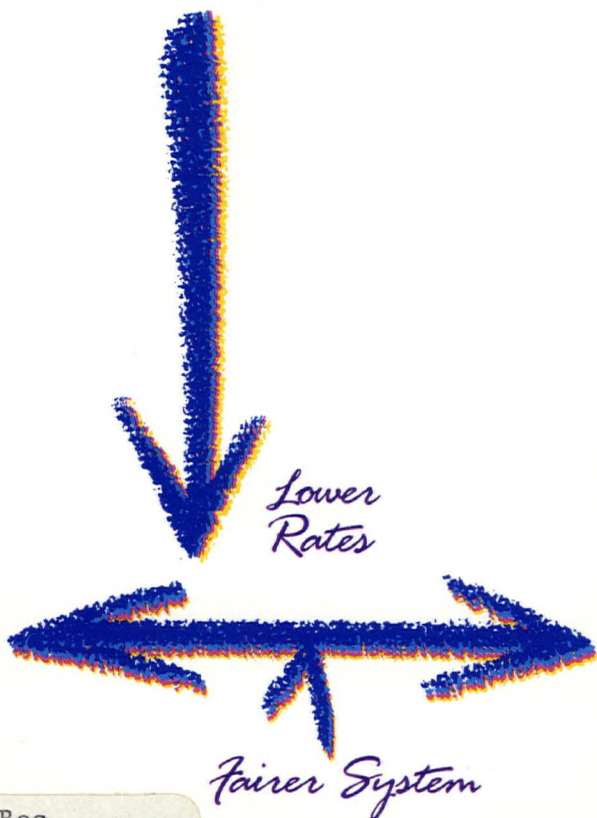


Tax Reform 1987

Excerpts from a speech
by the Honourable
Michael H. Wilson
Minister of Finance

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Introduction

Our tax system must help individuals and businesses deal with the challenges of the 1990s and into the next century.

It must reinforce our ability as a country to continue to provide the social programs needed by our people.

It must generate the hope and opportunity that will motivate Canadians to build a strong country in a very competitive world.

But to do this, the tax system must have the respect of Canadians. We know that it does not. And we know why.

We all know that the tax system allows many profitable corporations to avoid paying a fair share of tax, year after year.

We all know that it allows some people with very high incomes to pay less tax than the average Canadian wage-earner, year after year.

We all know that it allows those who are able to use special tax breaks to shift the burden to others less able to carry it.

Over the years, our tax system has become a crazy quilt of special incentives, special deductions and special write-offs.



Each special incentive gives a break to someone. But each special tax break means that taxes have to be higher for everyone else. Special breaks have made the income tax more and more complicated, and less and less fair.

During the past two years, I have acted to strengthen the integrity of the tax system. Many tax breaks have been eliminated. But further action is needed to restore faith and trust in the system, to ensure that it works for the benefit of all Canadians.

Highlights of the Proposals

I am proposing sweeping reforms to the personal and corporate income tax system. Beginning January 1, 1988:

- We will reduce or eliminate many special tax breaks. Those high-income individuals and profitable corporations who currently pay little tax will carry a greater share of the tax burden.
- We will further increase the fairness of our personal income tax by converting tax exemptions and deductions to tax credits, with particular benefits for lower-income and elderly Canadians.

- We will reduce the burden of taxation on those who have not been taking advantage of special tax breaks. As a result, 80 per cent of Canadian households will have lower personal income taxes in 1988. A typical family of four earning \$30,000 will pay about \$500 less in taxes.

The proposals will be implemented in two stages. Income tax changes will take effect beginning in the 1988 taxation year. In the second stage, the existing sales tax will be replaced by a new sales tax system.

The reform proposals are a package. They strike a responsible balance among the many objectives that our tax system must serve in addition to raising revenues: objectives such as targeting assistance to those who need it most, promoting regional equality and encouraging greater investment in Canada's future.

Some will argue that the government should have wiped out more tax incentives. But I am not prepared to abandon key national and regional priorities. The incentives that will remain in the system are there for good reasons.

Others will argue for retention of some of the tax breaks being eliminated. But let us not forget that they are asking for special tax breaks for some which mean higher taxes for many others.

Our reforms are designed to be neither a revenue grab nor a windfall. On balance, the reformed system will raise about the same revenue as the current system.

But, the reforms make fundamental changes in who pays and how much.

Those who have made extensive use of tax preferences will pay more tax. Many corporations and some individuals will pay more. Most individuals and some businesses will pay less. Corporations will carry a bigger share of the total tax load. Sales tax revenues will be increased.

Personal Income Tax Reform

Federal personal income taxes will be reduced by about \$2 billion in 1988 and more than \$11 billion over the next five years.

Most Canadians will pay lower taxes because of two far-reaching changes: a new structure of federal income tax rates and the conversion of exemptions and deductions to tax credits.

Beginning in 1988, there will be three federal income tax rates: 17 per cent on the first \$27,500 of taxable income, 26 per cent on the next \$27,500 and 29 per cent on taxable income over \$55,000.

Despite having only three tax brackets, the personal income tax system will be more progressive.

The key to making the system more progressive is the conversion of exemptions and deductions to tax credits. This will eliminate federal income tax for 850,000 Canadians, 250,000 of whom are senior citizens. Let me explain how credits make this happen.

If the government were to introduce a program to help the elderly or the disabled, and if the program were set up so that richer people got a bigger payment than poorer people, most Canadians would think that was unfair. And they would be right. But that is exactly what our current system of exemptions does.

For example, we now have a deduction of \$2,670 for Canadians 65 and over. For a senior citizen with \$15,000 of income, this is worth about \$455 in lower taxes. For another senior with \$100,000 of income, the same deduction would be worth \$910 – about twice as much.

Exemptions reduce the amount of income that is subject to tax. This makes their value greater for those with higher incomes because higher-income people have higher tax rates. Credits reduce tax payable. They are worth the same regardless of income.

We will replace exemptions with tax credits. In the case of the age credit, it will be worth \$550 in tax savings to all seniors.

The new credits will ensure that the vast majority of Canadians pay lower income taxes.

For example, nine out of 10 Canadians 65 and over will pay less federal tax in 1988. A typical elderly married couple with \$25,000 of income will pay about \$650 less.

The personal income tax reforms reflect a number of priority areas for this government.

We all want our younger Canadians to receive a good education. The new education and tuition credits can be claimed either by the student or a supporting spouse, parent or grandparent. This will substantially augment the availability of tax assistance for students pursuing a post-secondary education.

Our communities are strengthened and enriched by the contribution of volunteer organizations. The new tax credit for charitable giving has been designed to provide a substantial incentive for donations, particularly for low- and middle-income earners.

The tax reform proposals will continue to help Canadians become more self-reliant by saving for their retirement. The fairer and more flexible system I announced last October will not be changed. However, the \$15,500 limit for RRSP contributions will be phased in more slowly.

The farm community will continue to benefit from the existing \$500,000 capital gains exemption for farmland.

Canadians have created 840,000 jobs since September 1984. Much of this is the result of the efforts of individual men and women, each striving to build and grow in their own way.

To reinforce the job-creating potential of the small business sector, the \$500,000 capital gains exemption for shares of small businesses will become effective on January 1, 1988.

This government has encouraged small business, risk-taking and entrepreneurship, and will continue to do so.

But the most effective tax incentive is lower tax rates. Lower rates mean more reward for that extra effort.

And to provide that incentive for all taxpayers, we must restrict and remove a number of tax deductions and exemptions.

Self-employed Canadians are entitled to deduct expenses they incur in earning income. But some expenses represent an element of personal consumption. To recognize this, the deduction for business meals and entertainment will be restricted to 80 per cent of expenses incurred. Where home offices and automobiles are not used exclusively for business purposes, deductions for these expenses will be limited.

The lifetime capital gains exemption for all property, other than qualifying farm property and small business shares, will be held at the 1987 level of \$100,000.

The taxable portion of capital gains will rise from one-half to two-thirds in 1988 and three-quarters in 1990. The tax system will continue to give preferential treatment to capital gains and dividends in recognition of the risks associated with investment.

Those who receive investment income or make extensive use of tax preferences pay consistently lower taxes than others. After reform, they will pay more. About 1.5 million households will have an average tax increase of about \$665. They will continue to pay lower average effective rates of tax than those with similar income derived mostly from employment. But the gap will be narrowed.

Corporate Income Tax Reform

Tax reform will return the profit motive to investment by rewarding success. It will encourage investment decisions to be based far more on the imagination and creativity of research, engineering and marketing experts, and far less on the advice of tax specialists.

And it will ensure that profitable corporations carry a bigger share of the total tax burden. Federal corporate income tax revenues will increase by about \$5 billion over the next five years.

To maintain a competitive tax system the general federal rate will fall to 28 per cent in 1988. The rate for small business will fall to 12 per cent and the manufacturing rate will be reduced by 1991 to 23 per cent.

These lower rates will apply to a broader tax base with fewer special incentives. Capital cost allowances will be reduced. The rate of tax on capital gains will be increased. Deductions for meals and entertainment expenses will be limited. Small manufacturers will be taxed at the same rate as other small businesses.

New rules will ensure that profitable financial institutions and real estate companies pay their fair share of tax.

More balanced development across all regions will continue to be strongly supported through the tax system. The reform proposals maintain the relative incentive effect of the investment tax credits in the Atlantic and Gaspé regions, Cape Breton, and special investment tax credit regions across Canada.

The mining industry is important to regional economic growth. Incentives will be retained with the exception of earned depletion, which will be phased out by mid-1989. The average tax rate of the mining sector will remain one of the lowest.

The oil and gas industry will benefit over all from tax reform. The industry will continue to have access to flow-through shares.

The agriculture, logging and fishing sectors will have the lowest average tax rate of any sector.

The reformed system will strongly support two key priority areas for this government: research and development and labour-intensive economic sectors.

Firms engaged in R&D in Canada will continue to benefit from one of the most favourable tax regimes for R&D in the industrialized world.

Canada's wholesale and retail trade and service businesses are leaders in employment growth. Lowering their taxes will encourage new investment in these sectors in all parts of Canada.

Canadians quite rightfully resent it when they find that others avoid paying tax by bending the rules of the tax system. Lower rates and fewer preferences will reduce the incentive and opportunity for tax avoidance.

But further action is required. Legislative changes will provide a stronger basis for reassessing artificial tax avoidance transactions. Information reporting requirements for investment income and tax shelters will be strengthened to help identify avoidance and evasion.

Sales Tax Reform

A fair and effective sales tax is an essential part of the overall balance of Canada's tax system.

The present tax is fundamentally flawed. It is a hidden, arbitrary and capricious tax.

Many Canadians are unaware of this tax because it is normally applied when a product is manufactured and is hidden in the price of goods which are eventually sold to consumers. By the time it reaches the consumer, a dollar of tax paid by a manufacturer can raise the price to the consumer by a lot more than a dollar.

The existing sales tax puts more tax on Canadian-produced goods than it does on competing imports. It puts a hidden tax on our exports that makes them less competitive. That extra tax penalty is costing us jobs and creating them in other countries.

The existing sales tax will be replaced by a new sales tax that will apply to a much broader base. The result will be a lower tax rate and a fairer system.

Sales tax reform will eliminate the hidden tax in the prices consumers pay. It will remove the tax burden on exports and will treat our domestic producers on the same basis as their foreign competitors. It will make us more competitive in world markets and will enhance our trade initiatives.

The new sales tax will be accompanied by important changes to the personal income tax. The most important of these will be to substantially increase the refundable sales tax credit introduced by the government in 1986 and to extend this credit to many more Canadians. The new sales tax credit will be paid regularly and in advance.

The level of the credit and the income threshold for eligibility will be established to more than offset the impact of the new sales tax on low-income Canadians. In addition to the credit, when the new sales tax is introduced, the income surtaxes will be removed and there will be further income tax cuts for middle-income taxpayers. These measures will make the combined personal income and sales tax systems, after tax reform, more progressive than they now are.

The government is considering three alternative forms for the new sales tax. One is a National Sales Tax which would replace both the present federal sales tax and provincial retail sales taxes with one national system. Two federal-only sales taxes are also being considered: a Goods and Services Tax and a Value-Added Tax.

The government is committed to sales tax reform. It will proceed after consultation with provincial governments and other interested Canadians.

Fiscal Responsibility

Our progress in reducing the deficit is essential to our success in reducing interest rates, increasing growth and lowering unemployment. The proposals I am presenting tonight are fiscally balanced.

Sales tax reform will follow the reforms to our personal and corporate tax systems. In the interim, we must make the existing sales tax more reliable and deal with its worst competitive distortions. And we must raise more revenue, in conjunction with corporate income tax increases, to help fund the personal income tax cuts.

Effective January 1, 1988:

- The tax will be applied to marketing companies which do not operate at arm's-length with a manufacturer. It will also be moved to the wholesale level for a limited range of products.
- The tax will be extended to most telecommunications services at a rate of 10 per cent. The charges for basic residential telephone service will be exempt.

To further protect lower-income Canadians from the impact of these changes, the existing refundable sales tax credit will be increased from \$50 to \$70 for adults, and from \$25 to \$35 for children.

Economic and Fiscal Outlook

Our economic prospects for this year are little changed since my February budget. I am very much encouraged by the strong employment growth we have seen in recent months. The unemployment rate, at 9.1 per cent, is at its lowest level in more than five years. But what is most encouraging are the indications, from both employment data and recent surveys of investment intentions, that growth is becoming better balanced across the regions of Canada.

Over the medium term our economic prospects will depend greatly on the success of the industrialized countries in reducing the large international trade and fiscal imbalances that cast a shadow over world growth. Canada is playing a constructive role in this regard.

Our prospects will also depend on what we do at home. Making further progress on tax reform, on our trade initiatives and on the deficit will strengthen investment and growth in all regions of Canada.

Our fiscal outlook continues to be encouraging. I expect the deficit for this fiscal year to be \$29.3 billion. The debt-to-GDP ratio is expected to stabilize by 1991-92. This is a key objective of the government's medium-term fiscal strategy.

Conclusion

The package I am placing before Parliament and the nation respects our needs today and will help us build a better tomorrow. It reflects the concern we share for our senior citizens and the challenges facing our young people and our entrepreneurs. It respects the importance of our farmers and our resource industries. It recognizes the competitive battles being fought daily by our manufacturers and the challenge of the future for our technology and service sectors. It provides tax savings to individual Canadians and gives them the freedom to spend, save or invest as they see fit.

Some are being asked to pay a greater share through a reduction in tax preferences. In making these decisions, I have considered carefully the key goals of greater fairness and competitiveness. And where the impact is substantial, the change will be phased in over time.

But in the final analysis, this package will be judged on whether we have given to our senior citizens more peace of mind and security; to those in greatest need, a fairer and reduced tax burden; to our young, a greater sense of opportunity and hope; and to our working people, more incentive, stability and freedom.

I believe we have met these tests.

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