | n.a. | n.a. | n.a. | n.a. |
| 9. Accrued capital gains income not included elsewhere | n.a. | n.a. | n.a. | n.a. | n.a. |
| 10. $1,000 investment income deduction | 620 | 740 | 905 | 950 | 835 |
| 11. Other accrued investment income not included elsewhere | n.a. | n.a. | n.a. | n.a. | n.a. |
| 12. Non-taxation of investment income on life insurance policies | 185 | 215 | 230 | 270 | 290 |
| 13. Excess of tax depreciation over book depreciation for unincorporated businesses not included elsewhere | 90 | 95 | 95 | 95 | n.a. |
| 14. 3-per-cent inventory valuation adjustment for unincorporated businesses | 25 | 30 | 30 | 35 | 30 |
| 15. Tax deferral available from income averaging annuity contracts | 330 | 370 | 295 | – | – |
| 16. Deductibility of prepaid expenses | n.a. | – | – | – | – |
| 17. Deferral of tax from use of holdbacks on progress payments by contractors | n.a. | n.a. | n.a. | n.a. | n.a. |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| 18. Deferral of tax from use of billed-basis accounting by professionals | n.a. | n.a. | n.a. | n.a. | n.a. |
| **VI. Health and Welfare** | | | | | |
| **A. Health** | | | | | |
| 1. Deductibility of medical expenses | 32 | 38 | 43 | 57 | 65 |
| **B. Income Maintenance** | | | | | |
| 1. $1,000 pension income deduction | 105 | 125 | 140 | 140 | 150 |
| 2. Age exemption | 215 | 310 | 390 | 450 | 500 |
| 3. Non-taxation of Guaranteed Income Supplement and Spouses Allowance payments | S | S | S | S | S |
| 4. Tax advantage on savings in registered pension plans (RPPs) and registered retirement savings plans (RRSPs) | 2950 | 3450 | 3950 | 4600 | 4900 |
| 5. Rollovers of pension payments and lump sum receipts into RRSPs | * | * | * | * | * |
| 6. Tax advantage of savings in deferred profit-sharing plans | 75 | 50 | 55 | n.a. | n.a. |
| 7. Deductibility of alimony and support payments | n.a. | 60 | 75 | 90 | 95 |
| 8. Income splitting through interest-free loans between family members | n.a. | n.a. | n.a. | n.a. | n.a. |
| 9. Marital exemption | 1015 | 1055 | 1115 | 1220 | 1385 |
| 10. Exemption for wholly dependent children | 660 | 680 | 745 | 890 | 940 |
| 11. Exemptions for other dependants | 25 | 27 | 27 | 14 | 15 |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|
| | | | | ($ millions) | | |
| 12. | Child tax credit | 935 | 1040 | 1070 | 1515 | 1435 |
| 13. | Child care expense deduction | 50 | 55 | 65 | 75 | 110 |
| 14. | Non-taxation of worker's compensation payments | 150 | 205 | 250 | 300 | 250 |
| 15. | Non-taxation of income from personal injury awards | S | S | S | S | S |
| 16. | Non-taxation of up to $10,000 of death benefit | n.a. | n.a. | n.a. | n.a. | n.a. |
| 17. | Inter-spousal capital gains rollover | n.a. | n.a. | n.a. | n.a. | n.a. |
| 18. | Transfer of spouse's federal tax reduction | – | – | – | 325 | 325 |
| **C.** | **Social Assistance** | | | | | |
| 1. | Non-taxation of means- and needs-tested and income-tested social assistance benefits | S | S | S | S | S |
| 2. | Exemption for the disabled and the blind | 13 | 15 | 17 | 21 | 24 |
| **D.** | **Indians and Eskimos** | | | | | |
| 1. | Non-taxation of income earned by Status Indians on reserves | n.a. | n.a. | n.a. | n.a. | n.a. |
| **E.** | **Housing and Urban Renewal** | | | | | |
| 1. | Non-taxation of realized capital gains on owner-occupied residences – half taxation | 640 | 640 | 360 | n.a. | n.a. |
| | – full taxation | 1350 | 1350 | 760 | n.a. | n.a. |
| 2. | Registered home ownership savings plan deduction | 95 | 100 | 100 | 105 | 125 |
| 3. | Multiple unit residential buildings provision | 40 | 50 | 60 | 65 | 65 |
| 4. | Non-taxation of various homeowner grants | – | – | – | 90 | 140 |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **VII. Education Assistance** | | | | | |
| 1. Non-taxation of first $500 of scholarship and bursary income | S | S | S | S | S |
| 2. $50 per month education deduction | 31 | 34 | 36 | 43 | 45 |
| 3. Deduction of tuition fees | 34 | 42 | 45 | 51 | 55 |
| 4. Deduction of contributions to teachers exchange fund | S | S | S | S | S |
| 5. Special tax treatment of registered education savings plans | S | S | S | S | S |
| **VIII. Culture and Recreation** | | | | | |
| 1. Deductibility of itemized charitable donations and the $100 standard deduction | 360 | 405 | 460 | 485 | 515 |
| 2. 100-per-cent write-off for Canadian films | 20 | 45 | S | S | S |
| 3. Non-taxation of capital gains on gifts of property under the Cultural Property Export and Import Act | – | S | S | S | S |
| 4. Write-off on art work purchased by unincorporated businesses | S | S | S | S | S |
| 5. Non-taxation of lottery and gambling winnings | | | | | |
| government lotteries | 135 | 150 | 150 | 175 | 215 |
| race track betting | 220 | 245 | 255 | 260 | 250 |
| other gambling | n.a. | n.a. | n.a. | n.a. | n.a. |
| 6. Deduction for clergymen's residence | 11 | 12 | 13 | 14 | 15 |
| 7. Non-taxation of certain income of individuals who have taken vows of perpetual poverty | S | S | S | S | S |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **IX. Fiscal Transfer Payments** | | | | | |
| 1. Income tax abatement to Quebec for contracting out of the shared-cost programs | 830 | 955 | 1095 | 1140 | 1140 |
| 2. Transfers of income tax room to provinces in respect of shared-cost programs | 3115 | 3660 | 4320 | 4675 | 4650 |
| **X. Public Debt** | | | | | |
| No selective measures under this category | | | | | |
| **XI. Other Selective Tax Measures** | | | | | |
| 1. General averaging for individuals | 255 | 350 | 415 | – | – |
| 2. Forward averaging for individuals | – | – | – | n.a. | n.a. |
| **XII. Memorandum Items** | | | | | |
| 1. Basic Personal Exemption | 4925 | 5620 | 6500 | 7675 | 8100 |
| 2. Federal tax reduction (including amount transferred from spouse in 1982 and 1983) | 2260 | 2575 | 2830 | 2515 | 2500 |
| 3. Employment expense deduction | 635 | 685 | 720 | 780 | 1070 |
| 4. Deductibility of unemployment insurance contributions | | | | | |
| employee share | 235 | 260 | 395 | 410 | 610 |
| employer share | 325 | 360 | 555 | 575 | 850 |

Table 1 (Cont'd)

**Selective Tax Measures: Personal Income Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| 5. Deductibility of Canada and Quebec Pension Plan Contributions | | | | | |
| employee share | 300 | 340 | 400 | 450 | 480 |
| employer share | 300 | 340 | 400 | 450 | 480 |
| 6. Dividend gross-up and tax credit | 690 | 860 | 1075 | 1140 | 785 |
| 7. Deduction of up to $5,000 of farm losses by part-time farmers | n.a. | n.a. | n.a. | n.a. | n.a. |
| 8. Non-taxation of expense allowances of MPs, MPPs, Royal Commissioners, and certain municipal officials | S | S | S | S | S |
| 9. Deduction of up to $2,000 of allowable capital losses against other income | 21 | 25 | 70 | 65 | 45 |

Table 2

## Selective Tax Measures: Corporate Income Tax

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper[1] bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| **All Corporations**[2] | | | | | | | |
| **A. Tax Deferrals, Exemptions and Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 1380 | 2090 | 2000 | 2280 | 1725 | 2215 | n.a. |
| 2. Inventory allowance | 470 | 585 | 370 | 495 | 355 | 500 | 520 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 260 | 355 | 375 | 525 | 565 | 800 | 480 |
| (b) Exemption of pre-1971 capital gains | 1235 | 1430 | 775 | 1075 | 2520 | 2820 | n.a. |
| (c) Deferral of capital gains income through various rollover provisions | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 4. Allowable business investment loss | S | 1 | 1 | 3 | 6 | 8 | n.a. |
| 5. Additional scientific and research deduction | 14 | 25 | 50 | 70 | 60 | 100 | 105 |
| 6. Deductibility of prepaid expenses | | | | | | | |
| 7. Tax losses from fast write-offs of leased assets | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n. a. |
| 8. Deductibility of carrying charges on land | | | | | | | |

Symbols: n.a. : Estimates not available.
– : Not applicable.
s : Revenue impact expected is small.

(1) The lower bound value represents the tax saving for the firm in the current year due to both the application of selective tax measures items in the current year and the carry-back to previous years of current-year losses arising from selective tax measures. The lower bound estimate assumes that the value o f losses created by selective tax measures carried forward is nil. The upper bound value is computed assuming that corporations which have current tax losses will have sufficient taxable income in future years to take full advantage of their loss carry-forwards.

(2) The estimates for all corporations may be greater than the sum of the eight sectors. Two reasons for this difference are the inability to assign all corporations to an industrial sector and the ex clusion of insignificant measures from individual industrial sectors.

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| 9. Excess deduction for intangible assets | | | | | | | |
| 10. Expensing of advertising costs | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| (a) Non-deductibility of advertising expenses in foreign media | | | | | | | |
| 11. Fast write-off for Canadian development expenses | | | | | | | |
| 12. 33 1/3-per-cent earned depletion allowance | 935 | 1150 | 1140 | 1425 | n.a. | 1210 | n. a.[3] |
| 13. Fast write-off for Canadian exploration expenses | | | | | | | |
| (a) Deferral of Canadian exploration expense redefinition | – | – | – | – | n.a. | 75 | 6 |
| 14. Resource allowance in lieu of deductibility of provincial royalties | n.a. | –265 | n.a. | –330 | n.a. | –450 | n.a. |
| (a) Resource allowance and deductibility of provincial royalties for Syncrude project | – | – | n.a. | 30 | n.a. | 40 | 45 |
| 15. Additional earned depletion on frontier oil and gas well exploration costs | 55 | 65 | 32 | 65 | n.a. | n.a. | n.a. |
| 16. Additional earned depletion for heavy oil and tertiary recovery projects (supplementary depletion) | 65 | 70 | 43 | 60 | n.a. | n.a. | n.a. |
| 17. Excess bad debt deduction and contingency reserves for chartered banks | n.a. | 80 | n.a. | 110 | n.a. | 200 | –115 |
| 18. Preferential tax treatment of income debentures and term preferred shares | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 19. Non-taxation of provincial assistance for venture investments in small business | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 20. Small Business (Development) Bonds | – | – | n.a. | 2 | n.a. | 75 | 145 |

[3] An n.a. appears here for measures 11 through 16 for 1982 even though there are values for the oil and gas industry, because of unavailability of information for the other sectors.

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| 21. Tax exemption on income of foreign affiliates of Canadian corporations | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 22. Patronage dividend deduction by credit unions, co-operatives | 150 | 165 | 245 | 265 | n.a. | 255 | n.a. |
| 23. Deductibility of itemized charitable donations | 45 | 50 | 49 | 60 | 50 | 60 | 55 |
| B. **Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 1020 | 1065 | 1255 | 1310 | n.a. | 1250 | 1370 |
| 32. Low tax rate for credit unions and co-operatives | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 33. Non-qualifying small business deduction | S | S | S | 13 | n.a. | n.a. | n.a. |
| 34. Manufacturing and processing deduction | 455 | 485 | 440 | 480 | n.a. | 425 | 330 |
| 35. Exemption of small businesses from the corporate surtax | – | – | – | – | – | – | 50 |
| 36. Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit (excluding (a) below) | n.a | 430 | n.a. | 490 | n.a. | 445 | 330 |
| (a) Investment tax credit applicable to scientific and research expenditures | n.a. | 75 | n.a. | 90 | n.a. | 110 | 95 |
| 38. Employment tax credit | 11 | 11 | 18 | 18 | n.a. | 15 | 8 |
| 39. Logging tax credit | n.a. | 60 | n.a. | 29 | n.a. | 11 | 3 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|
| | | Upper bound | Upper bound | Upper bound | Upper bound |
| | | ($ millions) | | | |
| D. | **Other Corporate Items** | | | | |
| 40. | Exemption from withholding tax for interest on foreign currency deposits | 570 | 790 | 1675 | 1490 |
| 41. | Exemption from withholding tax for interest on long term corporate securities | 105 | 145 | 250 | 335 |
| 42. | Reduction in withholding tax on dividends paid to non-residents from corporations with a degree of Canadian ownership | 70 | 75 | 85 | – |
| E. | **Memorandum Items** | | | | |
| 44. | Investment corporation deduction | 3 | 4 | 4 | 10 |
| 45. | Refundable Part I Tax on investment income of private corporations | 165 | 210 | 270 | 315 |
| 46. | Refundable capital gains for special investment corporation | 31 | 35 | 34 | 29 |
| 47. | Non-resident-owned investment corporation refund | 17 | 12 | 42 | 16 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| **I. Agriculture, Forestry and Fishing** | | | | | | | |
| **A. Tax Deferrals, Exemptions and Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation[4] | 3 | 5 | −3 | −2 | 3 | 5 | n.a. |
| 2. Inventory allowance | 1 | 2 | 1 | 2 | 1 | 2 | 2 |
| 3. Capital gains | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 7 | 11 | 32 | 36 | 18 | 25 | 5 |
| (b) Exemption of pre-1971 capital gains | 30 | 35 | 75 | 85 | 30 | 34 | n.a. |
| 22. Patronage dividend deduction by credit unions, etc. | 1 | 1 | 13 | 13 | n.a. | S | n.a. |
| 24. Cash basis accounting | | | | | | | |
| 25. Flexibility in inventory accounting | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 26. Deferral of income on grain sales and from destruction of livestock | | | | | | | |
| **B. Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 38 | 43 | 49 | 60 | n.a. | 65 | 75 |
| **C. Credits** | | | | | | | |
| 37. Investment tax credit[5] | n.a. | 12 | n.a. | 22 | n.a. | 21 | 25 |
| 39. Logging tax credit | n.a. | 2 | n.a. | 4 | S | S | S |

[4] A negative value for a selective tax measure occurs where book depreciation is greater than tax depreciation for a corporation.

[5] Includes the value of ITC applicable to scientific and research expenditures.

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| **E. Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 4 | n.a. | 15 | n.a. | 6 | 8 |
| **II. Manufacturing** | | | | | | | |
| **A. Tax Deferrals, Exemptions and Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 601 | 819 | 1006 | 932 | 873 | 905 | n.a. |
| 2. Inventory allowance | 130 | 182 | 174 | 249 | 147 | 231 | 207 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 11 | 21 | 23 | 41 | 44 | 70 | 14 |
| (b) Exemption of pre-1971 capital gains | 50 | 80 | 37 | 95 | 90 | 135 | n.a. |
| 5. Additional scientific and research deduction | 9 | 15 | 33 | 45 | 31 | 50 | 60 |
| 11. Fast write-off for Canadian development expenses<br>12. 33 1/3-per-cent earned depletion allowance<br>13. Fast write-off for Canadian exploration expenses | 48 | 65 | 25 | 70 | n.a. | 65 | n.a. |
| 14. Resource allowance in lieu of deductibility of provincial royalties | n.a. | 10 | n.a. | 21 | n.a. | 28 | n.a. |
| 22. Patronage dividend deduction by credit unions, co-operatives | 31 | 37 | 50 | 65 | n.a. | 85 | n.a. |
| **B. Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 130 | 145 | 135 | 155 | n.a. | 165 | 180 |
| 34. Manufacturing and processing deduction | 370 | 395 | 325 | 355 | n.a. | 320 | 240 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|---|
| | | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | ($ millions) | | | | | | |
| C. | **Credits** | | | | | | | |
| 37. | Investment tax credit | n.a. | 255 | n.a. | 310 | n.a. | 235 | 155 |
| 38. | Employment tax credit | n.a. | 6 | n.a. | 8 | n.a. | 8 | 4 |
| 39. | Logging tax credit | n.a. | 55 | n.a. | 25 | n.a. | 10 | 3 |
| E. | **Memorandum Items** | | | | | | | |
| 45. | Refundable Part I Tax on investment income of private corporations | n.a. | 25 | n.a. | 23 | n.a. | 48 | 25 |
| **III.** | **Construction** | | | | | | | |
| A. | **Tax Deferrals, Exemptions, and Deductions** | | | | | | | |
| 1. | Excess of tax depreciation over book depreciation | 31 | 37 | 40 | 65 | 13 | 16 | n.a. |
| 2. | Inventory allowance | 2 | 3 | 3 | 4 | 4 | 4 | 2 |
| 3. | Capital gains: | | | | | | | |
| | (a) Exemption of half of post-1971 capital gains | 6 | 8 | 7 | 11 | 19 | 27 | 6 |
| | (b) Exemption of pre-1971 capital gains | 42 | 50 | 22 | 30 | 23 | 31 | n.a. |
| 27. | Holdbacks on progress payments to contractors | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| B. | **Tax Rate Reductions** | | | | | | | |
| 31. | Small business deduction | 120 | 125 | 160 | 165 | n.a. | 165 | 165 |
| 34. | Manufacturing and processing deduction | 2 | 2 | 3 | 3 | n.a. | 3 | 3 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 2 | n.a. | 6 | n.a. | 8 | 4 |
| 38. Employment tax credit | n.a. | S | n.a. | 1 | n.a. | 1 | S |
| E. **Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 9 | n.a. | 12 | n.a. | 11 | 17 |
| **IV. Transportation and Storage** | | | | | | | |
| A. **Tax Deferrals, Exemptions and Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 65 | 100 | 85 | 135 | 140 | 205 | n.a. |
| 2. Inventory allowance | 6 | 9 | 4 | 7 | 3 | 8 | 8 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 6 | 10 | 6 | 13 | 9 | 15 | 7 |
| (b) Exemption of pre-1971 capital gains | 28 | 39 | 23 | 33 | 36 | 47 | n.a. |
| 11. Fast write-off for Canadian development expenses | | | | | | | |
| 12. 33 1/3-per-cent earned depletion allowance | 55 | 55 | 40 | 40 | n.a. | 20 | n.a. |
| 13. Fast write-off for Canadian exploration expenses | | | | | | | |
| 22. Patronage dividend deduction by credit unions, co-operatives | 25 | 27 | 31 | 31 | n.a. | 33 | n.a. |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|---|
| | | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | ($ millions) | | | | | | |
| B. | **Tax Rate Reductions** | | | | | | | |
| 31. | Small business deduction | 29 | 32 | 48 | 50 | n.a. | 47 | 50 |
| 36. | Exemption from branch tax for transportation companies | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C. | **Credits** | | | | | | | |
| 37. | Investment tax credit | n.a. | 34 | n.a. | 37 | n.a. | 42 | 33 |
| D. | **Other Corporate Items** | | | | | | | |
| 43. | Exemption of foreign shipping and aircraft companies from Canadian income tax | n.a. | n.a. | n.a. | n.a . | n.a. | n.a. | n.a. |
| V. | **Communications** | | | | | | | |
| A. | **Tax Deferrals, Exemption and Deductions** | | | | | | | |
| 1. | Excess of tax depreciation over book depreciation | –10 | –10 | –15 | –3 | –11 | –1 | n.a. |
| 3. | Capital gains: | | | | | | | |
| | (a) Exemption of half of post-1971 capital gains | 4 | 4 | 1 | 1 | 4 | 4 | 2 |
| | (b) Exemption of pre-1971 capital gains | 8 | 8 | 7 | 7 | 9 | 11 | n.a. |
| 5. | Additional scientific and research deduction | S | S | 3 | 3 | 5 | 5 | 9 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| **B. Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 7 | 7 | 3 | 3 | n.a. | 3 | 4 |
| 34. Manufacturing and processing deduction | 1 | 1 | 2 | 2 | n.a. | 3 | 2 |
| 36. Exemption from branch tax for communication companies | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **C. Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 4 | n.a. | 5 | n.a. | 9 | 9 |
| **VI. Public Utilities** | | | | | | | |
| **A. Tax Deferrals, Exemptions and Other Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 19 | 13 | 60 | 65 | 70 | 30 | n.a. |
| 2. Inventory allowance | 1 | 1 | S | 1 | 0 | 3 | 2 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | S | S | S | S | 1 | 1 | 2 |
| (b) Exemption of pre-1971 capital gains | S | 1 | S | 1 | 1 | 1 | n.a. |
| 11. Fast write-off for Canadian development expenses<br>12. 33 1/3-per-cent earned depletion allowance<br>13. Fast write-off for Canadian exploration expenses | 15 | 16 | 7 | 10 | n. a. | 18 | n.a. |
| **B. Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 1 | 1 | 2 | 2 | n.a. | 1 | 3 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | S | 4 | S | 1 | 1 | 2 | 1 |
| **VII. Wholesale Trade** | | | | | | | |
| A. **Tax Deferrals, Exemptions and Other Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 60 | 95 | 90 | 95 | 50 | 65 | n.a. |
| 2. Inventory allowance | 65 | 80 | 80 | 100 | 80 | 105 | 105 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 15 | 15 | 9 | 13 | 23 | 32 | 13 |
| (b) Exemption of pre-1971 capital gains | 60 | 70 | 25 | 44 | 47 | 60 | n.a. |
| 5. Additional scientific and research deduction | S | 1 | S | 1 | 2 | 2 | 2 |
| 11. Fast write-off for Canadian exploration expenses<br>12. 33 1/3-per-cent earned depletion<br>13. Fast write-off for Canadian development expenses | 2 | 4 | 1 | 1 | n.a. | 2 | n.a. |
| 22. Patronage dividend deduction by credit unions, co-operatives | 10 | 11 | 40 | 41 | n.a. | 11 | n.a. |
| B. **Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 160 | 160 | 205 | 205 | n.a. | 155 | 180 |
| 34. Manufacturing and processing deduction | 21 | 21 | 18 | 19 | n.a . | 13 | 10 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | ($ millions) | | | | | | |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 15 | n.a. | 17 | n.a. | 18 | 12 |
| 38. Employment tax credit | n.a. | 1 | n.a. | 3 | n.a. | 2 | 1 |
| E. **Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 13 | n.a. | 10 | n.a. | 13 | 17 |
| **VIII. Retail Trade** | | | | | | | |
| A. **Tax Deferrals, Exemptions and Other Deductions** | | | | | | | |
| 1. Excess tax depreciation over book depreciation | 24 | 26 | 21 | 26 | 19 | 19 | n.a. |
| 2. Inventory allowance | 55 | 70 | 60 | 75 | 65 | 75 | 80 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 8 | 10 | 13 | 15 | 9 | 10 | 13 |
| (b) Exemption of pre-1971 capital gains | 35 | 42 | 38 | 45 | 44 | 47 | n.a. |
| 11. Fast write-off for Canadian development expenses | | | | | | | |
| 12. 33 1/3-per-cent earned depletion | 1 | 2 | 3 | 3 | n.a. | 2 | n. a. |
| 13. Fast write-off for Canadian exploration expenses | | | | | | | |
| 22. Patronage dividend deduction by credit unions, co-operatives | 12 | 13 | 14 | 15 | n.a. | 11 | n.a. |
| B. **Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 160 | 165 | 230 | 235 | n.a. | 235 | 235 |
| 34. Manufacturing and processing deduction | 6 | 6 | 7 | 7 | n.a. | 5 | 6 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 2 | n.a. | 4 | n.a. | 2 | 3 |
| 38. Employment tax credit | n.a. | 2 | n.a. | 2 | n.a. | 2 | 1 |
| E. **Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 11 | n.a. | 15 | n.a. | 12 | 13 |
| **IX. Finance** | | | | | | | |
| A. **Tax Deferrals, Exemptions, and Other Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 170 | 295 | 145 | 265 | 180 | 310 | n.a. |
| 2. Inventory allowance | 40 | 42 | 3 | 4 | 1 | 3 | 2 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half post-1971 capital gains | 160 | 195 | 195 | 250 | 340 | 445 | 370 |
| (b) Exemption of pre-1971 capital gains | 555 | 595 | 370 | 420 | 1875 | 1985 | n.a. |
| 11. Fast write-off for Canadian development expenses<br>12. 33 1/3-per-cent earned depletion allowance<br>13. Fast write-off for Canadian exploration expenses | 13 | 24 | 22 | 32 | n.a. | 27 | n.a. |
| 14. Resource allowance in lieu of deductibility of provincial royalties | n.a. | 3 | n.a. | 9 | n.a. | 5 | n.a. |
| 17. Excess bad debt deduction and contingency reserves for chartered banks | n.a. | 80 | n.a. | 110 | n.a. | 200 | –115 |
| 22. Patronage dividend deduction by credit unions, etc. | 60 | 65 | 95 | 100 | n.a. | 100 | n.a. |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | | ($ millions) | | | |
| 28. Additional reserve for qualified annuities | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| 29. Non-taxation of life insurance companies' world income | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| B. **Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 135 | 140 | 150 | 150 | n.a. | 140 | 135 |
| (a) Eligibility of credit unions | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a |
| 36. Exemption from branch tax for banking | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 8 | n.a. | 4 | n.a. | 10 | 8 |
| D. **Other Corporate Items** | | | | | | | |
| 40. Exemption from withholding tax for interest on foreign currency deposits | n.a. | 570 | n.a. | 790 | n.a. | 1675 | 1490 |
| E. **Memorandum Items** | | | | | | | |
| 44. Investment corporation deduction | n.a. | 3 | n.a. | 4 | n.a. | 4 | 10 |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 65 | n.a. | 95 | n.a. | 135 | 190 |
| 46. Refundable capital gains for special investment corporations | n.a. | 31 | n.a. | 35 | n.a. | 34 | 29 |
| 47. Non-resident-owned investment corporation refund | n.a. | 17 | n.a. | 13 | n.a. | 42 | 16 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| **X. Services** | | | | | | | |
| **A, Tax Deferrals, Exemptions, and Other Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 32 | 50 | 50 | 80 | 46 | 75 | n.a. |
| 2. Inventory allowance | 7 | 8 | 3 | 4 | 10 | 11 | 10 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 20 | 27 | 21 | 34 | 34 | 42 | 13 |
| (b) Exemption of pre-1971 capital gains | 90 | 110 | 105 | 170 | 115 | 165 | n.a. |
| 5. Additional scientific and research deduction | S | 1 | 1 | 3 | 11 | 14 | 11 |
| 30. Deferral of tax from use of billed-basis accounting by professionals | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| **B. Tax Rate Reductions** | | | | | | | |
| 31. Small business deduction | 190 | 190 | 240 | 250 | n.a. | 230 | 285 |
| 34. Manufacturing and processing deduction | 8 | 8 | 12 | 13 | n.a. | 17 | 21 |
| **C. Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 8 | n.a. | 14 | n.a. | 20 | 22 |
| **E. Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 22 | n.a. | 17 | n.a. | 22 | 30 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|---|
| | | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | | | ($ millions) | | | |
| **XI.** | **Mining** | | | | | | | |
| **A.** | **Tax Deferrals, Exemptions, and Other Deductions** | | | | | | | |
| 1. | Excess of tax depreciation over book depreciation | 125 | 230 | 220 | 275 | 85 | 260 | n.a. |
| 2. | Inventory allowance | 10 | 15 | 13 | 18 | 3 | 11 | 14 |
| 3. | Capital gains: | | | | | | | |
| | (a) Exemption of half of post-1971 capital gain | 7 | 10 | 55 | 65 | 8 | 55 | 5 |
| | (b) Exemption of pre-1971 capital gains | 45 | 70 | 41 | 100 | 215 | 265 | n.a. |
| | (c) Total exemption | 50 | 80 | 95 | 165 | 225 | 320 | n.a. |
| 5. | Additional scientific and research deduction | 0 | 1 | 5 | 6 | 1 | 2 | 1 |
| 11. | Fast write-off for Canadian development expenses | | | | | | | |
| 12. | 33 1/3-per-cent earned depletion allowance | 140 | 215 | 95 | 170 | n.a. | 37 | n.a. |
| 13. | Fast write-off for Canadian exploration expenses | | | | | | | |
| 14. | Resource allowance in lieu of deductibility of provincial royalties | n.a. | 165 | n.a. | 180 | n.a. | 85 | n.a. |
| 15. | Additional earned depletion on frontier oil and gas well exploration costs | 10 | 12 | 1 | 29 | n.a. | n.a. | n.a. |
| **B.** | **Tax Rate Reductions** | | | | | | | |
| 31. | Small business deduction | 8 | 8 | 15 | 16 | n.a. | 12 | 11 |
| 34. | Manufacturing and processing deduction | 5 | 7 | 8 | 8 | n.a. | 4 | 3 |
| 36. | Exemption from branch tax of iron ore mining corporations | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 55 | n.a. | 55 | n.a. | 34 | 15 |
| D. **Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 1 | n.a. | 2 | n.a. | 4 | 7 |
| **XII. Oil and Gas** | | | | | | | |
| A. **Tax, Deferrals, Exemptions and Other Deductions** | | | | | | | |
| 1. Excess of tax depreciation over book depreciation | 155 | 300 | 300 | 335 | 255 | 315 | n.a. |
| 2. Inventory allowance | 18 | 26 | 25 | 31 | 45 | 47 | 60 |
| 3. Capital gains: | | | | | | | |
| (a) Exemption of half of post-1971 capital gains | 7 | 24 | 8 | 37 | 32 | 49 | 28 |
| (b) Exemption of pre-1971 capital gains | 285 | 325 | 19 | 36 | 48 | 55 | n.a. |
| 5. Additional scientific and research deduction | 3 | 5 | 7 | 10 | 11 | 16 | 9 |
| 11. Fast write-off for Canadian development expenses | | | | | | | |
| 12. 33 1/3-per-cent earned depletion | 655 | 765 | 945 | 1095 | n.a. | 1035 | 660 |
| 13. Fast write-off for Canadian exploration expenses | | | | | | | |
| (a) Deferral of Canadian exploration expense redefinition | – | – | – | – | n.a. | 75 | 6 |
| 14. Resource allowance in lieu of deductibility of provincial royalties | n.a. | –445 | n.a. | –540 | n.a. | –570 | –565 |
| (a) Resource allowance and deductibility of provincial royalties for Syncrude project | – | – | n.a. | 30 | n.a. | 40 | 45 |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | | 1980 | | 1981 | | 1982 |
|---|---|---|---|---|---|---|---|
| | Lower bound | Upper bound | Lower bound | Upper bound | Lower bound | Upper bound | Upper bound |
| | | | ($ millions) | | | | |
| 15. Additional earned depletion on frontier oil and gas well exploration costs | 44 | 55 | 30 | 34 | n.a. | S | S |
| 16. Additional earned depletion for heavy oil tertiary recovery projects (supplementary depletion) | 65 | 70 | 43 | 60 | n.a. | 1 | 8 |
| 22. Patronage dividend deduction by credit unions, etc. | 4 | 4 | 5 | 5 | n.a. | 15 | n.a. |
| B. **Tax Rate Reductions** | | | | | | | |
| 34. Manufacturing and processing deduction | 34 | 36 | 65 | 70 | n.a | 60 | 22 |
| C. **Credits** | | | | | | | |
| 37. Investment tax credit | n.a. | 105 | n.a. | 110 | n.a. | 155 | 105 |
| E. **Memorandum Items** | | | | | | | |
| 45. Refundable Part I Tax on investment income of private corporations | n.a. | 11 | n.a. | 9 | n.a. | 9 | 1 |
| **Special Energy Taxes** | | | | | | | |
| 48. Net Petroleum and Gas Revenue Tax (PGRT) revenues | | – | | – | | 950 | 1650 |
| 49. Small producers' credit against PGRT | | – | | – | | – | 30 |
| 50. Net Incremental Oil Revenue Tax (IORT) revenues | | – | | – | | – | 240 |
| 51. IORT Low Productivity Well Allowance | | – | | – | | – | n.a. |
| 52. Natural Gas and Gas Liquids Tax revenues | | – | | – | | 845 | 1240 |
| 53. Canadian Ownership Special Charge revenues | | – | | – | | 630 | 910 |
| 54. Oil Export Charge revenues | | 720 | | 850 | | n.a. | n.a. |

Table 2 (Cont'd)

**Selective Tax Measures: Corporate Income Tax**

| | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|
| | Upper bound | Upper bound | Upper bound | Upper bound |
| | | ($ millions) | | |
| **XIII. F. Other Tax Measures** | | | | |
| 55. Transfer of income tax room to provinces in respect of shared-cost programs | 240 | 275 | 270 | 240 |
| 56. Exemption from withholding tax for interest on provincial direct and guaranteed debt | 220 | 255 | 315 | 415 |
| 57. Exemption from withholding tax for interest on municipal direct and guaranteed debt | 41 | 44 | 48 | 60 |
| 58. Exemption from withholding tax for interest on Government of Canada debt | 95 | 130 | 160 | 185 |
| 59. Non-taxation of registered charities | n.a. | n.a. | n.a. | n. a. |
| (a) Non-taxation of non-profit scientific research corporations | n.a. | n.a. | n .a. | n.a. |
| (b) Non-taxation of non-profit corporations providing low cost housing for the aged | n.a. | n.a. | n.a. | n.a. |
| 60. Income tax exemption for provincial and municipal corporations | n.a. | n.a. | n.a. | n.a. |
| 61. Non-taxation of certain federal Crown corporations | n.a. | n.a. | n.a. | n.a. |
| 62. Political tax credit | 1 | 1 | S | S |
| 63. Gifts to the Crown | n.a. | n.a. | n.a. | n.a. |

Table 3

**Selective Tax Measures: Commodity Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| I. **General Government Services** | | | | | |
| 1. Exemption of goods purchased by the Office of the Governor General | S | S | S | S | S |
| II. **Foreign Affairs** | | | | | |
| No selective measures under this category | | | | | |
| III. **Defence** | | | | | |
| 1. Exclusion of the research and development component of defence purchases | n.a. | n.a. | – | – | – |
| 2. Exemption of defence memorials and monuments | S | S | S | S | S |
| IV. **Transportation and Communications** | | | | | |
| 1. Exemption of transportation equipment | 260 | 250 | 310 | 220 | 235 |
| V. **Economic Development and Support** | | | | | |
| A. **Farming and Fishing** | | | | | |
| No selective measures under this category | | | | | |
| B. **Resource Sector** | | | | | |
| 1. Non-adjustment of specific sales tax rate on gasoline | 40 | 45 | – | – | – |

Symbols: n.a. : Estimates not available.
— : Not applicable.
s : Revenue impact expected to be small, less than $5 million.
* : Value included elsewhere.

Table 3 (Cont'd)

**Selective Tax Measures: Commodity Tax**

| | Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|---|
| | | | | ($ millions) | | |
| C. | **Regional Development** | | | | | |
| | No selective measures under this category | | | | | |
| D. | **Energy Conservation** | | | | | |
| 1. | Exemption of energy conservation goods and insulation materials | 20 | 30 | 35 | 35 | 40 |
| E. | **Manufacturing Sector** | | | | | |
| | No selective measures under this category | | | | | |
| F. | **Research and Development** | | | | | |
| 1. | Exemption of scientific apparatus | * | * | * | * | * |
| G. | **Small Business** | | | | | |
| 1. | Sales tax exemption for small manufacturers (less than $50,000 of taxable sales) | 20 | 20 | 25 | 25 | 25 |
| H. | **Labour Force** | | | | | |
| | No selective measures under this category | | | | | |
| I. | **General Business and Investment Incentives** | | | | | |
| 1. | Exemption of metric scales and conversion kits | S | S | S | S | S |
| 2. | Exemption of non-manufacturing commercial uses of fuel and electricity | 220 | 245 | 315 | 380 | 400 |

Table 3 (Cont'd)

**Selective Tax Measures: Commodity Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **VI. Health and Welfare** | | | | | |
| **A. Health** | | | | | |
| 1. Exemption of drugs | 70 | 80 | 95 | 105 | 120 |
| 2. Exemption of purchases by hospitals, sanatoria, etc. | 40 | 55 | 70 | 85 | 95 |
| 3. Exemption of health and medical instruments and appliances | 6 | 8 | 9 | 10 | 11 |
| **B. Income Maintenance** | | | | | |
| 1. Exemption of food and non-alcoholic beverages | 1800 | 2000 | 2265 | 2450 | 2580 |
| 2. Exemption of home-heating fuels and electricity | 325 | 385 | 470 | 570 | 590 |
| 3. Exemption of clothing and footwear | 525 | 575 | 640 | 665 | 705 |
| **C. Social Assistance** | | | | | |
| 1. Exemption of goods manufactured by the handicapped | S | S | S | S | S |
| **D. Indians and Eskimos** | | | | | |
| No selective measures under this category | | | | | |
| **E. Housing and Urban Renewal** | | | | | |
| 1. Reduced rate of sales tax on building materials and equipment | 395 | 415 | 480 | 405 | 430 |
| 2. Exemption of construction equipment | 80 | 90 | 105 | 105 | 105 |
| 3. Exemption of ready mix concrete and goods in competition with on-site construction | 75 | 80 | 90 | 90 | 80 |
| **VII. Education Assistance** | | | | | |
| 1. Exemption of equipment and construction materials bought by educational institutions | 30 | 30 | 35 | 35 | 40 |
| 2. Exemption of technical, educational, and other books | 55 | 60 | 65 | 85 | 75 |

Table 3 (Cont'd)

**Selective Tax Measures: Commodity Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| **VIII. Culture and Recreation** | | | | | |
| 1. Exemption of newspaper and magazine production | 135 | 150 | 175 | 185 | 200 |
| 2. Exemption of a range of cultural and religious materials | S | S | S | S | S |
| 3. Exemption of imported antiques | S | S | S | S | S |
| 4. Exemption of amusement devices and equipment for use at exhibits or fairs | S | S | S | S | S |
| 5. Exemption of bicycles and tricycles | 7 | 9 | 11 | 10 | 11 |
| 6. Exemption of the outputs of craftsmen, artists, and sculptors | 5 | 6 | 7 | S | S |
| **IX. Fiscal Transfer Payments** | | | | | |
| 1. Exemptions of a range of municipal purchases | 30 | 35 | 40 | 45 | 45 |
| 2. Exemption of provincial purchases for provinces not party to the Reciprocal Taxation Agreements | 30 | 30 | 30 | 30 | 25 |
| **X. Public Debt** | | | | | |
| No selective measures under this category | | | | | |
| **XI. Other Tax Preferences** | | | | | |
| 1. Exemption of goods imported in travellers' baggage | n.a. | n.a. | n.a. | n.a. | n.a. |
| 2. Exemption of manufacture of coins | n.a. | n.a. | n.a. | n.a. | n.a. |

Table 3 (Cont'd)

**Selective Tax Measures: Commodity Tax**

| Functional Category and Item | 1979 | 1980 | 1981 | 1982 | 1983 |
|---|---|---|---|---|---|
| | | | ($ millions) | | |
| XII. **Memorandum Items** | | | | | |
| 1. Exemption of services from the sales tax base | 4590 | 5190 | 5925 | 6450 | 7065 |
| 2. Commodity taxes other than manufacturer's sales tax: | | | | | |
| gasoline | 425 | 440 | 405 | 410 | 445 |
| tobacco | 795 | 870 | 940 | 1055 | 1155 |
| alcohol | 805 | 910 | 1070 | 1100 | 1210 |
| jewellery | 50 | 50 | 50 | 45 | 40 |
| heavy cars, car air conditioners, private planes, motorcycles, boat motors | 34 | 26 | 27 | 21 | 26 |
| air transport | 159 | 160 | 180 | 195 | 205 |
| telecommunications programming services | – | – | – | – | 15 |
| other | 11 | 8 | 13 | 14 | 11 |
| 3. Exemption from special excise tax on gasoline for commercial users | 140 | 135 | 115 | 110 | 95 |

## Appendix 1

# A Description of Selective Tax Measures in the Personal Income Tax System

### Introduction

This appendix provides a brief description of each of the personal income tax provisions included in the selective tax measures account and outlines any changes in tax provisions that have occurred during the period covered by this account. A number of items included in this section affect both personal and corporate taxes payable. Additional information on these items is provided in Appendix 2 pertaining to corporate tax provisions.

The main source of estimates for personal income tax measures is the sample of tax returns used by Revenue Canada for their annual publication, *Taxation Statistics.* Based on this sample, a microsimulation tax model has been developed which can produce reliable estimates of the revenue impact of a simulated change in the tax system. Selective tax measures estimated in this fashion include the age, disability, marital and dependent child exemptions, the education and tuition fee deductions, and the $1,000 pension and investment income deductions, to name a few. Some other provisions for which data are available on the microsimulation model also require substantial further computations and information from other sources (e.g., tax deferral provisions such as the treatment of RRSPs and RPPs, and the MURB provision). Nevertheless, revenue cost figures for the majority of these tax measures can be estimated quite reliably.

There are other provisions, however, for which information is not available from Revenue Canada tax return samples and which must be computed using other less accurate techniques and data from a variety of sources. The non-taxation of capital gains on owner-occupied dwellings, for example, uses data from several Statistics Canada sources, as well as other sources such as the Canadian Real Estate Association. Estimates for these items are subject to wider margins of error. In all cases, the values provided in the tables should be viewed as mid-points of a range of estimates.

In the following descriptions of selective tax measures, unless otherwise stated, the revenue cost estimates are computed using the microsimulation tax model.

## Selective Tax Measures in the Personal Income Tax System

### I. General Government Services

1. ***Political Contribution Tax Credit:*** The *Income Tax Act* allows taxpayers a credit for donations to registered political parties at the federal level. The credit is 75 per cent of the first $100 of contributions, 50 per cent

on the next $450 of contributions and 33 1/3 per cent on contributions exceeding $550. The maximum credit claimable is $500. The value of this item was $8 million in 1983.

2. *Non-Taxability of Income from the Office of Governor General:* This income is exempt from individual taxation. The value of this item is very small.

3. *Non-Taxation of RCMP Pensions or Compensation for Injury, Disability or Death:* Payments of these amounts are not included in income for tax purposes. Based on Public Accounts data, the tax forgone is estimated to be under $5 million in 1983.

4. *Non-Taxation of Allowances to Volunteer Firemen:* Volunteer firemen may receive up to $500 ($300 prior to 1982) of allowances which are not included in income for tax purposes. The value of this item is under $5 million annually and is computed using estimates of the number of volunteer firemen receiving such allowances and their approximate marginal tax rates.

## II. Foreign Affairs

1. *Non-Taxation of Special Allowances for Diplomats and Other Government Employees Posted Abroad:* Payments of these amounts are non-taxable. Estimates are based on information obtained from the Department of External Affairs on allowances paid to employees. The estimate for this item for 1983 is $8 million.

2. *Overseas Employment Deduction/Tax Credit:* To aid Canadians seeking overseas contracts, starting in 1980, Canadian employees working abroad more than six months could exclude half their overseas employment income up to a maximum of $50,000 from income for tax purposes. This measure applied to persons working on construction, installation, agricultural and engineering projects, in resource exploration and development, and in other prescribed activities. The 1983 revenue cost of this item is approximately $17 million. Effective from the 1984 taxation year, the deduction is replaced by a credit of 80 per cent of tax otherwise payable on up to $100,000 of qualifying overseas employment income.

## III. Defence

1. *Non-Taxation of Veterans Allowances, Civilian War Pensions and Allowances, and Other Service Pensions:* These pension payments are not subject to individual income taxation. The estimate is based on payments reported in the Public Accounts and Main Estimates. In computing the value of this item, the amount of war pensions received is multiplied by the marginal tax rate applicable for CPP benefits. (The allowances are

income tested and thus likely entail a negligible amount of forgone revenue.) The estimate for this item for 1983 is $85 million.

2. *Non-Taxation of Service Pensions from Other Countries:* Service pensions received by Canadian residents from countries that were allies of Canada are not subject to individual income taxation. This item is expected to be small in value.

3. *Non-Taxation of Income from War Savings Certificates:* These payments are not subject to individual income taxation. This selective tax measure is very small in value.

## IV. Transportation and Communications

No selective measures under this category.

## V. Economic Development and Support

### A. Farming and Fishing

1. *Five-Year Block Averaging For Farmers and Fishermen:* Farmers and fishermen are allowed to average their incomes once every five years over the preceding five-year period and adjust their tax as if their income in each year had equalled the five-year average. Given that the benchmark tax system would require tax to be paid annually on the income received in that year, this constitutes a selective tax measure. Because of the progressive rate structure in the personal income tax, farmers and fishermen with fluctuating incomes benefit through the use of this averaging device. Values for this item are not available.

2. *Cash Basis Accounting:* Farmers and fishermen can elect to use the cash basis of accounting for tax purposes (except in respect of depreciable assets). Other taxpayers must generally use accrual accounting, which is the basis for the benchmark tax structure. Under the cash basis, receipts are included in income only when received and expenses are deductible when actually paid. This can permit a deferral of tax, in that costs paid are immediately deductible despite the fact that the resulting income may not arise until a later year. For example, inventory costs can be deducted as a current expense unlike the case for most other taxpayers who must use accrual accounting methods. Moreover, accounts receivable (i.e., accrued) in the year but not yet received are not taxable.

   Although no estimates are currently available, this item could be substantial in size. It is also important to note that this item interacts with other tax provisions available to the farming sector.

3. ***Flexibility in Inventory Accounting:*** Farmers using the cash basis method of accounting are allowed to depart from it with regard to their livestock inventory. Under cash basis accounting, net additions to inventory are treated as a cost which is deducted in computing income. When a farmer's livestock inventory is growing from year to year, such costs could put him in a loss position for tax purposes. However, a discretionary amount can be added to income each year not exceeding the fair market value of livestock on hand at year end. This amount must then be deducted from income the following year. The effect of this provision is to allow farmers who are building up their herds to avoid the time limit on carrying forward losses, or to make fullest use of the five-year block averaging provisions. No estimates are available for this item.

4. ***Deferral of Tax on Capital Gains on Intergenerational Rollovers of Family Farms:*** Sales or gifts of business assets to children or grandchildren (on or before death of the taxpayer) would usually give rise to taxable capital gains to the extent that the fair market value exceeded the cost base of the property under the existing tax system. On intergenerational transfers of farm property or shares in a farm corporation, the taxation of capital gains is deferred until the property passes outside of the family. This is a departure from accrual taxation and also a departure from the deemed realization provisions of the existing tax system. The February 1984 budget introduced several technical changes to this rollover provision, designed to facilitate the transfer for individuals in special circumstances. Values for this item are not available.

5. ***Deferral of Income on Grain Sold Through Deferred Cash Tickets:*** Under the deferred cash ticket program of the Canadian Wheat Board, western farmers may make deliveries of grain before the year-end and receive payment in the form of a ticket that may be cashed in the following year. The payment is included in income for tax purposes only when the ticket is cashed. This results in a deferral of tax. The estimates of its value are computed on a cash flow basis and compare in each year the amount brought into income from the previous year with the amount of current income deferred for tax purposes until the following year. The negative value in 1982 arises because the amount deferred in 1981 (taxable in 1982) was greater than the amount deferred from 1982 to 1983. The 1983 estimate for this item is $30 million.

6. ***Deferral of Income on Destruction of Livestock:*** On the election of the taxpayer, where there has been forced statutory destruction of livestock (e.g., as a result of brucellosis control measures), the income received as a result of the forced destruction can be deemed to be income in the following year. This results in a deferral of tax. No estimates are available for this item.

7. ***Expensing of Certain Capital Expenditures:*** Certain expenditures of a capital nature, such as land clearing and improvement costs and

expenditures incurred to replace individual trees or vines in orchards and vineyards, are allowed to be expensed at the time they are incurred. This allows for both a deferral and a partial exclusion of tax in that the costs are immediately deductible whereas only one-half of the resulting increase in the value of the property is taxed as a capital gain and only upon sale of the property. No estimates are available for this item.

8. ***Exemption from Requirement to Pay Quarterly Tax Instalments:*** Unlike other taxpayers earning business income, farmers do not have to pay quarterly instalments of tax. Instead, they pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year. This provides farmers with a tax deferral not available to other taxpayers. The value of this item is estimated to be under $5 million annually.

9. ***Deduction of One-Quarter of All Farm Home Expenses and Two-Thirds of Automobile Expenses Without Proof of Use for Business Purposes:*** Farmers can deduct 25 per cent of all home expenses including capital cost allowance (CCA) on the home and 66 2/3 per cent of automobile expenses including CCA without proof of use for business purposes. Other self-employed individuals are able to deduct such expenses only to the extent that they can show that the property is used for business purposes. A selective tax measure arises to the extent that the flat percentage deductions exceed the actual amounts of business use of the assets. No estimates are available for this item.

10. ***Investment Tax Credit on Farming and Fishing Investments:*** This item is the value of the investment tax credit applicable to the farming and fishing sectors. It is obtained from *Taxation Statistics*, and is adjusted to take into account that the amount of the tax credit reduces the amount of CCA deductible. The estimate of this item is approximately $100 million in 1983. The investment tax credit provision is discussed more generally in Appendix 2.

11. ***Excess of Tax Depreciation over Book Depreciation:*** This item refers to the tax savings arising from the fast write-offs in the CCA system in the farming and fishing sectors. The available data indicate that it is small in value. This selective tax measure is discussed generally in Appendix 2.

## B. Resource Sector

1. ***Drilling Funds, Flow-Through Shares and Other Resource-Related Deductions:*** Individuals may be entitled to deduct Canadian exploration expenses (CEE), Canadian development expenses (CDE), Canadian oil and gas property expenses (COGPE), frontier exploration allowance, earned depletion or supplementary depletion for one of several reasons. An individual may personally engage in resource-related activities, in

which case the usual rules apply. (See Items 11, 12, 13, 15, and 16 in Appendix 2.) More frequently, another party undertakes the activity and flows through the related tax deductions to the individual who has provided financing for the activity.

Historically, this flow-through of resource-related tax deductions has taken one of two forms, either through drilling funds or flow-through shares. "Drilling funds", as they were generally known, were limited partnership interests in closed-end entities which explored for, developed, or bought properties for the purpose of producing oil or gas. The investor included in his personal income tax return the share of profits (or losses) accruing to him and was also entitled to deduct any related CEE, CDE, COGPE, frontier exploration allowance or supplementary depletion. The frontier exploration allowance, which could be earned between April 1, 1977 and March 31, 1980, provided an important incentive to individuals wishing to invest in drilling funds. This measure provided an additional deduction of 66 2/3 per cent of any well costs over $5 million. Another important incentive to individual investors in the resource sector was an amendment introduced in 1976 that permitted taxpayers who were not principal business corporations to deduct new CEE without any restrictions. Formerly, these taxpayers could deduct a maximum of 30 per cent of their cumulative Canadian exploration expenses each year.

Flow-through shares are issued by corporations to investors in return for exploration and development expenses incurred by the investor for the benefit of the corporation. In a practical sense, flow-through shares may be used to transfer to an investor future CEE, CDE, COGPE and, in the case of mining corporations, certain earned depletion deductions. Two amendments to the *Income Tax Act* made flow-through share financing an attractive alternative. A November 12, 1981 budget change permitted investors to treat flow-through shares as capital property in certain circumstances. Prior to that time, these shares had been treated as inventory and subject to tax as income upon disposition. The April 19, 1983 budget announced an amendment to allow depletion related to certain mining exploration expenses incurred after April 19, 1983 to be deducted from any source of income up to a limit of 25 per cent of the taxpayer's income. As a result, investors without resource profits became eligible to deduct certain mining earned depletion.

The entire amount of resource-related deductions claimed by individuals is treated as a selective tax measure in this section of the account. (Refer to Items 11, 12 and 13 in Appendix 2 for implications of this treatment.) The value of this item for 1983 is estimated to be $45 million.

2. ***Capital Gains Treatment for Prospectors and Grubstakers:*** Individuals and their financial backers who make a resource discovery can arrange their affairs so that the resulting income (the increase in value of the resource

property) is treated as a capital gain for tax purposes, and the realization of that gain can be deferred at the discretion of the owners of the discovery. This constitutes a departure from the benchmark tax system since half of the income is never taxed and tax on the other half is deferred. The value of this item is expected to be under $5 million.

## C. Regional Development

1. *Portion of Investment Tax Credit:* That portion of the revenue cost of the investment tax credit associated with higher rates of credit in specific regions should properly be classified under regional development. The value of this item is included in items V.A.10 and V.I.1.

2. *Portion of Employment Tax Credit:* That portion of the revenue cost of the employment tax credit associated with higher rates of credit in specific regions should properly be classified under regional development (see Item V.H.1).

## D. Energy Conservation

1. *Non-Taxation of Home Insulation Grants in Nova Scotia and Prince Edward Island:* Under the benchmark tax structure, all transfer payments to persons are part of income for tax purposes. Until December 1981, individuals in Prince Edward Island and Nova Scotia were eligible for non-taxable home insulation grants of up to $500. The value of this item is estimated to be under $5 million for 1981 and is computed based on the amounts paid out under this program and estimates of the marginal tax rates of the recipients.

## E. Manufacturing Sector

No selective measures under this category.

## F. Research and Development

1. *Immediate Write-Off of R&D Expenditures:* All expenses on R&D may be written off immediately in the year incurred despite the fact that many of these expenditures are capital in nature, designed to produce future income. This selective tax measure is expected to be small in value for unincorporated businesses.

2. *Scientific Research Tax Credits:* SRTCs were introduced in the April 1983 budget to allow firms which engage in research and development to flow the value of their immediate write-offs for R&D expenses (item 1 above) through to their investors. The value of this item

at the personal level is $85 million in 1983. (No values are provided in Table 2 for this item as that table contains values to 1982 only.)

## G. Small Business

1. ***Deferral of up to $200,000 of Capital Gains on Intergenerational Transfers of Small Business:*** Sales or gifts of business assets to children or grandchildren (on or before death of the taxpayer) would usually give rise to taxable capital gains under the existing tax system to the extent that the fair market value exceeded the cost base of the property. On intergenerational transfers of shares in certain incorporated small businesses to a child or grandchild of the taxpayer after May 25, 1978, up to $200,000 of capital gains may be deferred until the business is eventually transferred outside the family. This is a departure from accrual taxation and also a relaxation of the general rule of deemed realization. No estimates are available for this item.

2. ***Special Tax Treatment of Employee Stock Options:*** Under the benchmark tax system, any benefits provided to employees in the form of stock options issued and exercised at a price lower than their fair market value are considered to be fully taxable just like ordinary wages and salaries. However, effective from April 1977, the exercise of options by employees of Canadian-controlled private corporations (CCPs) to buy shares in the corporation at a cost below their fair market value does not immediately give rise to any taxable income. Instead, if the shares are held for more than two years, any difference is treated as a capital gain so that only one-half of the gain is taxable and then only when the shares are eventually sold by the employee. The February 1984 budget provided an additional tax incentive for other corporations (i.e., non-CCPCs) offering employee stock option plans. Effective from February 15, 1984, for employees of these corporations only 50 per cent of the benefit is subject to tax. No estimates are available for this item.

3. ***Full Offset of Certain Allowable Capital Losses:*** In general, up to $2,000 of allowable capital losses (one-half of realized losses) can be offset against income other than capital gains by individuals. Corporations cannot offset any capital losses against income other than capital gains. However, both individuals and corporations can offset any amount of allowable capital losses incurred on arm's-length sales of shares or debt of Canadian-controlled private corporations (CCPCs) against any other income, not just capital gains income. In addition, any of these allowable business investment losses not absorbed in the year are carried over as non-capital losses and, hence, can also be deducted against non-capital income in other years without restriction. While the general structure of the current loss provisions has been taken as part of the benchmark tax structure, this provision is a selective tax measure for taxpayers investing in CCPCs, which are typically small businesses. The revenue cost of this provision is estimated to about $50 million for 1983.

4. *Non-Taxation of Provincial Assistance for Venture Investments:* Normally when a taxpayer receives assistance in the form of a grant or tax credit in respect of the purchase of a share, the cost of the share for purposes of computing any subsequent capital gain or loss is reduced by the amount of the assistance. The *Income Tax Act* provides that there be no such adjustment to the cost base of shares in the case of assistance under prescribed provincial venture capital programs, thereby providing a selective tax measure for such investments. Since 1981, venture capital programs have been prescribed in Quebec, Ontario, Manitoba, Saskatchewan, and Alberta. Estimates of the tax cost of this provision are not available at this time.

## H. Labour Force

1. *Employment Tax Credit:* Beginning in March 1978, a program of non-refundable tax credits was instituted for employers who created new full-time jobs. The value of the credits varied depending on the geographic region. The program terminated at the end of March 1981, although the unused portion of credits could be carried forward for five years. The values in Table 1 (under $5 million annually) refer to credits received by unincorporated employers. The majority of the tax credits were received by corporate employers (and are included in Table 2).

2. *Non-Taxation of Employee Benefits in the Form of Subsidized Loans:* Prior to 1979, the benefit associated with certain interest-free or low-interest loans to an employee were not, as a result of administrative practice, specifically taxable. Starting in 1979, such benefits, calculated by reference to a prescribed rate of interest, became taxable with the exception of benefits related to a loan of up to $50,000 for purchasing a house as a result of a move or transfer, loans used to buy shares in the employer corporation, and a standard $500 exemption. Under the benchmark system, the benefit associated with any such subsidized loans would be included in income (including the extent to which the prescribed interest rate for tax purposes is below the actual market rate). The November 1981 budget eliminated the standard $500 exemption and phased out the exemption for housing loans. Estimates for this item are not currently available.

3. *Non-Taxation of Employer-Paid Premiums for Private Health Insurance and Group Term Life Insurance of up to $25,000:* Employer payments of premiums for private health insurance including dental plans and for group term life insurance coverage of up to $25,000 per employee are not considered a taxable benefit for the employee. Under the benchmark tax system, such benefits would be taxable to the employee.

   The estimates were derived using data from the 1978 Statistics Canada publication, *Employee Compensation in Canada*, and various issues of the Public Service Staff Relations Board publication, *Employee*

*Benefits and Working Conditions.* The revenue cost estimate for this item in 1983 is about $400 million.

4. ***Non-Taxation of Other Non-Monetary Benefits:*** There are a range of benefits that an employer can provide his employees without giving rise to taxable income in the employees' hands. These include group sickness and accident insurance, discounts on purchases of the employer's merchandise, subsidized meals in staff lunchrooms and canteens, subsidized school services for employees' families in remote areas, recreational facilities provided free or at a nominal charge, and transportation to work in vehicles owned by the employer. The costs of these benefits can be deducted by the employer in determining his taxable income. Under the benchmark tax system, the value of all such benefits would be taxable to the employee. It should be noted that many such benefits are exempted as a matter of administrative practice because of the problem of attributing benefits, and not through any explicit provisions in the *Income Tax Act.* No estimates for this item are available.

5. ***Deductibility of Employer Contributions to Non-Registered Employee Benefit Plans:*** Under the benchmark tax structure, once amounts are allocated to the individual employees, they become taxable in their hands. Under an employee benefit plan, the employee is required to pay tax on such amounts only when he receives the funds (rather than when they are allocated to him). However, employers cannot claim a deduction for their contributions until the employee receives the payment out of the plan. (Prior to December 11, 1979, employers could claim an immediate deduction for their contributions.) To the extent that the employee's marginal tax rate is higher than his employer's, tax is deferred for the period of time that the funds have been allocated, but not paid to the employee. The advantage is most significant, of course, where the employer is non-taxable. Estimates are not available for this item.

6. ***Non-Taxation of Vacation-With-Pay Trusts:*** In a number of industries such as construction, paid vacations are arranged by having employers and possibly employees contribute to vacation-with-pay trusts. Subsequently, the trust makes payments to entitled workers during their vacations. The April 1980 economic statement exempted from tax retroactively to 1972 any income earned in such trusts. The estimate for this item is under $5 million annually.

7. ***Non-Taxation of Strike Pay:*** Strike pay is not included in income for tax purposes. This is a departure from the comprehensive income base of the benchmark tax structure. The estimate for this item in 1983 is $4 million.

   It should be noted that union dues are fully deductible from income in computing tax payable. Union dues are considered a necessary expense to earn employment income and thus their deductibility does not constitute a selective tax measure.

8. *Non-Taxation of Northern Allowances:* Pursuant to a remission order, housing and travel benefits provided to employees in the North and in specified isolated posts are not required to be included in income for tax purposes. This exemption is only afforded to those employees who are covered by an employer benefit plan that was arranged prior to November 13, 1981. In addition, a second remission order provides a limited exemption to employees who receive such benefits but are not covered by the first order. The revenue cost estimate for this item for 1983 is $25 million.

## I. General Business and Investment

1. *Investment Tax Credit Not Included Elsewhere:* This is the value of the investment tax credit (adjusted for the reduction in CCA claimable) given to individuals excluding that portion already included under the farming and fishing category. The estimate for this item is $24 million for 1983. The total cost of the ITC for individuals is $124 million for 1983 (including the amounts received for farmers and fishermen.)

2. *Non-Taxation of One-Half of Capital Gains Income:* Under the existing tax system, one-half of most capital gains realized since the beginning of 1972 (or "valuation day") need not be included in income for tax purposes by either individuals or corporations. Under the benchmark tax system, these gains would be fully taxable on accrual and capital losses would be deductible against other income. In estimating the value of this item, it is assumed that in the absence of this provision, capital gains would be taxed fully on realization while up to $4,000 of capital losses (double the existing limit) could be deducted from other income in the year. The estimate for this item for 1983 is $440 million.

3. *Non-Taxation of Capital Gains Income Accrued Prior to 1972:* All capital gains realized after 1971 but accrued prior to 1972 (or "valuation day") need not be included in income for tax purposes. Under the benchmark tax system, these gains would be fully taxable. No estimates are available for this item.

4. *Flow-Through of Capital Gains:* Private corporations (e.g., those not listed on a recognized stock exchange and not controlled by a public corporation) can distribute the exempt one-half of any realized capital gains received (accumulated in their "capital dividend account") to their shareholders in the form of a special dividend that is completely exempt from tax in the shareholders' hands. Under the benchmark tax system, corporations and their shareholders are treated as separate taxpaying units, so that capital gains realized by corporations would be fully taxable as corporate income and any distributions to shareholders fully included in the shareholders' income. Estimates are not available for this item.

5. *Capital Gains Treatment of Stock Dividends of Public Corporations:* Stock dividends paid by public corporations are not included in the incomes of recipients like ordinary dividends but rather their value when realized by sale is treated as a capital gain. Thus, only one half of the value of the stock dividend is taxable and only upon the ultimate sale of the stock. No estimates are available for this item.

6. *$1,000 Capital Gains Exemption for Personal Use Property Transactions:* Personal use property (such as automobiles and boats) is distinguished from other property by the fact that its primary use is for the enjoyment of the owner. A floor of $1,000 is placed on the cost base in calculating capital gains for tax purposes from the sale of personal use property. Thus, any difference between the actual cost base and sale proceeds up to $2,000 is exempted from tax. No losses are allowed in respect of personal use property. The estimate for this item is less than $5 million annually.

7. *$200 Capital Gains Exemption on Foreign Exchange Transactions:* In addition to the selective tax provision for capital gains in general, the first $200 of capital gains or losses on foreign exchange transactions are not taken into account. The estimate for this item is less than $5 million annually.

8. *Deferral of Capital Gains Income Through Various Rollover Provisions:* Certain rollover provisions offer special tax treatment with respect to the existing tax system in that they allow an exemption from taxation of capital gains on a realization basis. Since the benchmark tax system includes all accrued gains in the tax base, it is more for information purposes that the following rollover provisions have been separately identified:

   i) *Involuntary Dispositions:* Tax on any realized capital gains resulting from an involuntary disposition (for example, expropriation or insurance proceeds received for an asset destroyed in a fire) where the funds are reinvested in a replacement asset within a specified period may, at the option of the owner, be deferred until the replacement property is disposed of.

   ii) *Voluntary Dispositions:* Tax on realized capital gains resulting from the voluntary disposition of land and buildings not used to generate rental income can be deferred if replacement properties are purchased soon thereafter (for example, a business changing location).

   iii) *Transfers to a Corporation for Consideration Including Shares:* A taxpayer can sell an asset to a corporation in exchange for cash and/or its shares (not only as part of a reorganization). No capital loss can be realized in such a transaction, but no capital gain need be realized, at the discretion of parties to the transaction.

9. *Accrued Capital Gains Income Not Included Elsewhere:* This item represents the deferral of tax liability relative to the benchmark tax structure arising from the fact that accrued but unrealized capital gains are not taken into income each year. Estimates for this item are not available.

10. *$1,000 Investment Income Deduction:* In recognition of the impact of inflation on the taxation of interest, dividends, and taxable capital gains income of individuals, up to $1,000 of such income need not be included in income for tax purposes. Any unused portion of this deduction is transferable between spouses. In this regard, a change was introduced in the November 1981 budget, so that beginning in 1982 the amount of the deduction transferred cannot exceed the amount by which the marital exemption of the supporting taxpayer is reduced thereby. The estimate for this item in 1983 is $835 million.

11. *Other Accrued Investment Income Not Included Elsewhere:* Prior to 1982, taxpayers had the option of reporting certain types of investment income (for example interest on Canada Savings Bonds, deferred annuities, and loans where interest is accumulated over more than one year) on an accrual or on a realization basis. This permitted a deferral of tax. The November 1981 budget limited this tax deferral by requiring the accrued investment income from debt obligations and deferred annuities to be reported at least every three years. No estimates are available for this item.

12. *Non-Taxation of Investment Income on Life Insurance Policies:* Whole life insurance policies generally have premiums which in the early years of the policy exceed the amount needed to cover the pure insurance costs of the policy. These amounts plus accumulated interest earnings go into a reserve which is used to keep the premiums level in later years as the pure insurance costs of the policy rise.

    The interest income of the reserve is not taxed as it is earned. Where the policy is held until death, no tax is levied on these interest earnings (except in some cases where substantial policy dividends are received in cash each year). Although the interest income is taxed when a policy is surrendered, there is nevertheless a tax deferral in these instances.

    The November 1981 budget introduced two changes of note to this tax provision. First, it provided that for certain policies issued after December 2, 1982 which have a high income component relative to insurance protection, the investment income is taxable every three years on accrual. Second, for policies issued after December 2, 1982, it changed the method used in computing accumulated interest earnings subject to tax upon surrender of the policy.

    The value for this item ($290 million in 1983) is estimated by multiplying the investment income earned on reserves of life insurance companies held for their life insurance policies by an assumed marginal tax rate.

13. *Excess of Tax Depreciation Over Book Depreciation Not Included Elsewhere:* This selective tax measure refers to the excess of tax over actual depreciation not considered explicitly under any other heading. The values in Table 1 ($90 million in 1982) are computed using *Taxation Statistics* data on CCA claimed by individuals and an estimate of the ratio of book depreciation to CCA for individuals (obtained from Statistics Canada's publication, *Corporation Taxation Statistics*).

14. *3-per-cent Inventory Valuation Adjustment:* In recognition of the impact of inflation on inventory costs, businesses may claim a deduction equal to 3 per cent of their tangible opening inventories (other than real estate). The value in Table 1 ($30 million in 1983) is in respect of unincorporated businesses and is obtained by prorating the deduction allowed to corporations by the ratio of sales of unincorporated businesses to corporations.

15. *Tax Deferral Available From Income Averaging Annuity Contracts:* Until 1982, individuals could defer paying tax on certain types of income through the purchase of an income averaging annuity contract (IAAC). IAACs involved an initial lump sum premium and a subsequent stream of annuity payments. These periodic payments could either be for a fixed term of up to 15 years or for life. Under the provision, the IAAC premium was deductible (up to the amount of income from qualifying sources) and the subsequent annuity payments were included in income upon receipt. The income sources qualifying for IAAC treatment included a number of business-related items such as taxable capital gains, recaptured depreciation on disposal of depreciable property, the taxable portion of the sale of goodwill or other "eligible capital property", sale of inventory upon ceasing or disposing of a business, and stock option benefits. Because of the difficulty in segregating the component amounts, the whole of the revenue cost estimate for IAACs is included here despite the fact that for certain qualifying income sources, the IAAC provision could more appropriately be classified under the "health and welfare" or "culture and recreation" categories.

    The November 1981 budget eliminated the IAAC provision commencing in 1982 and required that IAACs purchased between the budget date and the end of 1981 could only have a one-year term, after which the deferred amounts could qualify for the forward averaging provision.

    In prior accounts, the revenue cost for this provision was estimated as the current-year value of the deduction of IAAC premiums. The estimating methodology has been revised in this account to take into consideration that the annuity payments contain a principal element that would not be brought into income in the current year had the IAAC provision never existed. The principal element brought into income each year is estimated using data on IAAC premiums over the years, and standard loan repayment schedules (with assumptions on the average interest rates and terms of the IAAC repayment period). The estimate for this item is $295 million in 1981, the year the IAAC provision was terminated.

16. ***Deductibility of Prepaid Expenses:*** Under the benchmark tax system, expenses are only deductible in a year to the extent they are associated with income in that year. However, prior to December 11, 1979, certain prepaid expenses were allowed to be deducted in the year in which they were incurred. This effectively provided for a deferral of tax. This tax provision was terminated for outlays made after the above-noted date. No estimates are available for this item.

17. ***Holdbacks on Progress Payments by Contractors:*** In the construction industry, contractors are typically given progress payments as their work progresses. However, a portion of these payments (e.g., 10 to 15 per cent) is often held back until the entire project is satisfactorily completed. This holdback need not be brought into the income of a contractor until the construction to which it applies is certified as complete. However, a contractor can often fully write off his expenses under the construction contract as they are incurred. The contractor, therefore, has an optional faster write-off of expenses than would be allowed under accrual accounting. This gives rise to a deferral of tax. No estimates are available for this item.

18. ***Billed-Basis Accounting by Professionals:*** Under accrual accounting, costs should be matched with their associated revenues. Professionals in computing their income for tax purposes, however, are allowed to elect either an accrual or a billed-basis accounting method. This implies that costs of work in progress under the latter method can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This gives rise to a deferral of tax.

    The November 1981 budget contained a provision which reduced the scope of this tax provision. Effective for fiscal periods ending after December 31, 1981, professionals other than accountants, dentists, lawyers, medical doctors, veterinarians, or chiropractors are required to treat work-in-progress as inventory, and they may deduct expenses on work-in-progress only when the work is billed. Estimates are not available for this item.

## VI. Health and Welfare

### A. Health

1. ***Deductibility of Medical Expenses:*** In computing income for tax purposes, taxpayers may deduct specified medical expenses to the extent that they exceed 3 per cent of net income. The February 1984 budget expanded

the list of qualifying expenses, adding such items as hearing-ear dogs for profoundly deaf persons, cloth diapers for incontinent adults, and hydraulic wheelchair lifts. The revenue cost of this provision is estimated to be $65 million for 1983.

## B. Income Maintenance

1. ***$1,000 Pension Income Deduction:*** A deduction in respect of up to $1,000 of private pension income (excluding Old Age Security pensions and Canada or Quebec Pension Plan benefits) can be claimed in computing income for tax purposes. Unused portions of the deduction may be transferred between spouses. The range of pension income qualifying for the deduction is restricted if the taxpayer is under age 65. The November 1981 budget placed further restrictions on the availability of the $1,000 pension income deduction for individuals under 65 years of age. Effective from 1982 for such individuals, lump sum payments are not eligible for the deduction. Also, individuals under age 60 can only qualify for the deduction if they do not exceed the general limits for contributions to RRSPs – thereby precluding individuals who roll their pension income into an RRSP. In addition, amendments were introduced to ensure that the pension income deduction transferred between spouses cannot exceed the amount by which the marital exemption of the supporting taxpayer is reduced as a result of the pension income received by the spouse. The estimate for this item is $150 million in 1983.

2. ***Age Exemption:*** Individual taxpayers age 65 or over are entitled to claim an exemption of $2,360 in 1983, thereby allowing them to reduce their taxable income. Unused portions of the exemption may be transferred between spouses. The revenue cost of this item is $500 million for 1983.

3. ***Non-Taxation of Guaranteed Income Supplement (GIS) and Spouses Allowance Payments:*** Payments under these programs are not included in income for tax purposes. (There is an exception in the case of the marital exemption and the transferable amounts of the age and disability exemptions which are reduced by the amount of GIS income received by the spouse). The revenue cost of this item is expected to be under $5 million annually.

4. ***Tax Advantage on Savings in Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs):*** Both individuals and employers on their behalf can make tax-deductible contributions to RPPs. In addition, employees and self-employed persons can make deductible contributions to RRSPs. All such deductions are subject to annual limits, and the contributions must be to approved plans. The income earned in these plans accumulates free of tax. Finally, when the individual retires or matures his RRSP, all payments out of the plans are fully included in his income, or in the income of a surviving spouse or orphaned children.

These provisions allow a significant deferral of tax, in some cases extending beyond the lifetime of the taxpayer. Such a deferral amounts to an interest-free loan to the taxpayer.

As noted in Section 4 in the text, previous accounts evaluated this tax item by focusing on the interest value of the deferral of taxes. This account computes the value of the measure using a cash flow approach, in which federal tax revenues each year are compared to what taxes would have been received had the provision never existed.

The actual calculation of the revenue cost value of the measure consists of three components. First, the revenue cost of the deduction of employee contributions and the non-taxation of employer contributions (as taxable benefits) is computed. Second, the revenue that would be obtained from the taxation of the interest income of the plans in the hands of the contributors is estimated. It should be noted that, as we are estimating the revenues that would have been collected had the selective tax measure *never* existed, it is necessary to recompute the size of these funds (and hence, their associated interest earnings) assuming that these plans had never been afforded special tax treatment. Given that the contributions and the rate of growth for these plans would be smaller without tax assistance, the size of the funds would be much reduced from what they are at present. The amounts of savings that would have been expected without assistance are computed using data over many years on the contributions, earnings and payments out of pension funds. It is also important to note that, in computing the tax that would be collected on this interest income, the possibility that some of the income would qualify for the $1,000 interest income deduction has not been taken into account, due to data limitations. The third component of the revenue cost calculation is the estimation of the taxes currently collected on pension income and withdrawals from RRSPs. This last component is subtracted from the sum of the first two to estimate the net effect on federal revenues in each year of the preferential treatment of RPPs and RRSPs. Using this methodology, the value of this item is estimated to be $4.9 billion in 1983.

5. ***Rollovers into RRSPs:*** Taxpayers can at their discretion defer recognition of certain sources of income for tax purposes. Old Age Security pension payments, Canada and Quebec Pension Plan benefits, and benefits from RPPs can be rolled over into an RRSP. This gives rise to an additional deferral. The value of this item is included in the amounts estimated for the RPP/RRSP measure described above.

The February 1984 budget provided a tax-free rollover to an RRSP for taxable capital gains of up to $120,000 on the sale of a qualifying farm property. The maximum amount of qualifying taxable capital gain for a specific individual is determined by multiplying $10,000 by the number of years between 1972 and 1983 that the taxpayer was a full-time farmer. The February 1984 budget also included a provision preventing the tax-free transfer of pension benefits to RRSPs from an unregistered plan.

6. ***Tax Advantage of Saving in Deferred Profit Sharing Plans (DPSPs):*** Employers may set up a plan for their employees under which the employers can make tax-deductible contributions. These amounts are taxable in the hands of the employees only later when the benefits are received. The employer's contribution must be at least partially linked to the firm's profitability, and cannot exceed $3,500 per employee (less any contributions by the employer to a registered pension plan in respect of the employee) or 20 per cent of his earnings, whichever is less.

   The November 1981 budget modified this provision to disallow any deductions by the employer in respect of persons who are principal shareholders of the corporation, or persons related to the employer. In addition, plans registered after November 12, 1981 must contain a provision prohibiting such persons from being beneficiaries of the plan.

   The methodology used in computing the value of this item has been changed. In prior accounts it was calculated as the value of the deduction to the employer. Ideally, the value of this selective tax measure should be computed as the difference between the taxes the government collects under the present scheme and those it would have collected had the measure never existed (i.e., as if employer contributions were treated as taxable benefits, the interest earnings of these plans were allocated and taxed in the hands of employees, and the subsequent payments out of the fund to retirees were exempt). Unfortunately, data limitations prohibit the use of this approach. The values shown in the table are obtained by multiplying the value of DPSP contributions in each year by the estimated marginal tax rate of the recipients. Although estimates are not available for 1982 and 1983, they are expected to be much smaller than the $55 million figure estimated for 1981 as a result of the amendment in the 1981 budget described above.

7. ***Deductibility of Support Payments:*** Payments by a taxpayer to a divorced or separated spouse for support based on a written separation agreement are deductible in computing income for tax purposes and taxable in the hands of the recipient. These payments are typically in respect of personal expenses for children and the former spouse. The revenue estimate for this item is computed as the value of the deduction to the payor less the tax collected from the recipient. The estimate for this item is $95 million in 1983.

   The February 1984 budget introduced certain changes to this provision. First, it allowed payments made prior to a written agreement or court order to qualify for reciprocal tax treatment (i.e., deductible to payor, taxable for recipient) and second, it permitted certain non-periodic payments to third parties (e.g., payments for child's medical bills, etc.) to qualify where both parties agree.

8. *Income Splitting Through Interest-Free Loans Between Family Members:* Normally, the attribution rules prevent income splitting when a taxpayer gives an income-producing asset to his spouse or child. These rules act to attribute the income for tax purposes back to the person who made the gift. However, these rules can be circumvented by use of an interest-free loan. If a taxpayer makes an interest-free loan to a spouse or dependent child who invests the funds, the resulting investment return is taxable in the hands of the spouse or child, typically at a lower marginal rate. Under the benchmark tax structure, loans between family members would be deemed to be at market rates of interest. No estimates are available for this item.

9. *Marital Exemption:* A married taxpayer who supports a spouse is entitled to an exemption of $3,330 in 1983 less the amount of the spouse's income in excess of $570. Included in this item is the value of the equivalent to married exemption whereby single parents can claim the married exemption in respect of a dependent child. The revenue estimate for this item is $1,385 million for 1983.

10. *Exemption for Wholly Dependent Children:* Children and grandchildren of a taxpayer who were wholly dependent and either under age 21, or mentally or physically infirm, or in full-time attendance at a school or university, entitle the taxpayer to claim an exemption. The amount of the exemption is $710 for children under age 18 and $1,300 for children 18 or over in 1983. The revenue cost of this measure is $940 million for 1983. Note that a portion of this item could be classified under Category VII, Education Assistance.

11. *Exemptions for Other Dependants:* Other relatives of the taxpayer (sisters, brothers, nieces, nephews, aunts, uncles, grandparents), who are either under age 21 or were physically or mentally infirm or in full-time attendance at a school or university, can be claimed as dependants. The amount of the exemption in 1983 is $710 for those under age 18 and $1300 for those age 18 or over (in each case, less one-half of the dependant's income above a specified threshold). The amount of the exemption (except for nieces and nephews) is also limited to amounts actually spent by the taxpayer for support. Beginning in 1982, the exemptions for Canadian taxpayers supporting dependants living outside Canada are limited to payments made to the taxpayer's spouse and children. The revenue cost of this measure is $15 million in 1983. Note that a portion of this item could be classified under Category VII, Education Assistance.

12. *Child Tax Credit:* Families with children on whose behalf they are receiving family allowances (basically children under age 18) are entitled to a refundable tax credit ($343 in 1983) less 5 per cent of the

amount of the parents' combined net income in excess of a specified threshold ($26,330 in 1983). The June 1982 budget introduced a temporary $50 increase (to $343) in the Child Tax Credit for the year 1982. The April 1983 budget continued the credit at this level for 1983. The April 1983 budget also froze the threshold family income limit for 1983 and subsequent years at the 1982 level ($26,330). The value for this item is $1,435 million in 1983.

13. ***Child Care Expense Deduction:*** Expenses in respect of dependent children under age 14 such as baby-sitting fees and nursery costs are deductible in computing income for tax purposes where such expenses are incurred to earn income. Prior to 1983, the maximum amount of the deduction was limited to $1,000 per child up to a total of $4,000, or two-thirds of "earned income". Beginning in 1983, these limits were raised to $2,000 per child up to a total of $8,000. In most cases, the deduction must be claimed by the lower income spouse. As of 1983, the higher income spouse can claim the deduction where the other parent is in full-time attendance at an educational institution or is mentally or physically infirm. The revenue cost of this measure is $110 million for 1983.

14. ***Non-Taxation of Worker's Compensation Payments:*** Similar issues arise in the examination of the treatment of worker's compensation as arose in the discussion of the conceptual treatment of unemployment insurance in the main text. However, although UI benefits are taxable, benefits under provincial worker's compensation programs are not included in income for tax purposes. This is a departure from the comprehensive income base of the benchmark tax structure. The revenue cost of this item is computed by multiplying the value of compensation benefits by an estimated marginal tax rate applicable to the recipients. The estimate is $250 million for 1983.

15. ***Non-Taxation of Certain Income from Personal Injury Awards:*** Interest or other income (including accrued capital gains) earned on certain capital amounts that were received as personal injury awards, for example, the awards to thalidomide children, is not included in income for tax purposes provided the recipient is under age 21. The estimate for this item is less than $5 million annually.

16. ***Non-Taxation of up to $10,000 of Death Benefit:*** Typically where an amount is paid by an employer to an employee's widow upon the employee's death, the lesser of $10,000, an amount equal to the employee's remuneration over the past year, or the amount of the death benefit need not be included in income for tax purposes. No estimates are available for this item.

17. ***Inter-Spousal Capital Gains Rollover:*** Usually, the death of a taxpayer gives rise to a deemed realization of any accrued capital gains. An exception is allowed, however, for property passing to a taxpayer's surviving spouse either directly or by way of a spousal trust. This

treatment permits a deferral of tax. No estimates are available for this item.

18. *Transfer of Spouse's Federal Tax Reduction:* Beginning in 1982, any amounts of the federal tax reduction unused by one spouse can be transferred to the other spouse to reduce his or her tax payable. The revenue cost of this item is approximately $325 million for 1983.

## C. Social Assistance

1. *Non-Taxation of Social Assistance Benefits:* Means- and needs-tested social assistance benefits are not included in income for tax purposes. (There is an exception in the case of certain means-tested benefits which serve to reduce the amount of the marital exemption and the transferable amounts of the age and disability exemptions.) Because of the low incomes of the recipients, the value of this tax measure is expected to be quite small.

2. *Exemption for Blind and Disabled:* Blind and disabled taxpayers are entitled to an additional tax exemption ($2,360 in 1983). Unused portions of this exemption may be transferred between spouses. The February 1984 budget extended this provision to individuals who became confined to a bed or wheelchair in the taxation year and in the opinion of a medical practitioner will continue to do so for a period of at least 12 months. The revenue cost of this item is estimated to be $24 million for 1983.

## D. Indians and Eskimos

1. *Income Earned on Reserves:* Income earned by Indians on reserves is not included in income for tax purposes. No estimate is available for this item.

## E. Housing and Urban Renewal

1. *Non-Taxation of Capital Gains on Principal Residences:* Capital gains associated with an owner-occupied residence are completely exempt from tax. This account incorporates major improvements in the data and in the estimating methodology used in computing the value of this tax measure. In past accounts, it was assumed that 20 per cent of the housing stock is turned over each year, one-quarter of which is held for an average of 7.5 years, one-half for 5 years and the remaining one-quarter for 2.5 years. The new methodology incorporates data on the

duration of occupancy of owner-occupied dwellings from the 1971 and 1981 Census and unpublished data from the Statistics Canada 1977 Asset and Debt Survey to better estimate the total number of previously occupied houses sold each year, their average duration of occupancy prior to their sale, and the average initial purchase prices of these houses. In addition, the cost base of houses sold in the year is adjusted to include expenditures on capital repairs and major additions and renovations obtained from Statistics Canada consumer expenditure surveys. These modifications result in significantly improved estimates of total capital gains on principal residences.

In addition, in previous accounts, the value of the provision was estimated assuming full taxation of capital gains on principal residences. This measured the total value of the selective tax measure in relation to the benchmark tax structure. However, as noted previously, this account attempts to evaluate each provision assuming that only the particular item under consideration is amended (i.e., the marginal approach). Accordingly, this selective tax measure is evaluated assuming that in its absence only one-half of the capital gain on principal residences accrued since 1972 would be taxable. This is, of course, a major factor in the substantially reduced values for this item. For informational purposes, the table also provides values assuming these gains were fully taxable. For 1981, the most recent year for which estimates are available, the revenue cost estimate for this item is $360 million assuming half-taxation of the gain and about $760 million under the assumption of full-taxation. (The latter value is more than double the former because the additional gain would push the taxpayer into a higher tax bracket.)

Effective from 1982, the exemption of capital gains on the sale of a principal residence is limited to one residence per family, defined to include the husband, wife, and unmarried children under 18 years of age. Where more than one principal residence was owned by members of a family at the end of 1981, only the capital gain accrued after 1981 on a non-qualifying residence is subject to tax.

2. ***Registered Home Ownership Savings Plan (RHOSP) Deduction:*** A taxpayer who does not own a home can deduct up to $1,000 per year to a cumulative maximum of $10,000 of contributions to a registered home ownership savings plan. Any investment income earned within the plan is not taxable. All of the accumulated savings can then be withdrawn tax-free to purchase a house. If assets accumulated in the plan are not used to purchase a house, they are taxable when withdrawn, but the taxpayer has still received a tax deferral. The estimated value of this measure is the revenue cost of the deduction of all RHOSP contributions made in the year, under the assumption that all funds accumulated will eventually be used for house purchases. The revenue estimate for this item for 1983 is $125 million.

The April 1983 budget provided for two temporary modifications to the RHOSP provision. First, it allowed eligible individuals to "top up" their cumulative RHOSP contributions to the full $10,000 contribution limit upon acquisition of a newly constructed home prior to the end of 1984. Second, it permitted individuals to withdraw funds out of their RHOSPs without tax consequences provided the funds were used to purchase qualifying new home furnishings and appliances in 1983.

3. *Multiple Unit Residential Building (MURB) Provision:* This provision is an exception to the general provision that losses for tax purposes arising from the application of capital cost allowances to rental property income cannot be deducted from other non-rental income. The CCA on MURBs can be offset against any other income as an incentive for taxpayers to invest in these types of dwelling units. Thus, tax deferral benefits from faster write-offs are more widely available. With respect to the creation of new MURBs, the provision terminated at the end of 1981 except for building projects already started. However, the ability of CCA-created losses to be deductible against other income continues for the life of the building and thus still gives rise to a selective tax measure.

   The estimate for this item is computed by simulating the revenue cost in each year of allowing CCA-created losses on MURBs to be deducted against other income. Ideally the estimate should offset this by the revenue gains in the year from the recapture of CCA on MURBs sold, and the reduced amount of CCA claimable in the year on profitable MURBs (arising because of the extra CCA deducted in earlier non-profitable years). However, no data is available on these effects. The revenue estimates for this item (e.g., $65 million for 1983) are therefore somewhat overstated.

4. *Non-Taxation of Various Homeowner Grants:* A number of grant programs were introduced in 1981 and 1982 to aid current and prospective homeowners and stimulate the construction industry. First, the Canada Mortgage Renewal Plan was introduced in the November 1981 budget and provided grants of up to $3,000 to aid homeowners facing mortgage renewals at high interest rates. It was extended to December 31, 1983 in the June 1982 budget. Second, the Canada Renovation Plan was introduced in early 1982 and provided grants to encourage home-owners to undertake home renovations. Third, the Canadian Home Ownership Stimulation Plan was introduced in the June 1982 budget and provided $3,000 cash grants to first-time homebuyers purchasing prior to 1983 and to purchasers of newly constructed houses on which work had started before December 31, 1982 (later extended to April 30, 1983). All the above grants were non-taxable. The estimates were arrived at by applying an estimate of the marginal tax rate of recipients to the amounts of grants paid out under each program. The revenue estimate for 1983 is $140 million.

## VII. Education Assistance

1. *Non-Taxation of First $500 of Scholarship and Bursary Income:* The first $500 of scholarship and bursary income is exempt from tax. The revenue cost of this provision is less than $5 million annually.

2. *$50 per Month Education Deduction:* Students who are enrolled at a "designated educational institution" (mainly universities and colleges) are entitled to claim a deduction from income for tax purposes of $50 for every month of full-time attendance. Unused portions of this deduction may be used by a taxpayer (typically a parent) who claimed a dependant's exemption in respect of the student. The estimate for this item for 1983 is $45 million.

3. *Deduction of Tuition Fees:* Students may deduct their tuition fees for courses or full-time enrollment at a college or university in computing their income for tax purposes. This deduction provides a selective tax measure on the assumption that education is a form of personal consumption. If, instead, education is viewed as an investment, then the immediate deduction of tuition costs allows a fast write-off of a capital cost. Effective for the 1982 taxation year, the minimum threshold for eligible tuition fees was raised from $25 to $100. The estimate for this item for 1983 is $55 million.

4. *Deduction of Contributions to Teachers' Exchange Fund Contributions:* Teachers are allowed a deduction for up to $250 in contributions per year to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries present in Canada under a teacher's exchange agreement. The revenue cost of this item is less than $5 million annually.

5. *Special Tax Treatment of Registered Education Saving Plans:* A taxpayer can set aside funds to pay the educational expenses of a designated beneficiary (usually a child) in a registered education savings plan. The investment return on these funds is not taxable until the funds are drawn upon by the beneficiary for educational purposes, and then are only taxable in his hands. Thus, selective treatment arises both in the deferral of tax on the investment return and in having this return taxed at the beneficiary/student's typically lower marginal rate of tax. The revenue cost of this item is less than $5 million annually.

## VIII. Culture and Recreation

1. *Deductibility of Itemized Charitable Donations and the $100 Standard Deduction:* Taxpayers who make donations to registered charities may claim a deduction in computing their income for tax purposes equal to the amount of their donations, provided this amount does not exceed 20 per cent of their net income. Prior to 1981, any excess donations

over this 20-per-cent limit could be carried forward one year. This was extended to five years beginning in 1981. Individuals with charitable donations plus deductible medical expenses (over the 3-per-cent floor) less than $100 can claim a standard deduction of $100. (The April 1983 budget eliminated the standard deduction beginning in 1984). For tax purposes, donations must be made to registered Canadian charities. The estimate for this item is $515 million for 1983.

2. ***100-Per-Cent Write-Off for Canadian Films:*** Investments in films meeting a set of Canadian content criteria can be depreciated at up to a 100-per-cent rate for tax purposes, compared to the 30-per-cent declining balance basis for other films. In addition, unlike investments in other films, losses arising from the fast write-off for certified Canadian films can be deducted against other income. Lastly, it should be noted that the implementation of the half-year limitation for first-year CCA which was generally effective for other assets commencing in 1982, was deferred for one year until 1983 for these films.

   The revenue cost estimate for this item is computed by comparing the annual tax costs of the present CCA deduction for films to the value of the deductions that could have been claimed had this tax provision never existed. (This latter amount is computed using data on film investments since 1976 and assuming that on average, income from such films would be sufficient to allow the deduction of only 40 per cent of the value of investments in films. It is also assumed that there would be a one-year lag between the time the investments were made and the CCA would begin to be claimed.) The revenue cost for this item was under $5 million for 1983.

3. ***Cultural Property Import and Export Act:*** Certain objects certified as being of cultural importance to Canada under the *Cultural Property Import and Export Act*, may, if donated to a designated museum or art gallery, be exempt from capital gains tax. At the same time, the whole of the fair market value of the property may be claimed for purposes of the deduction for charitable donations (without the 20-per-cent limit noted in Item 1 above). Capital gains on the disposition are also exempt from tax if the object is sold rather than given to the museum or art gallery. The estimate for this item is under $5 million annually.

4. ***Write-Off on Art Work:*** Until November 12, 1981, all art work acquired by a business (unincorporated or incorporated), for example, to be displayed in an office, could be depreciated for tax purposes on a 20-per-cent declining balance basis (Class 8). Most art works tend to depreciate very slowly; in many cases their value appreciates and their durability is such that they may last for centuries. Thus, under the benchmark tax structure, works of art owned by a business are not considered depreciable assets. Depreciation claims on such works of art therefore give rise to a deferral of tax, assuming the work is eventually

sold at which time the CCA is recaptured; otherwise there is a permanent reduction in tax. The November 1981 budget limited this provision to works of art produced by Canadian artists. Estimates for this item are unavailable.

5. *Non-Taxation of Lottery and Gambling Winnings:* Lottery and gambling winnings are not included in income for tax purposes. The estimate for the non-taxation of winnings in government lotteries is based on information on prizes paid under Loto Canada and provincial lotteries multiplied by the average marginal tax rate on taxable income. Values for the non-taxation of winnings from horse racing are estimated using data on federal taxes on such betting. Ideally, the tax base should be adjusted to allow for the deduction of the cost of tickets or wagers from such gambling gains (but not against other income sources). However, information on these costs for individuals with net gains from such gambling is not available. In this respect the estimates provided here (for example, $215 million for lotteries and $250 million for race track betting in 1983) are overstated. While it is not possible to accurately estimate the revenue forgone from not taxing income from other forms of gambling (bingos, etc.), it is likely to be quite substantial.

6. *Deduction for Clergyman's Residence:* A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct his housing costs from his income for tax purposes. The estimate for this item, e.g., $15 million in 1983, is calculated using census information on the number of clergymen in Canada, Statistics Canada expenditure data on rent, and an assumed marginal tax rate.

7. *Non-Taxation of Certain Income of Individuals Who Have Taken Vows of Perpetual Poverty:* Where an individual has taken a vow of perpetual poverty as a member of a religious order, he may deduct donations to the order up to the total amount of his pension and employment income (but not investment or other income) in lieu of the deduction of charitable donations. The revenue cost of this item is expected to be under $5 million annually.

## IX. Fiscal Transfer Payments

1. *Quebec Abatement:* Individuals resident in Quebec were entitled to an abatement which reduced their 1976 federal basic tax (federal tax before deduction of federal tax cuts and credits) by 24 percentage points. This abatement provided the province extra "tax room" instead of direct federal transfers in respect of certain federal-provincial cost-shared programs. With the change in fiscal arrangements in 1977 (see next item), the general abatement to all provinces was increased; consequently, the special abatement for Quebec residents was reduced to 16.5 percentage points for 1979 and subsequent years. The estimate for this item is $1,140 million for 1983.

2. *Transfers of Income Tax Room to Provinces:* In 1967, federal-provincial fiscal arrangements were altered such that the federal government substituted a transfer of individual and corporate income tax points for direct cash transfers to provinces under the cost-shared program for post-secondary education. The tax changes involved were an increase in the corporate income tax abatement from 9 to 10 percentage points, effectively reducing the current federal corporate income tax rate from 37 per cent to 36 per cent (46 per cent is the rate before any abatements), and 4-percentage-point increase in the personal income tax abatement. (The general personal income tax abatements were embodied in a revised rate schedule in 1972.) In 1977, there was a further change in fiscal arrangements wherein the federal and provincial governments agreed to substitute an abatement of 13.5 percentage points of individual income tax and one point of corporate income tax for direct federal transfer payments in respect of post-secondary education, hospital insurance, and medicare programs. These new abatements were inclusive of the abatements provided earlier in 1967. The estimate for this item is $4.65 billion for 1983.

## X. Public Debt

No selective measures under this category.

## XI. Other Tax Preferences

1. *General Averaging:* Prior to 1982, the general-averaging provision provided a reduction in tax for taxpayers who experienced relatively sharp increases in income. If their net income in a year had increased more than 10 per cent over the previous year *and* had increased more than 20 per cent over the average of the previous four years' incomes, then the income above these thresholds was not subject to progressively higher rates of tax. In 1982, the general-averaging provision was eliminated.

2. *Forward Averaging:* In 1982, the general-averaging provision was replaced with the forward-averaging mechanism which permits taxpayers with large income increases in a year to average the increases over future years when they expect to be in a lower tax bracket. Under this provision, the individual pays a special refundable tax (at a rate equivalent to the top marginal tax rate) on the amount of income being forward averaged. This sum can be brought into income in a later year when the taxpayer's income, and hence, his marginal tax rate, is lower. At that point, the taxpayer may claim a credit for the special refundable tax he has already paid. To recognize inflation, both the amount of income which is forward averaged and the available tax credit carried forward are both indexed to the rate of inflation.

As noted in the text, although the forward-averaging provision can enhance neutrality over the longer term, it is considered to be a selective tax measure because it is discretionary in nature and deviates from the benchmark's annual accounting period. No estimates for this item are available at this time.

## XII. Memorandum Items

1. ***Basic Personal Exemption:*** All tax filers are given a basic personal exemption ($3,770 in 1983) in computing their income for tax purposes. As this exemption is provided to all filers, it is not a selective tax measure and it is included as a memorandum item for information purposes. The estimated value of the deduction in 1983 was $8.1 billion.

2. ***Federal Tax Reduction:*** Prior to 1982, the federal tax reduction was set at 9 per cent of federal taxes payable with a minimum of $200 and a maximum of $500. For 1982 and 1983, the reduction was set at a flat $200 per taxpayer. This tax reduction is general in application and, hence, does not constitute a selective tax measure. It should be noted that effective from 1982, unused portions of the $200 tax reduction can be transferred between spouses. This element of the provision is non-neutral and therefore constitutes a selective tax measure. For information purposes, the entire value of the federal tax reduction ($2.5 billion in 1983), including the transferable element (item VI.B.18), is included here as a memorandum item.

3. ***Employment Expense Deduction:*** Individuals with employment income are allowed a 20 per cent (3 per cent prior to 1983) deduction up to a maximum of $500 from this income as an arbitrary allowance in respect of certain expenses incurred in earning that income. Such expenses are not themselves deductible. While in principle the actual expenses should be deductible, practical considerations would make such a provision impossible to administer. Thus, a selective tax measure (or tax penalty) could be viewed as arising to the extent the arbitrary 3-per-cent deduction exceeded (or was less than) actual employment expenses. It is not possible to estimate these amounts. Instead, the figures in Table 1 (e.g., $1,070 million in 1983) show the value of the employment expense deduction to taxpayers.

4. ***Deductibility of UI Contributions:*** Employee contributions to unemployment insurance are deductible and employer contributions are not required to be included in the incomes of their employees. As noted in the text, depending on how one characterizes the UI plan, this treatment can be viewed either as adhering to the benchmark or as constituting a selective tax measure. For informational purposes, the revenue costs of the deduction of employee contributions and the non-inclusion of the employer contributions as employee benefits ($610 million and $850 million respectively for 1983) are provided in this section.

5. *Deductibility of CCP/QPP Contributions:* Under the present system, CPP and QPP employer contributions are deductible and contributions be employers are not required to be included in the incomes of employees. As noted in the text, the treatment of CPP and QPP under the benchmark structure depends on how these plans are characterized. For informational purposes, the revenue costs of deduction of CPP/QPP employee contributions and the exclusion of employer contributions from the incomes of employees ($480 million for each in 1983) are provided in this section.

6. *Dividend Gross-up and Tax Credit for Individuals:* As a partial move toward an integrated personal and corporate income tax system, the current tax system treats dividends to individuals from Canadian corporations in a special way. Any such dividend income is first "grossed-up" for tax purposes to 150 per cent of its actual amount. Subsequently, a non-refundable credit against tax otherwise payable may be claimed equal to 34 per cent of the actual amount of dividends received (37.5 per cent of dividends received prior to 1982). As noted in the text, given that this provision can be viewed as enhancing neutrality by integrating the personal and corporate income tax systems, it is not regarded in this account as a selective tax measure but rather is included for informational purposes as a memorandum item. The value of this item at the federal level is estimated as the amount of dividend tax credit claimed less the extra federal tax levied on the grossed-up portion of dividends received. The value for 1983 is estimated to be $785 million.

7. *Deduction of up to $5,000 of Farm Losses by Part-Time Farmers:* Individuals whose major source of income is not farming are allowed to deduct up to $5,000 of losses on a farm operation against other income. To the extent that this provision limits the deductibility of legitimate business losses, this item can be viewed as a tax penalty. However, because of the variety of special tax provisions available to part-time farmers (as described in Section V.A.), the tax losses reported may not accurately reflect real economic losses. To the extent that the provision serves to restrict the deductibility of those accounting losses, the $5,000 limit can be viewed as a restriction on the size of these other selective tax measures. No estimates are available for this item.

8. *Non-Taxation of Expense Allowances of MPs, MPPs, Royal Commissioners, and Certain Municipal Officials:* Individuals in these positions are generally given a flat amount per annum in addition to their salaries to cover a variety of expenses they typically incur, or additional amounts to cover certain living and travelling expenses. These amounts are not included in income for tax purposes. However, in principle it could be argued that these amounts should be included in income and the associated expenses, other than personal expenses, allowed as deductions. The net revenue impact of such alternative treatment cannot be readily estimated.

9. ***Deduction of up to $2,000 of Allowable Capital Losses:*** Individual taxpayers are allowed to deduct up to $2,000 of allowable capital losses (one-half of realized capital losses) against income other than capital gains. Although the deduction of such capital losses against other income is not regarded as a selective tax measure, for informational purposes, the value of allowing such deductions is included here as a memorandum item. For 1983, the estimate for this item is $45 million.

## Appendix 2

# A Description of Selective Tax Measures in the Corporate Income Tax System

### Introduction

This appendix provides a brief description of each of the provisions included in Table 2. For some measures there exists more than one logical benchmark which can serve as the point of reference in valuing the measure. The choice of an appropriate benchmark is discussed when required.

The description of each corporate tax measure follows the numerical ordering of Table 2. However, before discussing each item individually, there is a general discussion of the procedures used to estimate and classify the measures in the account.

### General Note on Estimating Methodology

Information used to estimate the various corporate income tax measures has been obtained from a number of sources. The major source of data was provided by Revenue Canada from unpublished sources. Revenue Canada, as part of the tax collection process, creates a data source with tax information from all corporations filing tax returns in a year. From this "universe" file, a weighted sample file is created using criteria related to industry, asset size, type of corporation, tax status and tax jurisdiction. For each of the corporations in the sample, a range of additional information is transcribed from financial statements and other tax schedules.

A corporate tax model was developed to use the data from the sample file to simulate changes in the tax structure. The tax model, by simulating the removal of a single deduction or a change in a particular capital cost allowance rate, makes it possible to calculate the marginal tax value of each measure for each corporation. Use of the tax model increases the accuracy of measurement, as it allows for the impact of interactions and the assignment of the appropriate corporate tax rate in valuing each measure. The lower bound estimates in Table 2 could only be calculated for measures where sufficient data were available in the corporate tax model.

The benchmark used to value the selective tax measures is a corporate tax system which levies the statutory federal tax rate of 36 per cent plus applicable surtaxes on book income. Therefore, in the period between 1980 and the end of 1983, the rate used was 37.8 per cent. However, in valuing any one tax measure the corporation's marginal tax rate, not the statutory rate, was used. That is, each measure was valued as if all other measures within the tax system remained unchanged.

Because of the substantial period of time needed to obtain and transcribe all the necessary data and to make an annual sample file operational, calculations using the model are currently available up to the 1981 taxation year. For 1982, the values for most of the tax measures were estimated by multiplying the aggregate claim made by profitable corporations by their average marginal tax rate. This estimate is equivalent to the upper bound estimate calculated using the model. Though the model is not yet available for 1982, Revenue Canada tax information is available for the years 1979 to 1982 inclusive.

Not all corporate tax measures were calculated using the tax model. Certain measures, such as the various withholding tax measures and the special energy tax measures, were calculated using other data sources. These include the *Bank of Canada Review*, Petroleum Monitoring Agency survey data, various Statistics Canada publications, and unpublished Petroleum and Gas Revenue Tax data collected by Revenue Canada.

## Categorization of Items by Industrial Category

To provide more information, an industrial breakdown of the major corporate tax measures has been included in Table 2. The broad industry classifications are defined by the 1960 Standard Industrial Code (SIC) and are indicated in Table A. To allow easy reference to the explanations in the appendix, a tax measure allocated to more than one industry retains the same identifying number.

## Tax Measures from Table 2

### A. Tax Deferrals, Exemptions and Deductions from Income

The following corporate tax measures deviate from the benchmark tax structure.

1. *Excess of Tax Depreciation over Book Depreciation:* Rather than allowing the deduction of normal accounting depreciation from income, the tax system provides for the deduction of a capital cost allowance (CCA), which differs in several fundamental ways from actual economic or physical depreciation.

   First, the CCA rates at which assets can be written off against income are typically faster than actual depreciation or than the rates used in companies' financial accounts which represent the companies' own estimates of the useful lives of their assets. This is especially true in the case of incentive CCA classes such as for manufacturing machinery and equipment. The fast write-off results in a deferral of tax. For example, in the case of an asset eligible for a fast write-off, the CCA system allows a larger deduction from income when the asset is new, hence lower taxable income and a lower tax liability than if the "actual" depreciation had been claimed. Correspondingly, when the asset is

Table A

**Industries Classified by Standard Industrial Code**

| Industry | | Standard Industrial Code |
|---|---|---|
| I. | Agriculture, Forestry and Fishing | 001-049 |
| II. | Manufacturing | 101-364, 370-399 |
| III. | Construction | 400-499 |
| IV. | Transportation and Storage | 501-527 |
| V. | Communications | 543-548 |
| VI. | Public Utilities | 572-579 |
| VII. | Wholesale Trade | 600-629 |
| VIII. | Retail Trade | 630-699 |
| IX. | Finance | 700-799 |
| X. | Services | 800-899 |
| XI. | Oil and Gas | 061-064, 365-369 |
| XII. | Mining | 050-060, 065-099 |
| XIII. | All Corporations | Includes all the above and any other corporation not within one of the categories. |

older, all or virtually all of the CCA will have been claimed and book depreciation or actual depreciation will be greater than that allowed for tax purposes. Thus, income for tax purposes in these later years would be higher than if book depreciation had been used. The net effect is that income tax is deferred. However, in the case of a growing firm with many assets, the larger CCA claims on the newer assets (larger both because of the fast write-off and because the firm is growing) will always be sufficient to offset the smaller CCA claims on older assets; so that taxable income is continually lower than it otherwise would be. In this case, the tax deferral becomes indefinite and is equivalent to a tax reduction. In principle, a tax deferral is equivalent to an interest-free loan from the government to the taxpayer. The value of such a tax benefit equals the interest rate times the amount of loan – i.e., the amount of tax deferred.

The second main difference between CCA claimable and actual depreciation is that taxpayers have discretion in the rate at which they utilize their CCA. If a taxpayer does not have sufficient taxable income, he need not claim the CCA available to him in that year; he can wait for a future year. In this way, taxpayers avoid creating a tax loss which is subject to a time limit on when it can be written off against other income. There is no time limit on using CCA; however, the tax benefit from having an accelerated CCA declines when the use of the deduction is deferred. By comparison, the benchmark tax system, since it uses actual depreciation, implies no discretion in the determination of net income. The revenue implication of this discretionary aspect of the CCA system is not fully captured in the estimates in Table 2.

The third basic difference between CCA claimable and normal accounting depreciation arises from the pooling of assets, with certain exceptions, in a CCA class. (One exception is rental buildings which are treated as individual assets.) Accounting depreciation is determined by reference to each asset individually. If an asset that originally cost $100 has depreciated so that its current book value is $50, and it is sold for $70, the $20 difference would, in principle, be brought into income. However, under the CCA system, this asset would typically be grouped with other assets in a CCA class and the proceeds of a sale simply serve to reduce the total undepreciated value of the class. The effect of this is that the $20 would be brought into income only gradually, as CCA claims for this class are made over a period of years. Thus, the recapture of any "excess" depreciation claim is deferred well beyond the time of disposition of the assets. Similarly, there is a corresponding deferral in the recognition of losses when the asset is sold for less than its depreciated value.

Tax depreciation and book depreciation also differ in their treatment of interest payments related to the acquisition of the capital asset. For accounting purposes, interest payments are capitalized in the cost of the asset; for tax purposes, interest payments are expensed in the year they are made.

The final notable difference is when depreciation deductions start for tax and accounting purposes. Accounting practices use the put-in-use rule, whereby no depreciation is recorded in the company's books until the asset is put in use. For example, no depreciation is claimed throughout the period in which an asset is being constructed. However, for tax purposes an asset can be depreciated from the day of acquisition, the day in which the business has title to the asset. For major capital assets being constructed by the business there can be a significant timing differential between when depreciation is taken for tax and book purposes.

In keeping with the cash flow concept for valuing tax measures, the value of the CCA provisions has been estimated in reference to the depreciation claimed for book purposes as recorded in the taxpayer's financial statements. That is, the value of a CCA measure is equal to the difference between the CCA and book depreciation multiplied by the corporation's marginal tax rate. These differences may understate the difference between CCA claims and "actual" depreciation because smaller firms tend to use the CCA rates both for tax purposes and for their own financial statements. In addition, it should be noted that under the cash flow approach it is possible that for some corporations, the selective tax measure will be negative in value. This can occur because a corporation may still be deducting book depreciation on assets which had already been written off for tax purposes or because it chooses not to claim its maximum CCA deduction but depreciates the asset for book purposes.

The issue of the appropriate method of valuing a tax measure, which was discussed in detail in the text, is relevant for evaluating CCA, because accelerated CCA write-offs create a tax deferral rather than a pure exemption. Therefore, it might be argued that the interest value of the deferral or the present value approach should be used in evaluating the CCA selective tax measure.

It should be noted that significant changes to the CCA system were made in the November 12, 1981 budget that will affect the value of the CCA measures. Of particular importance is the impact of the implementation of the half-year rule. In general, assets acquired after November 12, 1981 are limited to one-half the normal rate of write-off in the year of acquisition – the other half may be written off over future years. Implementation of the half-year rule was delayed until January 1, 1982 for multiple-unit residential buildings (MURBs) and January 1, 1983 for certified Canadian films. In addition, certain assets normally written off over one year were exempted from the half-year rule. The impact of these changes would only start to appear in 1982 and 1983 because of the transition rules.

A measure was also introduced requiring that all "soft costs" incurred during the period of construction of a building (including expenses such as interest, legal and accounting fees, and property taxes) be added to the capital cost of the land or building. Previously, an immediate write-off in full was allowed for these costs. The new rules provided transitional relief in respect of buildings on which construction had commenced or for which arrangements for construction had been sufficiently advanced prior to the announcement of the change. In addition, the new rule does not apply to soft costs incurred by a corporation whose principal business is the leasing, rental or sale, or development for lease, rental or sale, of real property.

In addition, the terminal loss rules were modified to deny a full deduction of the loss (undepreciated capital cost) for demolitions or other dispositions of buildings after November 12, 1981. That is, where the same taxpayer has another building in the year after that in which a loss arises, the loss will be added to its capital cost and depreciated. Otherwise, the terminal loss will be added to the cost base of any land owned by the taxpayer and thus the loss will offset the capital gain when the land is eventually sold. In any other case, one-half of the loss on destruction of the building will be treated as a business loss, deductible in the year.

The CCA rate exceeds book depreciation in many cases. The more generous provisions for certain assets are described below. However, the value of these provisions is included within the general provision for the relevant industries. Specific valuations of these special provisions could not be made under the cash flow method as book depreciation cannot be attributed to the various CCA classes.

a) ***Additional Depreciation Allowances on Grain Storage Facilities:*** Certain grain storage facilities acquired between April 1, 1972, and August 1, 1974, are eligible for additional CCA at rates from 13 to 22 per cent. These depreciation claims are in addition to the usual amounts claimable. However, the passage of time means that these are of limited significance in the years being considered.

b) ***Fast Write-Off on Manufacturing and Processing Assets (Class 29):*** Machinery and equipment used in manufacturing and processing purchased after May, 1972 and before November 12, 1981 could be written off for tax purposes at rates of up to 50 per cent in the first year with the remainder written off in the second year. After November 12, 1981, the implementation of the half-year rule resulted in such assets being depreciated over three tax years. The CCA deduction for this class is on a cumulative basis so that any deduction not taken in the year may be taken in full in the following year. A business making the maximum claim in a year may deduct 25 per cent of the capital cost of the asset in the first year, 50 per cent in the second year, and 25 per cent in the third year.

c) ***Additional Depreciation Allowances on Canadian-Built Ships:*** Ships constructed and registered in Canada can be written off at a 33 1/3-per-cent straight-line rate. Since November, 1981 such acquisitions are subject to the half-year rule.

d) ***Fast Write-Off on Power-Operated Movable Equipment (Class 22):*** Power-operated movable equipment designed for the purpose of excavating, moving, placing or compacting earth, rock, concrete or asphalt acquired after March 16, 1964 can be depreciated at a 50-per-cent declining balance rate. After November 12, 1981 the half-year rule applies to qualifying additions in this class.

e) *Additional Depreciation Allowances on Railway Assets:* There are three provisions providing additional depreciation allowances for railway assets. The first is that a taxpayer may claim an additional amount not exceeding 8 per cent of the undepreciated capital cost of a railway car acquired after May 25, 1976 that is owned by a taxpayer and rented, leased or used by the taxpayer in Canada in the taxation year, other than a railway car owned by a taxpayer that is a common carrier that owned or operated a railway.

The second provision is that a taxpayer may claim an additional amount for railway track and related property, except trestles, acquired after March 31, 1977 and before 1988 not exceeding 4 per cent of the undepreciated capital cost of such property as of the end of the taxation year. For trestles, the taxpayer may claim an additional allowance not exceeding 3 per cent of the undepreciated property of the asset acquired after March 31, 1977 and before 1988.

The third provision allows a taxpayer owning and operating a railway as a common carrier an additional amount not exceeding 6 per cent of the capital cost of property acquired after April 10, 1978 but before 1988 related to railway expansion and modernization.

f) *Fast Write-Offs for Communications Satellites (Class 30):* Unmanned telecommunication space craft can be written off on a 40-per-cent declining balance basis. After November 12, 1981, these assets are subject to the half-year rule.

g) *Additional Depreciation Allowances on Offshore Drilling Vessels:* Capital cost allowances not exceeding 15 per cent of undepreciated capital cost can be claimed in respect of offshore drilling vessels acquired after May 25, 1976, in addition to the usual CCA rate for ships.

h) *Accelerated Depreciation of Mining Assets (Class 28):* Taxpayers may elect to write off expenditures on certain assets related to a new mine or a major expansion of an existing mine as rapidly as the income from the new or expanded mine permits or on a 30-per-cent declining balance basis. The assets covered by this incentive include buildings, mining machinery and equipment, electrical equipment and related social infrastructure such as homes, schools, roads, and sewers.

i) *Immediate Write-Off on R&D Expenditures:* Current and capital expenses on R&D may be written off immediately in the year incurred. Under generally accepted accounting principles, expenditures that are capital in nature and designed to produce future income are depreciated over the period in which income is expected.

j) *Fast Write-Off on Pollution Control Equipment (Classes 24 and 27):* Prior to November 12, 1981, the cost of equipment acquired to control or limit air and water pollution could be deducted from income over two years. Since 1981, to incorporate the half-year rule, such assets can be depreciated over three tax years. The CCA deduction for this class is on a cumulative basis so that any deduction not taken in the year may be taken in full in the following year. A business making the maximum claim in a year may deduct 25 per cent of the asset in the first year, 50 per cent in the second, and 25 per cent in the third year.

k) *Fast Write-Off on Energy Conservation Machinery and Equipment (Class 34):* Prior to November 12, 1981, up to 50 per cent of the capital cost of certified equipment acquired after May, 1976 and before 1985 and used for the generation of electricity or the production and distribution of heat could be written off in the first year and the remainder in the second year. After November 12, 1981, because of the half-year rule, such assets must be depreciated over three or more tax years. The CCA deduction for this class is on a cumulative basis so that any deduction not taken in the year may be taken in full in the following year. A business making the maximum claim in a year may deduct 25 per cent of the capital cost of the asset in the first year, 50 per cent in the second, and 25 per cent in the third year.

l) *Multiple Unit Residential Building (MURB) Provision:* This provision is an exception to the general rule that tax losses arising from the application of capital cost allowances to rental property income cannot be offset against other non-rental income. The capital cost allowances (CCA) on MURBs can be offset against any other income as an incentive for taxpayers to invest in these types of dwelling units.

m) *100-Per-Cent Write-Off for Canadian Films:* Prior to November 12, 1981, investments in films meeting a set of Canadian content criteria can be depreciated at up to a 100 per cent rate for tax purposes. Other feature films can be depreciated on a 30 or 60-per-cent declining balance basis. Under the benchmark tax structure, accrual accounting requires that cost be matched against revenues so that costs of investing in a film would be spread over the income-generating life of the film. Since November 1981, the deduction has been subject to the half-year rule.

n) *Write-Off on Art Work:* Prior to November 1981, art work acquired by a business, for example, to be displayed in an office, can be depreciated for tax purposes on a 20-per-cent declining balance basis (Class 8). However, such works typically maintain their value or appreciate and often are in the nature of personal investments rather than a part of the firm's business operations.

Thus, under the benchmark tax structure, works of art owned by a business are not considered depreciable assets. Since November 12, 1981 a business can no longer claim CCA on certain antiques and art purchased.

o) ***Additional Allowances Certified by the Minister of Supply and Services:*** The Minister of Supply and Services may issue certificates that grant special depreciation over and above normal depreciation on certain classes of property for the taxpayer, in respect of plant acquisitions or expansions required in conjunction with a contract to supply to the government goods to be manufactured by the taxpayer.

2. ***Inventory Allowance:*** In recognition of the impact of inflation on inventory costs, corporations may claim a deduction equal to 3 per cent of their tangible opening inventory (other than real estate). Qualifying property must be held for sale or for the purpose of being processed, fabricated, manufactured, incorporated into, attached to, or otherwise converted into or used in the packaging of, property for sale in the ordinary course of the business.

3. *Capital Gains*

a) ***Exemption of One-Half of Post-1971 Capital Gains:*** The benchmark tax system is defined so that capital gains are fully included in income as accrued. The *Income Tax Act* includes only one-half of most capital gains realized on gains accrued since 1972. The treatment of capital gains is selective not only because half of the gain, a form of income, is exempted but also because the income is taxed when realized, not as accrued. This allows for a deferral of tax. The calculated value of the non-taxation of half of post-1971 capital gains is the value of only taking one half rather than the entire capital gain. The estimation does not attempt to value the deferral component of capital gains taxation.

b) ***Exemption of Pre-1971 Capital Gains:*** All capital gains realized after 1971 but accrued prior to 1972 or "valuation day" need not be included in income for tax purposes. The value of pre-1971 capital gain is estimated as the net book gain less the post-1971 capital gain multiplied by the corporation's marginal tax rate. The net book gain, however, includes not only the capital gain over the cost basis of the asset but the recaptured value of book depreciation allowances on assets such as real estate. Therefore, the value of pre-1971 capital gain is overestimated by the recaptured amount.

c) ***Deferral of Capital Gains Through Various Rollover Provisions:*** The taxation of capital gains is further influenced by provisions that permit taxpayers to avoid realization for tax purposes through various rollover provisions. Rollovers associated with amalgamations and other corporate reorganizations have been considered part of the benchmark tax structure. Since the benchmark tax base includes all accrued gains, it is for information purposes that this item is separately identified. This item includes such provisions as:

i) *Involuntary Dispositions:* Tax on any realized capital gains resulting from an involuntary disposition (for example, expropriation or insurance proceeds received for an asset destroyed in a fire) where the funds are reinvested in a replacement asset within a specified period may, at the option of the owner, be deferred until the replacement is disposed of.

ii) *Voluntary Dispositions:* Tax on realized capital gains resulting from the voluntary disposition of land and buildings not used to generate rental income can be deferred if replacements are purchased soon thereafter (for example, a business changing location).

iii) *Transfer to a Corporation for Consideration Including Shares:* A taxpayer can sell an asset to a corporation in exchange for cash and/or its shares (not only as part of a reorganization). No capital loss can be realized in such a transaction, but no capital gain need be realized, at the discretion of the parties to the transaction.

4. *Allowable Business Investment Loss:* Beginning in 1978, corporations can offset any amount of allowable capital losses incurred on arm's-length sales of shares or debt of Canadian-controlled private corporations (CCPCs) against any source of income. In general, corporations can offset capital losses only against capital gains. Therefore, though the general structure of the current loss provisions has been taken as part of the benchmark tax structure, this provision gives preferential treatment to taxpayers investing in CCPCs, which are typically small businesses. For the taxpayer this provision diverges from normal capital loss treatment to the extent that there are no capital gains.

5. *Additional Scientific and Research Deduction:* Between 1978 and November 1, 1983, taxpayers have been permitted to deduct an additional allowance of 50 per cent of the increase in their R&D expenses over the average of the three previous years' expenditure levels. This was in addition to the 100-per-cent deduction for all R&D expenditures. As part of the 1983 budget this provision was being phased out in favour of a 10-percentage-point increase in the investment tax credit rates for scientific research.

6. *Deductibility of Prepaid Expenses:* Under the benchmark tax system, expenses are only deductible in a year to the extent they were associated with income in that year. However, current administrative practice is to allow certain prepaid expenses as deductions as well. For example, a rental or insurance payment covering more than the current tax year may be deducted in full in computing income for tax purposes in the

year in which the payment was made. Under the benchmark tax system, only that portion of the payments applicable to the current tax year would be deductible in the year, the remainder being deductible in the subsequent years to which the costs relate. Thus, current practice in this area allows a deferral of tax.

7. *Tax Losses from Fast Write-Offs of Leased Assets:* For leasing contracts written prior to May 25, 1976, tax losses created by accelerated depreciation claims on movable assets leased to others can be used to offset any income source. Since that date, tax losses from such leasing contracts can only be offset against other leasing income. The earlier treatment diverges from generally accepted accounting principles.

8. *Deductibility of Carrying Charges on Land:* The current tax system allows the immediate write-off of interest costs, property taxes, and other expenses associated with the holding of undeveloped land by the real estate industry in the course of a taxpayer's business. (During the period from June 23, 1975 to November 16, 1978, these carrying charges were not allowed as a deduction.) Such land holding is a form of inventory. Thus, under generally accepted accounting principles regarding inventory, and under the benchmark tax system, such carrying charges would be costs associated with the acquisition of inventory that can be deducted as a cost of sales only when the land is finally sold. The current tax treatment therefore allows a tax deferral insofar as costs are recognized before the associated revenue.

9. *Excess Deduction for Intangible Assets:* The tax system allows one-half of the intangible assets, referred to as eligible capital property, to be depreciated on a 10-per-cent declining balance basis. An example of eligible capital property is goodwill which is purchased when buying a business. This treatment of intangible assets will give rise to a positive or negative value for this measure depending on its actual rate of depreciation. However, because of the difficulties in reasonably determining the useful life of intangibles, no estimate is attempted.

10. *Expensing of Advertising Costs:* The current tax system allows advertising costs to be treated as current expenditures. There is some question about whether advertising should be depreciated over a period of time rather than expensed. Some advertising, such as that of supermarkets in local newspapers, almost certainly has a useful life of less than a year. However, other advertising, such as that oriented towards enhancing a brand's image, could well have a useful life greater than a year. Under the benchmark, advertising should be depreciated over its useful life. Thus expensing advertising expenditures with useful lives greater than a year would be equivalent to a fast write-off and gives rise to a deferral of tax.

    (a) **Non-Deductibility of Advertising Expenses in Foreign Media:** Expenses for advertising in non-Canadian newspapers or periodicals and on non-Canadian broadcast media (mainly U.S. border radio and TV stations) cannot be deducted in computing income for tax purposes. Under the benchmark tax system, no differential treatment would be given to Canadian versus foreign advertising media.

*Items 11, 12 and 13*

The Canadian exploration expense (CEE), Canadian development expense (CDE), Canadian oil and gas property expense (COGPE), Canadian exploration and development expense (CEDE), foreign exploration and development expense (FEDE) and earned depletion deductions, in sum, provide an accelerated write-off of a taxpayer's exploration and development expenditures as compared to the corresponding deductions appearing in corporate books. Because deductions of exploration and development expenses are grouped differently in financial statements than for tax purposes only the total value of measures 11, 12 and 13 can be calculated. For this reason, it is difficult to determine whether any one provision, in itself, results in a faster write-off rate than the effective accounting rate. Instead, this appendix describes the accounting rules corresponding to each major item and makes an assessment about how the effective book write-off rate compares to the tax write-off rate under scrutiny. A separate discussion of CEDE and FEDE is not included because the amounts are relatively small.

The estimate of the total value of tax measures 11, 12 and 13 must be interpreted carefully. The ability of oil and gas and mining corporations to flow out CEE, CDE, COGPE, frontier allowance, supplementary depletion and, in certain cases, earned depletion deductions by establishing limited partnerships or by issuing flow-through shares affects the allocation of the tax measure between personal and corporate income tax sectors and among corporate sectors.

The personal income tax section of the account includes the tax value of limited partnership and flow-through share deductions to individuals. Since the accounting deductions which correspond to these write-offs appear in corporate books, the tax measure is underestimated in the corporate income tax section of the account. For the same reason, any resource-related tax measures recorded in the personal income tax section are overestimated.

A misallocation among corporate sectors also arises because corporate investors from other sectors buy flow-through shares from resource corporations. Once again, the relevant accounting deductions are recorded by taxpayers other than the beneficiaries of the flowed-through accelerated write-offs, leading to underestimated amounts being attributed to resource corporations and overestimated amounts being attributed to other corporations.

11. ***Fast Write-Off for Canadian Development Expenses:*** The income tax treatment of development expenditures depends on whether the expenditures are for oil and gas development or for mining development. Canadian mining development expenditures are classified as CEE and written off at a 100-per-cent rate. (See item 13.) Canadian oil and gas development expenditures are classified as CDE and written off at a 30-per-cent declining balance rate. Unused expenditures are accumulated in a separate account known as the cumulative Canadian development (CCDE) account.

    Generally accepted accounted principles indicate that companies may depreciate exploration and development expenditures on either a "full cost" or a "successful efforts" basis. The full cost method means that all costs, productive and unproductive, are capitalized and amortized as the reserves are produced and sold. The successful efforts method means that only those costs which result in the discovery of reserves and which have a future benefit in terms of future revenues are capitalized, other costs are expensed as incurred.

    The 30-per-cent declining balance rate for Canadian development expenses is most likely in excess of the effective write-off rate associated with the full-cost accounting method, whereby development expenditures are capitalized and amortized as oil and gas reserves are produced and sold. Whether or not the 30-per-cent rate is, in fact, accelerated depends on the life of the reserve being developed and on the rate of production from the reserve. For example, the 30-per-cent rate is accelerated in the case of a well that produces for 10 years. The 30-per-cent rate is also likely in excess of the effective write-off rate associated with the successful efforts accounting method because most development costs result in future benefits and are, therefore, amortized as the oil or gas reserves are produced and sold. Therefore, it is likely that the CDE provision gives rise to a deferral of tax.

    The estimate of this selective tax measure has been combined with measures 12 and 13. A combined estimate is provided because the tax system has three unique measures concerning depletion, while the financial statement has only one depletion entry.

12. ***33 1/3-Per-Cent Earned Depletion:*** Earned depletion is an additional deduction of certain exploration and development expenditures and other resource investments from taxable income. Taxpayers were entitled to deduct one-third of qualifying exploration and development expenses or of the costs of assets related to a new mine or to the processing of ores from new mines. These deductions were limited to 25 per cent of the taxpayer's annual resource profits. As in the case of CEE or CDE, earned depletion could be banked for future use.

    The October 1980 budget narrowed these provisions in relation to the oil and gas sector. Individuals investing in oil and gas were no longer entitled to earn depletion, effective January 1, 1981. The depletion allowance on conventional oil and gas was eliminated in 1981 as well. Other oil and gas expenditures earned a reduced amount of depletion from 1982 to 1984 and none thereafter, although certain expenditures related to enhanced oil recovery, tar sands mining projects and upgraders continued to earn depletion at the 33 1/3-per-cent rate.

Not only was the earned depletion system maintained for expenditures incurred in the mining sector but, as was announced in the April 1983 budget, earned depletion related to certain mining exploration expenditures was made deductible, subject to limits, against income from any source.

13. ***Fast Write-Off for Canadian Exploration Expenses:*** Expenditures incurred in prospecting, exploring for or searching for minerals, oil or gas, or incurred to develop mineral resources in Canada are deducted for tax purposes at a rate of up to 100 per cent. These expenditures are recorded by the taxpayer in a separate account known as the cumulative Canadian exploration expense (CCEE) account and any remaining balance may be deducted in a future taxation year. There is no time limit on carrying forward these expenses when they are "banked" in this manner.

    A corporation in the resource sector, known as a principal-business corporation (PBC), must deduct any balance in its CCEE account to the extent of its income for that taxation year and may not use this deduction to create a non-capital loss. This deduction is optional for a non-PBC or individual, and may be used by these taxpayers to create a non-capital loss.

    The accounting treatment of exploration expenditures was described under item 11.

    The 100-per-cent write-off rate for tax purposes is clearly quicker than the rate permitted by accounting rules which require the amortization of some of the expenditures. The CEE provision thus gives rise to a deferral of tax.

    (a) ***Deferral of Canadian Exploration Expense for Capped Wells:*** The October 1980 budget proposed to modify the definition of exploration expenses. Effective from January 1, 1981, wells drilled into a known accumulation of oil and gas, or wells drilled to determine the extent or quality of a known accumulation, were generally to be treated as development wells. Previously, the costs of such production and delineation wells could qualify for the exploration write-off if the well did not produce oil or gas within 12 months of its completion. As a result of the change, these wells would then have to be abandoned to be written off as CEE, rather than simply not producing for 12 months.

Scheduled modification to the law has been postponed until January 1, 1986. As a result, wells which are drilled by the end of 1985 in known accumulations of oil and gas and which do not commence production in commercial quantities within 12 months of their completion continue to be defined as CEE.

The value of this item is included in item 13 above.

14. *Resource Allowance in Lieu of Deductibility of Provincial Royalties:* The tax system provides a resource allowance equal to 25 per cent of a taxpayer's annual resource profits (before deduction of exploration expenses, development expenses, earned depletion and interest expenses.) The resource allowance is in lieu of the deductibility of provincial royalties, mining taxes and other Crown charges related to oil and gas or mining production. Therefore, this tax measure is estimated by comparing the resource allowance to the actual Crown charges.

    The November 1981 budget introduced a provision, effective January 1, 1982, to restructure the resource allowance for production from oil and gas wells. This provision limited the resource allowance to those taxpayers who are directly affected by the non-deductibility of Crown royalties and taxes. The resource allowance now applies to the total production profits of a taxpayer before the deduction of payments to other participants in the well that are not subject to Crown royalties. Those taxpayers with an interest in production but whose royalty income is not directly subject to non-deductible Crown levies no longer receive the resource allowance.

    (a) *Deductibility of Provincial Royalties for the Syncrude Project:* Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and provincial royalties in computing income subject to tax by way of a remission order. This is in contrast to the general rules which deny the deduction of provincial royalties but provide a resource allowance in lieu of this deduction.

15. *Additional Earned Depletion on Frontier Oil and Gas Well Exploration Costs:* From April 1, 1977 until March 31, 1980, individual and corporate taxpayers were entitled to earn depletion at a rate of 66 2/3 per cent of any CEE incurred in drilling a well, to the extent that the cost of the well exceeded $5 million. This additional deduction was known as the "frontier exploration allowance" or "superdepletion." Since the eligible expenditures could be banked for future years, benefits from this allowance were realized beyond 1980. All taxpayers may claim the frontier exploration allowance to the extent of any income for the year.

    The frontier exploration allowance was a temporary additional incentive which corresponded to no accounting deduction; therefore the value of this item is measured separately from items 11, 12 and 13.

16. ***Additional Earned Depletion for Heavy Oil and Tertiary Recovery Projects (Supplementary Depletion):*** From April 10, 1978 until the end of 1980, individuals and corporate taxpayers were entitled to earn "supplementary depletion" at a rate of 50 per cent of certain enhanced oil recovery project expenditures. One-third of the cost of property acquired for mining tar sands could also be added to this account. The limitation on the deduction of these amounts is one-half of a corporate taxpayer's income (any income) or 25 per cent of an individual's resource income for the year.

    Supplementary depletion is shown separately in the account for reasons analogous to those given for the frontier exploration allowance.

17. ***Excess Bad Debt Deduction and Contingency Reserve for Chartered Banks:*** Subsection 26(2) of the *Income Tax Act* provides for a reasonable amount as a reserve for doubtful debts. In addition to the provision for loan losses based on the five-year average loan loss, annual discretionary tax allowable appropriations for doubtful debts or unforeseen losses may be made to an Appropriations for Contingencies Account. This account is used to fund any difference between actual loan losses and the five-year average loan loss described above. These transfers are subject to a yearly maximum and cannot be made if they cause the balance in the account to exceed its prescribed limit of 1.5 per cent of the first $2 billion in eligible assets and 1 per cent of the remainder. Excess bad debt deductions can occur in any period where the average loan loss deduction plus the discretionary deduction exceed the actual loan losses.

18. ***Tax Treatment of Income Debentures and Term Preferred Shares:*** Income from these financial instruments issued prior to November 16, 1978 is treated as dividends for tax purposes even though it is similar to interest. Because inter-corporate dividends are tax-exempt to the recipient and non-deductible for the payer, these financial instruments have allowed loss corporations to obtain financing at much lower cost. If the borrowing corporation was in a loss position for tax purposes, perhaps as a result of claiming fast write-offs of its assets, the deductibility of interest costs on borrowed funds was of virtually no current value. Thus paying non-deductible dividends at an interest rate lower than market level has more immediate benefit. On the other hand, the lending agency (typically a bank) could receive tax-free inter-corporate dividends instead of taxable interest payments. As a result, the lender could afford to charge the borrower a lower rate of interest if the debt took the form of an income debenture or term preferred shares. Since November 16, 1978 the issuing of income debentures and term preferred shares was restricted so that only firms in financial difficulty could issue these instruments to financial institutions. However, it is still possible for term preferred shares to be issued to non-financial corporations as long as they are not guaranteed by financial institutions.

19. *Non-Taxation of Provincial Assistance for Venture Investments of Small Business:* Normally when a taxpayer receives assistance in the form of a grant or tax credit in respect of purchase of a share, the cost of the share for purposes of computing any subsequent capital gain is reduced by the amount of the assistance. The *Income Tax Act* provides that such treatment will not apply in the case of assistance under prescribed provincial venture capital programs.

20. *Small Business (Development) Bonds:* The Small Business Development Bond (SBDB) provision was originally introduced in the December 1979 budget and allowed small business corporations to issue bonds to financial institutions for which interest payments are treated as dividends. Because inter-corporate dividends are tax-exempt to the recipient and non-deductible for the payer, these financial instruments have allowed loss corporations to obtain financing at lower interest rates. The initial provision applied to any assets acquired prior to February 1982. As part of the November 1981 budget, a new financing provision, commonly referred to as the Small Business Bond, was introduced. The Small Business Bond could only be issued by small corporations and unincorporated businesses in financial difficulty. The Small Business Bond measure expires at the end of 1987.

21. *Tax Exemption on Income of Foreign Affiliates of Canadian Corporations:* Canada currently exempts from Canadian corporate income tax certain dividend income paid by controlled foreign affiliates and provides no tax credit for foreign taxes paid. As a result, the tax on distributed profits can be lower than what would be payable had the business activity occurred in Canada. This occurs whenever foreign tax rates are lower than those in Canada. As well, on certain undistributed profits a tax deferral occurs to the extent that foreign tax rates are lower than Canadian rates and this income is not subject to the "foreign accrual property income" (FAPI) provision.

22. *Patronage Dividend Deduction by Credit Unions, Co-operatives:* Credit unions and other co-operatives typically offer their products or services at close to market prices and interest rates. After the year end, any excess of revenues over costs is returned to members in the form of patronage dividends (or "allocations in respect of borrowings" for credit unions) based on their contribution to total revenues. These patronage dividends are deductible in computing the corporate income tax liability of credit unions and other co-operatives. They are not taxable to the recipients provided they are in respect of consumer goods and services (i.e., goods or interest costs that were not deductible by a taxpayer in computing his taxable income from a business or property). The appropriate treatment of patronage dividends is not clear. From one viewpoint, they are simply an accounting adjustment for members of co-operatives because of the difficulties of setting prices in advance to exactly match costs. According to this view, the dividend or allocation is a return of excess payments. Alternatively, the co-operative can be

viewed as a distinct corporate entity where the payment of dividends to members should not be deductible. From this viewpoint, co-operatives and credit unions perform the same roles as retailing, wholesaling, or banking corporations, all of which are taxable. Also, the payment of patronage dividends is not pursuant to any contractual arrangement.

Both viewpoints have some merit. The item has therefore been included based on the comprehensiveness criterion. The amount shown is the revenue impact of allowing patronage dividends to be deducted from corporate taxable income. (Deductions for allocations in respect of borrowing, however, are not included in the estimate.)

23. ***Deductibility of Charitable Donations:*** Taxpayers who make donations to registered charities may claim a deduction in computing their income for tax purposes equal to the amount of their donations, provided this amount does not exceed 20 per cent of their net income. Any donations over this limit can be carried forward one year. For tax purposes, donations must be to registered Canadian charities, which include religious, educational, medical and cultural institutions, as well as to registered Canadian athletic associations, certain non-profit housing corporations, Canadian municipalities, United Nations agencies, certain foreign universities, and foreign charities that have also been supported by the Canadian government. Not subject to the 20-per-cent rule is the value of gifts of cultural property made by corporations to institutions designated under the *Cultural Property Export and Import Act*. This is a selective tax measure based on the use to which income is put.

24. ***Cash Basis Accounting:*** Farmers and fishermen can elect to use the cash basis of accounting for tax purposes (except in respect of depreciable assets). Other taxpayers must generally use accrual accounting. Under the cash basis, receipts are included in income only when received and expenses are deductible when actually paid, regardless of when the income to which these costs relate arises. Under the benchmark tax structure, income is taxable when it accrues. Cash basis accounting may permit deferral of tax in that costs paid are immediately deductible despite the fact that the income to which they relate may not arise until a later year. For example, inventory costs can be deducted as a current expense unlike the rules applying to other taxpayers who must use accrual accounting methods. Moreover, accounts receivable (i.e., accrued) in the year but not yet paid are not taxable.

25. ***Flexibility in Inventory Accounting:*** Farmers who are using the cash basis method of accounting are allowed to depart from it with regard to their livestock inventory. Under cash basis accounting, net additions to inventory are a cost which is deducted in computing income. When a farmer's livestock inventory is growing from year to year, such costs could put him in a loss position for tax purposes. However, a discretionary amount can be added to income each year not exceeding the fair market value of livestock on hand at year-end. This amount

must then be deducted from income the following year. The effect of this provision is to allow farmers who are building up their herds to avoid the previous five-year and the current seven-year carry-forward limit on losses, or to make best use of the five-year block averaging provisions.

26. *Deferral of Income on Grain Sales and from Destruction of Livestock:* Under the deferred cash ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year-end where payment takes the form of a ticket that may be cashed in the following year. The payment is included in income for tax purposes only when the ticket is cashed.

On election of the taxpayer, where there has been forced statutory destruction of livestock (e.g., as a result of brucellosis) the income received as a result of the forced destruction can be deemed to be income in the following year. These measures are a departure from accrual accounting and result in a deferral of tax.

27. *Holdbacks on Progress Payments to Contractors:* In the construction industry, contractors are typically given progress payments as construction progresses. However, a portion of these progress payments (e.g., 10 to 15 per cent) is often held back until the entire project is satisfactorily completed. The amounts held back need not be brought into the income of a contractor until the construction to which it applies is certified as complete. However, a contractor can often fully write off his expenses under the construction contract as they are incurred. The contractor, therefore, has an optional faster write-off of expenses than would be allowed under the strict accrual accounting of the benchmark tax structure. However, where a contractor, in turn, withholds an amount from a subcontractor, the costs equal to the amount of the holdback are not considered to have been incurred by the contractor and, therefore, are not deductible in computing taxable income until paid. The net impact of these two measures on a given contractor's tax liability depends on the proportion of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable by the contractor for a given job, there is a deferral of tax. The contractor has an optional write-off of expenses that is faster than would be allowed under strict accrual accounting. If holdbacks payable are greater than holdbacks receivable by the contractor for a given job, there is a prepayment of tax.

28. *Additional Reserve for Qualified Annuities:* As a consequence of the November 1981 budget, an amendment to the Income Tax Regulations was made to repeal the special reserve deduction in respect of qualified annuities issued after 1981. Qualified annuities generally include those acquired from funds in deferred income plans such as RRSPs and RPPs.

29. ***Non-Taxation of Life Insurance Companies' World Income:*** All corporations under the benchmark tax system are taxable on their world income, with tax credits available in respect of foreign income taxes. Because of the nature of the industry, multinational insurers typically do not operate through incorporated national subsidiaries. The current tax system generally taxes only the domestic income of such multinational life insurers. This constitutes a selective tax measure to the extent that the foreign taxes paid are less than the Canadian taxes that would be levied on the income.

    However, for taxation years beginning after November 12, 1981, when properties are shifted in or out of the Canadian life insurance portion of an insurer's business, deemed disposition rules will apply. This change prevents the possibility, for example, of an insurer shifting an appreciated property on its books from its Canadian to its non-Canadian life insurance business in order to avoid paying Canadian tax on the subsequent sale of the property.

30. ***Deferral of Tax from Use of Billed-Basis Accounting by Professionals:*** Under accrual accounting, costs must be matched with their associated revenues. Professionals in computing their income for tax purposes, however, are allowed to elect either an accrual or a billed-basis accounting method. This implies that costs of work in progress under the latter method can be written off as incurred even though the associated revenues are not brought into income until the bill was paid or became receivable. This gives rise to a deferral of tax.

## B. Rate Reductions

The following items are measures that reduce the statutory corporate tax rate faced by a corporation.

31. ***Small Business Deduction:*** Canadian-controlled private corporations are eligible for a Small Business Deduction that lowers their federal corporate tax rate by 21 percentage points on active business income. For non-manufacturing corporations this results in a 15-per-cent federal corporate tax rate and for manufacturing corporations a 10-per-cent federal corporate tax rate. Prior to the November 1981 budget, the lower rate applied yearly on active business income up to $150,000 until the corporation's cumulative retained income equaled $750,000. Effective for 1982 and subsequent taxation years, the annual limit on income qualifying for the low tax rate was raised to $200,000 and the cumulative income limit was increased to $1,000,000. Another provision introduced in the November 1981 budget eliminated the deductibility of dividends in computing the cumulative income limit. After 1981, the total business income limit is dependent on the sum of income earned. In 1984, in a move towards simplifying the small business deduction, the total limit of $1,000,000 was removed. All Canadian-controlled

private corporations are now entitled to the small business rate on the first $200,000 of income. Hence the need for the cumulative deduction account has been eliminated.

32. *Low Tax Rate for Credit Unions and Co-operatives:* Credit unions and co-operatives are taxed essentially as if they were eligible for the Small Business Deduction. Thus, their tax rate is basically 15 per cent rather than 36 per cent on up to $200,000 income in a year. The value of this rate reduction is also included in the general provision for the Small Business Deduction.

33. *Non-Qualifying Income Small Business Deduction:* Corporations earning any non-qualifying business income but which satisfy the other limitations of the Small Business Deduction are eligible for a reduction of 12 2/3 per cent rather than 21 per cent on their taxes payable. Non-qualifying businesses are professional practices, service and management service corporations. The November 1981 budget further restricted the Small Business Deduction so that personal service businesses and individuals who incorporate and provide services in a manner similar to an employee are not eligible for the lower preferential rate. However, as part of the small business simplification measures, this provision was repealed in 1984. The value of the non-qualifying Small Business Deduction is included in the general provision for the Small Business Deduction.

34. *Manufacturing and Processing Deduction:* With the exception of corporations claiming a Small Business Deduction, the tax system provides for a 6-percentage-point reduction in taxes owing on manufacturing and processing income for corporations carrying on a manufacturing and processing activity. Corporations claiming a Small Business Deduction are entitled to a 5-percentage-point reduction. The manufacturing and processing deduction decreases the federal corporate tax rate on manufacturing and processing income to 10 per cent for small firms and 30 per cent for others.

35. *Small Business Exemption from Corporate Surtax:* In 1979, a temporary corporate surtax of 5 per cent was imposed on taxes paid on income earned between January 1, 1980 and January 1, 1982. In the November 1981 budget, the surtax was extended at a reduced rate of 2 1/2 per cent for 1983. The 1981 extensions did not apply to income eligible for the Small Business Deduction.

    The treatment of the corporate surtax is uncertain. If we consider the surtax as part of the basic tax rate and the benchmark, the exemption for small business is selective. If we consider the surtax as not part of the benchmark, the surtax on large corporations would imply a negative value. Here the surtax was considered part of the benchmark.

36. ***Exemption from Branch Tax for Transportation, Communication, Banking and Iron Ore Mining Corporations:*** Foreign corporations operating in Canada may do so either in a branch form, which is not a separate legal entity, or by incorporating a subsidiary. In order that the withholding tax is generally neutral between the two operating forms, a 25-per-cent tax is levied on the after-tax profits of a branch that are not reinvested in Canada, since these funds can be moved out to the foreign head office through an inter-branch transfer internal to the corporation. (Corporate income tax is levied on the branch as if it were incorporated.) The 25-per-cent branch tax, therefore, corresponds to the 25-per-cent withholding rate that applies to dividend payments to foreign parent corporations from incorporated Canadian subsidiaries. In the case of corporations resident in some countries with which Canada has a tax treaty, for example, the United States, rates of both the branch tax and withholding tax are lower. In a number of industries including transportation, communications, banking, and iron ore mining, businesses have been exempted from the branch tax.

## C. Credits

The following measures are credits against federal taxes payable.

37. ***The Investment Tax Credit (ITC):*** The *Income Tax Act* provides an Investment Tax Credit for investment in eligible assets. A basic 7-per-cent investment tax credit is attributable to new plant, machinery and equipment used in manufacturing and processing, farming and fishing, logging, grain storage, resource extraction, and transportation.

The ITC rate depends on the region of investment. The ITC rate for qualified property that is not transportation equipment or scientific research expenditures is 20 per cent in the Atlantic provinces and Gaspé, 10 per cent in "designated" regions defined under the *Regional Development Act*, and 50 per cent in selected prescribed regions for acquisitions after October 28, 1980 and before 1986.

For the years covered by this Account, the ITC earned in a year could be used in full against tax otherwise payable up to $15,000, and beyond that in amounts not exceeding half of federal tax otherwise payable. Any unused credits could be carried forward up to five years. However, the value of the credit was reduced to the extent that any credit claimed reduced the capital cost of the asset within the CCA system. This interaction was taken into account in the estimates for the ITC.

The ITC is selective because it provides beneficial treatment to certain taxpayers, depending on the manner in which they use their income and the region of the country in which they operate.

In the April 19, 1983 budget, a number of significant changes were made to the Investment Tax Credit. For credits generated after April 19, 1983, corporations are no longer limited in their deduction to $15,000 of federal taxes payable, and the unused tax credits can be carried back three years and forward seven years. As well, credits generated between April 19, 1983 and May 1, 1986 are partially refundable. For small Canadian-controlled private corporations, 40 per cent of the excess credits is refundable and for other corporations 20 per cent. Furthermore, qualified construction equipment was made eligible for the basic credit of 7 per cent. In addition, the share-purchase tax credit was enacted. The share-purchase tax credit allows corporations generating unusable credits after April 19, 1983 to issue new common equity after June 30, 1983 and before January 1, 1987 entitling the purchaser to a tax credit of up to 25 per cent of the value of the cost of the shares. Share purchase tax credits claimed by share purchasers reduce the amount of investment tax credits available to the issuing corporations.

(a) ***Investment Tax Credit Applicable to Scientific and Research Expenditures:*** There are also special ITC provisions applicable to scientific and research expenditures. For the period 1979 to 1982, the basic ITC on scientific and research expenditures is 10 per cent. However, there is a regional component for the ITC for scientific and research expenditures, which is 20 per cent in the Atlantic Provinces and Gaspé, and, regardless of region, 25 per cent for small corporations.

In the April 19, 1983 budget, two significant changes were made to the ITC applicable to scientific and research expenditures. The first measure increased the applicable rate on scientific and research expenditures by 10 percentage points. The second measure allowed corporation to flow out tax credits earned on scientific and research expenditures after April 19, 1983 to investors who would be eligible for a 50-per-cent scientific and research tax credit.

38. ***Employment Tax Credit:*** For the period March 8, 1979 to March 31, 1981, a program of employment tax credits was instituted. Employers who created new full-time jobs lasting at least three months and paying at least the minimum wage were eligible for a tax credit based on the number of new employees, the number of hours they worked (to a maximum of 40 hours per week for up to 12 months), and the geographic region. The credit ranged from $1.50 to $2.00 per hour (depending on the region). The credits were non-refundable and reduced wage costs deductible in respect of the employee. Unused credits could be carried forward up to five years and were transferable on an amalgamation. As with the investment tax credit, the value of the employment tax credit is not equal to the actual credit taken, but to a lesser amount because it is added to income for tax purposes.

39. *Logging Tax Credits:* The logging tax credit is a provision which allows a deduction against federal taxes payable equal to the lesser of 2/3 of any logging tax paid to a province and 6 2/3 per cent of income from logging operations in that province. This may be considered selective in that it is a special deduction against federal taxes payable for a tax paid by a particular industry to the provinces. In general, income taxes paid to the provinces are not deductible for federal income tax purposes.

## D. Other Corporate Items

The following measures exempt corporations from the withholding taxes and corporate taxes.

40. *Exemption From Withholding Tax For Interest on Foreign Currency Deposits:* In general, non-residents of Canada who receive Canadian income from employment, an unincorporated business, or realized capital gains pay income tax as if they were Canadian residents except that account is taken only of their Canadian rather than their world income. However, Canadian "property income" of non-residents (e.g., rent, royalties, dividends, interest, RRSP payments), is subject to withholding tax at a flat rate of 25 per cent, or the withholding tax rate prescribed in the Canadian tax treaty. In general, Canadian tax treaties specify a withholding tax rate of 15 per cent rather than the 25 per cent. Costs associated with generating this income are not deductible.

    On pragmatic grounds, the benchmark system is defined to include the withholding tax for all Canadian "property income" of non-residents.

41. *Exemption From Withholding Tax for Interest on Long-Term Corporate Securities:* Interest paid to arm's length non-residents on securities with a term to maturity of at least five years issued after June 23, 1975 and before 1986 is exempt from withholding tax. As with Item 41, the benchmark tax system provides for a flat rate withholding tax of 25 per cent on Canadian property income of non-residents. Because the withholding tax for most countries with whom Canada has a tax treaty is 15 per cent, the exemption was valued at 15 rather than 25 per cent.

42. *Reduction in Withholding Tax on Dividends Paid to Non-Residents from Corporations with a Degree of Canadian Ownership:* For dividends paid to non-residents prior to November 12, 1981, there was a 5-per-cent reduction in the withholding tax rate if the paying corporation was resident in Canada, had at least a quarter of its voting shares Canadian-owned, and at least a quarter of its directors resident in Canada.

43. *Exemption of Foreign Shipping and Aircraft Companies from Canadian Income Tax:* Foreign-owned companies are generally subject to Canadian corporate income tax on their Canadian profits if they have a permanent establishment in Canada. Foreign-owned shipping and

aircraft companies are, however, exempted from Canadian tax even though they have a permanent establishment in Canada.

## E. Memorandum Items

The following tax measures are parts of the tax system which provide some integration between the personal and corporate tax systems. The tax values of the following items are calculated as additional corporate taxes that would be owing if corporations and individuals are treated as separate tax units.

44. ***Investment Corporation Deduction:*** Investment corporations which are public corporations are allowed a 16 2/3-per-cent deduction in computing their tax, so that their effective federal tax rate is 19 1/3 per cent (except on capital gains income). This purpose of the deduction is to treat the shareholders of a public corporation in a manner similar to investments made through a private corporation.

45. ***Refunds of Part I Tax on Investment Income of Private Corporations:*** As a method of integrating the personal and corporate income taxes, a portion of the income taxes paid on investment income received by a private corporation (excluding inter-corporate dividends) is refunded to the corporation when this income is paid to shareholders as dividends.

46. ***Refundable Capital Gains for Special Investment Corporations:*** The current income tax system gives special treatment to investment corporations, mortgage investment corporations, mutual fund corporations and mutual fund trusts. In all these cases, the corporation or trust typically invests its shareholders' (or unit owners') funds in certain kinds of financial assets. These corporations are treated essentially as conduits which flow through their income to be taxed in the hands of the ultimate owners. For example, capital gains income paid out as dividends give rise to a refund of the Part I tax paid on that income, while recipients treat such dividends as capital gains. Mortgage investment corporation dividend payment are treated as interest payments and thus are deductible. Except in this case, dividends received are not taxable as a result of the general provision for inter-corporate dividends.

47. ***Non-Resident Owned Investment Corporation Refund:*** Non-resident-owned investment corporations are subject to a flat tax of 25 per cent on most of their income, but this tax is refundable when the income is distributed as a taxable dividend to its shareholders. The corporation is essentially treated as a conduit for the flow-through of income to the ultimate owners.

### *Special Energy Taxes*

This section outlines the tax measures implemented under the National Energy Program and agreements of 1981.

48. ***Petroleum and Gas Revenue Tax (PGRT) Revenues:*** The amounts reported for this item represent actual PGRT revenues, and are, therefore, net of the Small Producers' Credit against PGRT. (See the following item.)

The base for the PGRT is the production of petroleum and gas in Canada. The tax was implemented on January 1, 1981 at a rate of 8 per cent of wellhead revenues less a deduction for field operating expenses and other related expenses. On January 1, 1982, the rate was increased to 16 per cent and a 25-per-cent resource allowance was provided for taxpayers required to pay provincial royalties or other non-deductible provincial levies. Effective for the period between May 31, 1982 and June 1, 1983, there was a reduction in the general rate from 16 per cent to 14.67 per cent. Also effective after May 31, 1982, an annual corporate tax credit of up to $250,000 against tax on production revenue was introduced.

In addition, several measures reducing the PGRT liability of certain groups came into effect after the period covered in this document and are not included. Effective for the period January 1, 1983 to December 31, 1985, there is a reduction in the effective rate of PGRT to 8 per cent on the production revenue from the synthetic oil of integrated tar sands operations. The two-year rate reduction initially announced in the *National Energy Program: Update 1982* was extended for another year in the November 1984 Economic Statement. The April 1983 budget announced a capital deduction from PGRT for tertiary oil recovery projects (both heavy and light oil) for expenditures on or after January 1, 1983. In essence, these tertiary recovery projects do not pay PGRT until they have recovered their investment. The Economic Statement of 1984 also announced the doubling of the small producers' tax credit to $500,000, effective January 1, 1985.

Under the provision of the recent Western Accord, the PGRT will be phased out for existing production commencing January 1, 1986. For production revenue from conventional oil and gas, the effective rate will be reduced from its current level of 12 per cent to 10 per cent in 1986, 8 per cent in 1987 and 6 per cent in 1986. The effective rate on production revenue of synthetic oil from integrated tar sands plants will be lowered to 6 per cent in 1986, 4 per cent in 1987 and 2 per cent in 1988. Commencing January 1, 1989, the PGRT will be eliminated on all production.

During the phase-out period, wells on which drilling began on or after April 1, 1985 are exempted from PGRT. Incremental production revenue from a new waterflood or new tertiary oil recovery project certified by the Minister of Energy, Mines and Resources, which commences injection of fluids, steam, etc. on or after April 1, 1985 will also be exempt. Individual Canadian residents will have the first $10,000 of income, whether resource or royalty, exempt from the PGRT on production after December 31, 1985.

49. ***Small Producers' Credit Against PGRT:*** Effective June 1, 1982, an annual tax credit of up to $250,000 was introduced for corporations with working interest oil or gas income. As a result, small corporate producers earning less than about $2 million of net production revenue after this time were not liable to pay PGRT. As of January 1, 1985, this annual credit was increased to a maximum of $500,000, thereby exempting from PGRT up to the first $4 million of a corporation's net production revenue.

    Only one such credit is available to any one group of associated corporations and the credit does not apply against PGRT on royalty income.

50. ***Incremental Oil Revenue Tax (IORT) Revenues:*** The amounts reported for this item represent actual IORT revenues and are, therefore, net of the low productivity well allowance. (See following item.)

    For conventional oil discovered before 1981, revenues in excess of the levels that would have existed under the National Energy Program were subject to an Incremental Oil Revenue Tax (IORT) at a rate of 50 per cent after allowing a deduction for applicable provincial royalties. Incremental revenues, subject to this tax were excluded from income taxation.

    This tax was in effect from January 1, 1982 to May 31, 1982, for conventional old oil when it was suspended, initially until June 1, 1983, and subsequently until June 1, 1985. The tax was suspended on the production of old oil after December 31, 1984 from the bituminous sands plant operated by Suncor Inc. The tax was eliminated in the Western Accord.

51. ***Low productivity well allowance for IORT:*** There was a reduction of incremental revenues for IORT purposes from wells producing less than 20 barrels per day at a rate of 5 per cent per barrel below the 20-barrel threshold. Data limitations prevent estimation of this item.

52. ***Natural Gas and Gas Liquids Tax (NGGLT) Revenues:*** The NGGLT was effective November 1, 1980 and was originally levied on both domestic sales and exports of natural gas and gas liquids. The tax maintained a specific relationship between the price of natural gas and crude oil. In particular, the tax ensured that the wholesale price of natural gas in Toronto was approximately 65 per cent of the average refinery gate price of crude oil in Toronto. This 65-per-cent guideline has been achieved by periodically adjusting the rate of NGGLT. The rate has been successively reduced since February 1, 1983 as world oil prices remained stable while the producers' price of natural gas was increased according to terms of the energy agreement. On February 1, 1984, the rate of NGGLT was reduced to zero. The NGGLT will be repealed as a result of the Western Accord.

53. ***Canadian Ownership Special Charge (COSC) Revenues:*** This tax, levied as of May 1, 1981, applies to Canadian consumption of petroleum, natural gas, ethane, propane and butanes. It was introduced to generate funds to increase the degree of Canadian ownership of the oil industry. The tax has been set at zero effective June 1, 1985.

54. ***Oil Export Charge (OEC) Revenues:*** Oil export charges have been levied on all exports of crude oil and equivalent hydrocarbons and on most exports of oil products derived from domestic crude since 1974. The charge on crude oil is shared equally by the federal government and the producing province. Separate data for the federal government's share of OEC revenues for 1981 or 1982 are not available.

## F. Other Tax Measures

The following tax measures are not directly related to the corporate business sector in Canada.

55. ***Transfer of Income Tax Room to Provinces in Respect of Shared Programs:*** In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The tax change involved an increase in the corporate income tax abatement from 9 to 10 percentage points, effectively reducing the current federal corporate income tax rate from 37 per cent to 36 per cent (46 per cent was the rate before the abatements). The general personal income tax abatements were embodied in a revised rate schedule in 1972. These transfers of tax room have been valued because of functional equivalence criterion; they are substitutes for direct spending programs.

56. ***Exemption from Withholding Tax for Interest on Provincial Direct and Guaranteed Debt:*** Interest paid to non-residents on provincial debt, provincially owned corporations' debt, or on hospital or educational institution debt which is guaranteed by a province is exempt from the withholding tax if issued after April 15, 1966.

57. ***Exemption from Withholding Tax for Interest on Municipal Direct and Guaranteed Debt:*** Interest paid to non-residents on municipal debt or municipal guaranteed debt issued after April 15, 1966 is exempt from the withholding tax.

58. ***Exemption from Withholding Tax for Interest on Government of Canada Debt:*** Interest paid to non-residents on Government of Canada bonds or on bonds guaranteed by the Government of Canada is exempt from the withholding tax.

59. ***Non-Taxation of Registered Charities:*** Taxable income of registered charities, mainly investment income, is exempt from tax. This is a tax

preference for a specific group of taxpayers/legal entities. Two examples follow:

a) Non-taxation of non-profit scientific research corporations.

b) Non-taxation of non-profit corporations providing low-cost housing for the aged.

60. ***Income Tax Exemption for Provincial and Municipal Corporations:*** Under the current income tax system, provincial Crown corporations and municipal corporations are exempt from tax. Under the benchmark tax structure, such corporations would be taxable to the extent they had taxable income.

61. ***Non-Taxation of Certain Federal Crown Corporations:*** Federal Crown corporations listed under Schedule D of the *Financial Administration Act* are taxable. However, a number of other federal Crown corporations, while not so listed, carry on commercial activities and thus could have income which would otherwise be subject to tax.

62. ***Political Tax Credit:*** The *Income Tax Act* allows taxpayers a credit for donations to registered political parties at the federal level. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33 1/3 per cent on contributions exceeding $550.

63. ***Gifts to the Crown:*** A corporation may make a deduction in respect of the full amount of any gift it makes to Canada or to a province.

## Appendix 3

# A Description of Selective Tax Measures in the Commodity Tax System

### Introduction

This appendix provides a brief description of each of the commodity tax provisions included in the account of selective tax measures and outlines any changes in the tax provision that have occurred during the period covered by this account. In addition, the estimating methodology used in computing the values in the table are described along with any significant changes in the methodologies that have been incorporated into this account. However, before discussing each item individually, some general comments are made concerning the sources, and the accuracy of the revenue cost estimates.

The estimation of the revenue cost of selective tax provisions in the commodity tax system relies on a range of data sources. In some cases, such as the lower rate of sales tax on building materials, collections data are obtained directly from Revenue Canada accounts. For these items, the estimation of the tax cost of the provision is a fairly straightforward exercise and the values so obtained are quite reliable.

In the majority of cases, however, the revenue cost estimates are computed using much more indirect sources. For some measures, the value of the tax forgone from the exemption is based on consumption expenditures on the product, with appropriate allowances made for wholesaler and retailer margins (which apply after the tax point). In other instances, estimates are computed using data on manufacturers' shipments, adjusted for exports and imports of the exempt product.

Estimates computed using such indirect sources cannot be as accurate as those obtained using actual collections data. Typically, the data available are not disaggregated sufficiently to obtain precise values for the goods provided the exemption. This problem can be compounded in cases where the exemption is conditional in nature, i.e., it is available only to a specific group of purchasers. One data source that has been used frequently in this account in an attempt to overcome some of these difficulties is the Statistics Canada input-output tables. However, although efforts have been made to ensure that the estimates are consistent with all the available data, for many items the values provided should be viewed as approximations of the midpoint of a range of possible estimates.

## Selective Tax Measures: Commodity Tax System

### I. General Government Services

1. ***Exemption of Goods Purchased by the Office of the Governor General:*** Goods purchased by the Office of the Governor General are exempt from the federal sales tax. The revenue cost of this item (under $5 million annually) is computed using expenditure data from the Public Accounts.

### II. Foreign Affairs

No selective measures under this category.

### III. Defence

1. ***Exclusion of the Research and Development Component of Defence Purchases:*** Until 1980, a Remission Order issued under the *Financial Administration Act* exempted from federal sales tax the research and development portion of the sale price of manufactured goods, where the goods were procured for defence purposes. No estimates are available for this item.

2. ***Exemption of Defence Memorials and Monuments:*** Defence memorials and monuments are exempted from federal sales tax. The revenue cost of this item is under $5 million annually.

### IV. Transportation and Communications

1. ***Exemption of Transportation Equipment:*** The *Excise Tax Act* exempts a range of commercial transportation equipment. Insofar as this kind of equipment is used as an input to provide tax-free services, it should be reflected in the benchmark tax base. If, however, the benchmark tax base included the value of services, inputs such as transportation equipment would be exempt as the associated services would be taxed instead. The coverage of the selective tax measure estimate includes: highway trucks with a gross vehicle weight rating of 7,250 kilograms or more commercial trailers and semi-trailers, public and school buses, vans specially equipped to carry handicapped persons, railway locomotives and railway rolling stock, ships and other marine vessels purchased or imported for use exclusively in maritime activities, and aircraft used in public transportation of passengers, freight and mail as well as a range of specified activities (e.g., corporate and personal-use aircraft are excluded). The provision also exempts parts and equipment, in excess of $1,000 per unit, designed for permanent installation on the above tax-exempt goods. (All parts and equipment for qualifying aircraft are exempt.)

It should be noted that transportation equipment used in international service (e.g., by international air carriers, and shipping), are not taxable under the benchmark tax system and their exemption does not constitute a selective tax measure. The estimate for this item is $235 million for 1983.

## V. Economic Development and Support

### A. Farming and Fishing

No selective measures under this category.

### B. Resource Sector

1. *Non-Adjustment of the Specific Sales Tax Rate on Gasoline:* Until April 1980, the federal sales tax on gasoline and diesel fuel was, for administrative reasons, expressed as a specific amount per gallon rather than as a percentage of sale price. This tax, however, was not adjusted sufficiently to keep it in line with gasoline price increases. As a result, the effective rate of tax on these products, expressed as a percentage of sale price, declined and was somewhat less than the benchmark 9-per-cent rate throughout 1979 and into 1980. As a result, gasoline and diesel fuel were effectively afforded a lower rate of sales tax. In April 1980, the federal sales tax was converted to a 9-per-cent ad valorem levy thereby ending the lower tax rate. The selective tax measure value ($45 million in 1980) is the difference between the two amounts.

### C. Regional Development

No selective measures under this category.

### D. Energy Conservation

1. *Exemption of Energy Conservation Goods and Insulation Materials:* The *Excise Tax Act* provides for an exemption of a range of energy conservation goods. The estimate of the revenue cost of the provision covers the exemptions for insulation materials for buildings (used for wall cavities and roofs), thermal insulation (used for heating and cooling systems), and certain heat recovery units such as air to air heat exchangers. It is important to note that under the marginal approach of estimating selective tax measures (as discussed in Section IV of the text), the value of the exemption (e.g., $40 million in 1983) is obtained assuming that in the absence of the exemption, the 5-per-cent tax rate for construction materials and equipment for buildings would apply. The amount of the overall tax reduction not covered by this item, i.e.,

the difference between the statutory 9-per-cent rate and the 5-per-cent tax rate applicable to building materials and equipment, is about $30 million in 1983.

## E. Manufacturing Sector

No selective measures under this category.

## F. Research and Development

1. ***Exemption of Scientific Apparatus:*** The federal sales tax exempts a range of scientific apparatus. Most of the value of this item is included in the estimate of the tax exemptions for equipment, such as utensils and instruments for laboratory or scientific use, purchased by hospitals and educational institutions (see Items VI.A.3 and VII.1).

## G. Small Business

1. ***Small Manufacturer's Sales Tax Exemption:*** Manufacturers with total taxable sales of less than $50,000 are exempted from paying federal sales tax on their outputs. (They must pay sales tax on their inputs, however.) In addition, all production equipment purchased by such firms is exempt from sales tax. The estimate for this item is $25 million for 1983.

## H. Labour Force

No selective measures under this category.

## I. General Business and Investment Incentives

1. ***Exemption Conversion Kits for Metric Retail Scales:*** Prior to January 1, 1984, kits and parts to convert retail scales to metric units were exempt from sales tax while the tax on purchases of new metric scales was reduced by one-half. The revenue cost of this item is under $5 million annually.

2. ***Exemption of Non-Manufacturing Commercial Uses of Fuel and Electricity:*** Under the benchmark commodity tax structure, non-manufacturing commercial uses of fuel and electricity (e.g., in the retail, wholesale and service sectors) would be taxable, given that the sales of services by this sector are exempt. Of course, if the benchmark commodity tax base did include the outputs of the non-manufacturing commercial sector, this exemption would not be a selective tax measure. The estimates (e.g., $400 million for 1983) are based on consumption data from the

National Energy Board of oil, electricity and natural gas by the non-manufacturing commercial sector.

## VI. Health and Welfare

### A. Health

1. *Exemption of Drugs:* Drugs are exempted from federal sales tax. By consequence of the use of the marginal approach for estimating selective tax provisions, the value for this item excludes the sales of drugs to hospitals (see item 2 below).

2. *Exemption of Purchases by Hospitals, Sanitoria, etc.:* Under the benchmark commodity tax system, the manufactured and produced inputs used in providing tax-free services are taxable. The exemption of purchases of machinery, equipment, various supplies and building materials by hospitals thereby constitutes a selective tax measure. By consequence of the use of the marginal approach, the estimate does not cover the value of the tax exemptions for food, clothing, drugs, certain surgical instruments and supplies, and equipment such as X-ray machines purchased by hospitals which are covered by other general sales tax exemptions as well. In addition, the revenue cost of exempting hospital purchases of building materials is evaluated at the 5-per-cent tax rate (i.e., the rate that would apply if only the exemption for hospital purchases were eliminated) rather than the 9-per-cent general tax rate. The additional forgone revenue for these items is estimated to be about $50 million for 1983. (Thus, for 1983, when this $50 million value is added to the $120 million figure provided in Table 3, the total tax savings to hospitals is found to be approximately $170 million.)

3. *Exemption of Medical Instruments and Health Appliances:* The estimate of this tax exemption includes the federal cost of exempting goods such as hearing aids, eyeglasses, wheelchairs, trusses, artificial limbs, and surgical and dental instruments purchased by doctors and dentists, and X-ray equipment purchased by private laboratories. The estimate for 1983 is $11 million.

### B. Income Maintenance

1. *Exemption of Food and Non-Alcoholic Beverages:* The federal sales tax exempts sales of food and non-alcoholic beverages. Included in the estimate are purchases of food and non-alcoholic beverages by consumers, restaurants, and hotels. (Hospital purchases of food are not included in this item as they are also covered by the hospital purchases exemption). Also included in this estimate are home-produced food, confectionery and near foods, fresh fruits and vegetables, canned and packaged foods, and pet food. The estimates are obtained using

Statistics Canada input-output tables, and personal expenditure data. The revenue estimate for 1983 is approximately $2,580 million.

2. *Exemption of Home-Heating Fuels and Electricity:* Home-heating fuels and electricity purchased by consumers are exempt from federal sales tax. The estimates (e.g., $590 million in 1983) are based on data obtained from the National Energy Board on consumer expenditures on fuel and electricity.

3. *Exemption of Clothing and Footwear:* Clothing and footwear are unconditionally exempt from federal sales tax. The estimates (e.g., $705 million in 1983) are obtained using Statistics Canada input-output tables and personal expenditure data.

## C. Social Assistance

1. *Exemption of Goods Manufactured by the Handicapped:* Goods manufactured by institutions for the handicapped are exempted from sales tax. The value of this item is expected to be very small.

## D. Indians and Eskimos

No selective measures under this category.

## E. Housing and Urban Renewal

1. *Reduced Rate of Sales Tax on Building Materials:* Rather than the 9 per cent general rate, building materials are subject to a reduced rate of sales tax of 5 per cent. The estimates for this item (e.g., $430 million in 1983) are computed by grossing up Revenue Canada data on sales tax collections on building materials.

2. *Exemption of Construction Equipment:* Since the output of the construction sector is exempt from sales tax under the benchmark tax structure, any machinery, equipment, and materials used as inputs in the sector must be fully taxable. This exemption thus constitutes a selective tax measure. The estimate of the item (e.g., $105 million in 1983) is based on Statistics Canada data on sales of tractors, excavator cranes, trenchers and ditchers, graders, compactors and rollers, concrete machinery, asphalt equipment, and all other construction type machinery and attachments.

3. *Exemption of Ready-Mix Concrete and Goods in Competition with On-Site Construction:* Under the federal sales tax system, ready-mix concrete and other manufactured goods which could alternatively have been fabricated on a construction site are taxable only on their material inputs and not on their sale price. This constitutes a selective tax

measure since any value added in the manufacture of these goods is effectively exempted from tax. Some of the other manufactured goods affected by this provision are pre-cast concrete structures, structural steel for buildings, cement blocks, prefabricated buildings, roof trusses and septic tanks. The estimate (e.g., $80 million in 1983) is based on Statistics Canada input-output data and measures the difference between the tax paid on the inputs of these goods and the tax that would be charged if the goods were treated as other building materials and taxed at a 5-per-cent rate. By consequence of the use of the marginal approach in estimating the cost of tax provisions, the difference between the 9-per-cent statutory tax rate and the 5-per-cent rate applicable to building materials is not covered under this item or under the item relating to the lower tax rate for building materials (item 1 above). This amounts to about $130 million in 1983.

## VII. Education Assistance

1. ***Exemption of Equipment and Construction Materials Bought by Educational Institutions:*** The present federal sales tax exempts from tax materials used in the construction of buildings used by educational institutions and a range of equipment and apparatus purchased by these institutions. The October 1980 budget modified this tax provision to restrict the exemption for equipment and apparatus primarily to those goods directly used in teaching and research. The estimates are computed using Statistics Canada data on construction of educational institutions and purchases of equipment and supplies. The estimate for 1983 is $40 million.

2. ***Exemption of Technical, Educational and Other Books:*** This tax provision exempts the full range of hard cover and soft cover books such as encyclopedias, educational text books, fiction and non-fiction books from federal sales tax. The estimates (e.g., $75 million for 1983) are derived from Statistics Canada data on the printing and publishing industries and on imports and exports of books.

## VIII. Culture and Recreation

1. ***Exemption of Newspaper and Magazine Production:*** Newspapers and magazines are exempt from federal sales tax. In prior accounts, the value of this item was estimated based on the retail sales value of these goods adjusted for retail and wholesale markups. However, revenues to magazine and newspaper producers are derived from both retail sales and advertising. Consequently, the retail price may not accurately reflect the actual production costs. For this reason, Revenue Canada generally uses a formula approach (cost of materials plus 220 per cent) in determining a value for tax for taxable printing (e.g., catalogues).

This account employs this formula approach in computing the revenue cost estimate for this item. Information on the cost of materials in newspapers and magazines is obtained from Statistics Canada data on the printing and publishing industries. The estimate for this item for 1983 is $200 million.

2. *Exemption of a Range of Cultural and Religious Materials:* This exemption covers a variety of goods such as church organs, church bells, statues, hymn books, and religious pamphlets. Some of these items would fall under the exemptions for books, and newspapers and magazines described above. Revenue Canada data on the importation of these goods indicate that the cost of this provision is under $5 million.

3. *Exemption of Imported Antiques:* Imported antiques over 100 years old are exempt of federal sales tax. (The threshold was 50 years prior to 1981.) Domestic antiques are not included in the selective tax measure because they have already passed the tax point (i.e., sale by manufacturer).

4. *Exemption of Amusement Devices and Equipment for Use at Exhibits or Fairs:* Under the benchmark tax system, all goods used in providing tax-free services such as entertainment are taxable. The revenue cost of this tax measure is not available at this time.

5. *Exemption of Bicycles and Tricycles:* Bicycles and tricycles (but not replacement parts sold separately) are exempt from sales tax. The estimates (e.g., $11 million in 1983) are based on Statistics Canada data on the domestic production, importation and export of bicycles and tricycles.

6. *Exemption of the Outputs of Craftsmen, Artists, and Sculptors:* Included under this exemption are paintings, sculptures, carvings, handicrafts and other art objects. The October 1980 budget effected some changes to this provision (e.g., lithographs were made taxable). Most domestic producers of these products have sales under $50 thousand per annum and would not pay tax on their output even if these goods were made taxable (see item V.G.I.). Thus the revenue cost estimate here (under $5 million annually) relates primarily to imported works.

## IX. Fiscal Transfer Payments

1. *Exemption of a Range of Municipal Purchases from Sales Tax:* The *Excise Tax Act* exempts a range of goods purchased by municipalities. Included under this item is a range of construction materials, equipment such as those used in water and sewage treatment plants, municipal transit equipment, fire-fighting equipment, and road-making and water distribution equipment. Some of this equipment is also exempted under other provisions (e.g., transportation equipment, construction equipment exemptions) and, as a result of using the marginal approach to evaluate

selective tax measures, the revenue cost of exempting these goods is not included under this item. The estimate for this item is $45 million for 1983.

2. *Exemption of Purchases by Certain Provincial Governments:* Provinces not party to the Reciprocal Taxation Agreement are exempted from federal sales taxes on their purchases. Prior to April 1, 1983, Manitoba, Saskatchewan, Alberta and British Columbia were not participating in the Reciprocal Taxation Agreement and hence, were exempted from federal sales tax on their purchases. Following that date, British Columbia and Saskatchewan became party to the Agreement, and no longer qualify for the exemption. The estimate for this item is $25 million for 1983.

## X. Public Debt

No selective measures under this category.

## XI. Other Tax Preferences

1. *Exemption of Goods Imported in Travellers' Baggage from the Sales Tax:* Residents returning from visits abroad are allowed to bring back gifts and articles within various limits, depending on the length of their absence, without any payment of sales tax (or customs duty). The April 1983 budget doubled the various limits on such importations. An estimate of this item is not available.

2. *Exemption of Coins from Sales Tax:* Coins are considered a manufactured and produced good and are thus included in the benchmark commodity tax base. An estimate of the revenue cost of this measure is not available at this time. (It may be noted that the production of bank notes, i.e., dollar bills, etc., is taxable under the federal sales tax.)

## XII. Memorandum Items

1. *Exemption of Services from Sales Base:* On pragmatic grounds, the benchmark sales tax structure excludes services from the sales tax base. However, such a tax is clearly non-neutral in its treatment of goods and services. If services were included in the tax base, it would then be inappropriate to tax materials and machinery and equipment used directly in the provision of these services. The net revenue cost of the selective tax measure in this case would then be the excess of the value of non-taxation of services over and above the revenue collected from the taxation of materials and machinery and equipment used to produce the services. For instance, the net revenue cost in favour of repair services would become the excess of the total value of repair services

times the sales tax rate less the revenue collected from parts used in making repairs. Included in the estimate of this memorandum item are: housing services (gross paid and imputed rent); lodging at schools, hotels, etc.; communication services; child care expenses and household help; cleaning services; repairs; insurance premiums; moving, storage, garage rental and parking expenditures; personal care services; medical services; other professional services; rentals; amusement and recreation services; personal instruction services; membership dues in organizations and clubs; and tuition fees. For purposes of the estimate, it is assumed that services would be taxed at the federal sales tax rate applicable in the year. The estimate for this item is $7,065 million in 1983.

2. ***Other Commodity Taxes in Excess of Manufacturers' Sales Tax:*** The federal government levies a range of taxes on commodities in addition to the sales tax. For selective tax measure accounting purposes, one can view these taxes as being levied on a separate tax base, each with its own benchmark tax structure. Alternatively, these taxes can be considered tax penalties insofar as they cause more revenue to be collected than would be collected under a neutral sales tax alone. In either case, they are included here as memorandum items for information purposes.

   (a) ***Gasoline:*** A special excise tax of 1.5 cents per litre is levied on gasoline. It is levied only on non-commercial users of gasoline although commercial users pay the tax on their purchases and then apply to Revenue Canada for a refund. The estimate for this item is $445 million for 1983.

   (b) ***Tobacco:*** Cigars, cigarettes, and manufactured tobacco are subject to a combination of excise duties (under the Excise Act) and excise taxes (under the *Excise Tax Act*). In addition, the federal sales tax collected on sales of tobacco products is higher than for other products both because the sales tax rate is three percentage points higher than the general rate and because the excise duties enter into the base for calculating federal sales tax payable. The estimate for this item is $1,155 million in 1983.

   The October 1980 budget introduced an indexing system for the specific excise levies on these products based on the Consumer Price Index (CPI) tobacco products subgroup. Although originally designed to be quarterly (first increase on April 1, 1981) it was subsequently revised to apply annually with increases becoming effective each September. Effective with the September 1984 adjustment, the base for the indexing system was changed to the total CPI, rather than tobacco products subgroup of the CPI.

   (c) ***Alcohol:*** Beer, wine, and liquor are also subject to a combination of excise duties (under the *Excise Act*) and excise taxes (under the *Excise Tax Act*). Here too, the federal sales tax collected is greater than for other goods because the applicable tax rate is three percentage points higher than the general rate and the excise levies enter in the base upon which the tax is calculated. The revenue estimate for this item is $1,210 million for 1983.

The October budget also introduced an indexing system for the specific excise levies on beer, wine, and spirits based on the Consumer Price Index (CPI) alcoholic beverages subgroup with annual increases every September. As in the case of tobacco, the indexing base for levies on alcoholic beverages was changed to the total CPI effective for the September 1984 increase.

(d) *Jewellery:* Jewellery is subject to a 10-per-cent excise tax. The revenue estimate for this item is approximately $40 million for 1983.

(e) *Heavy Cars, Automobile Air Conditioners:* Cars in excess of a specified weight limit are subject to tax on the excess weight. Automobile air conditioners are subject to a flat rate of tax of $100 per unit. The revenue estimate for this item for 1983 is $26 million.

(f) *Air Transportation Tax:* The proceeds of this tax are earmarked for the air transportation program of the Department of Transport. It is levied on airline tickets as a percentage of the ticket price for flights within Canada, the U.S., and the islands of St. Pierre and Miquelon, and as a flat amount on other international flights. For 1983, the estimate for this item is $205 million.

(g) *Telecommunications Programming Services Tax:* The April 1983 budget introduced a 6-per-cent sales tax effective from July 1, 1983, on amounts charged for radio and television programming services. The tax applies to programming services provided by telecommunication including a charge for television cable rental, pay T.V., and movies shown on television in hotels. In 1983, $15 million was collected from this tax.

(h) *Other:* Clocks, watches, lighters, playing cards, and smokers' accessories are all subject to excise tax at various rates. The revenues collected from these taxes were $11 million in 1983.

3. *Refunds of Special Excise Tax on Gasoline for Commercial Users:* As noted above (item 2.(a) the special excise tax on gasoline is refunded to commercial users. The amount shown is the additional revenue that would be collected if commercial uses of gasoline were also subject to the special excise tax. The November 1984 Economic Statement proposed measures which facilitate the process of obtaining this refund (i.e., through an up-front rebate rather than a refund) for large volume purchasers. The 1983 estimate for this item is $95 million.

In a related measure, the November 1984 Statement provided a rebate of 3 cents per litre of the sales tax (not excise tax) paid on gasoline and diesel fuel for off-highway use by primary producers (farmers, fishermen, loggers, mine operators, hunters and trappers).