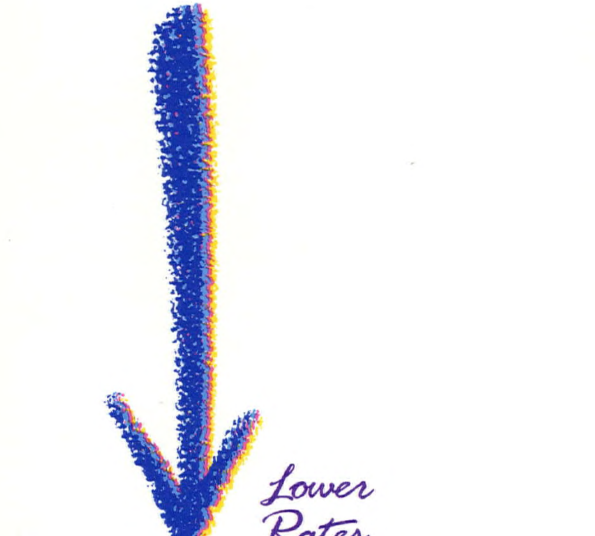
Tax Reform 1987

Personal Income Tax

June 18, 1987



Canada

Preface

Canada needs a fairer, more effective tax system.

We need it to ensure equitable sharing of the costs of public services vital to our economic, social and cultural well-being; and to strengthen our capacity to create jobs, opportunities and a better life for Canadians in a competitive world.

That is why the government is making important, comprehensive reforms in the nation's tax system. The first stage of reform, to the personal and corporate income tax, will be implemented in 1988. In stage two, the federal sales tax will be replaced by a better system, following further consultation with provincial governments and interested Canadians.

The cornerstone of comprehensive tax reform is a fairer tax system with lower tax rates on a broader tax base. Lower tax rates are the best incentive for Canadians to create economic benefits for themselves and for the nation. A broader tax base with fewer special tax breaks provides the means to bring down tax rates, ensures that taxpayers in similar circumstances will be taxed more equitably, and strengthens the foundation for further measures to reinforce social justice.

This booklet summarizes the changes the government proposes to make to the personal income tax system and the direct benefits of these changes: lower income taxes for most Canadians.

The Honourable Michael H. Wilson
Minister of Finance

Department of Finance Canada   Ministère des Finances Canada

Accent on People

Lower and fairer personal income taxes mean that individual Canadians will keep more of each additional dollar earned to spend, save or invest.

Lower-income and middle-income Canadians in particular will benefit from a fairer distribution of the tax burden and from shifting of the burden to corporate income taxes and sales taxes.

Comprehensive tax reform will help Canada become more competitive internationally. It will help to build greater economic strength through the most effective incentive: lower tax rates.

Comprehensive tax reform will strengthen social justice by making the income tax more progressive and the sales tax fairer by enriching the refundable sales tax credit and extending it to more lower-income Canadians.

Comprehensive tax reform will make the tax system more understandable, more reliable and better able to earn the respect of taxpayers.

A fairer, more effective tax system will benefit all Canadians.

How Taxpayers Gain

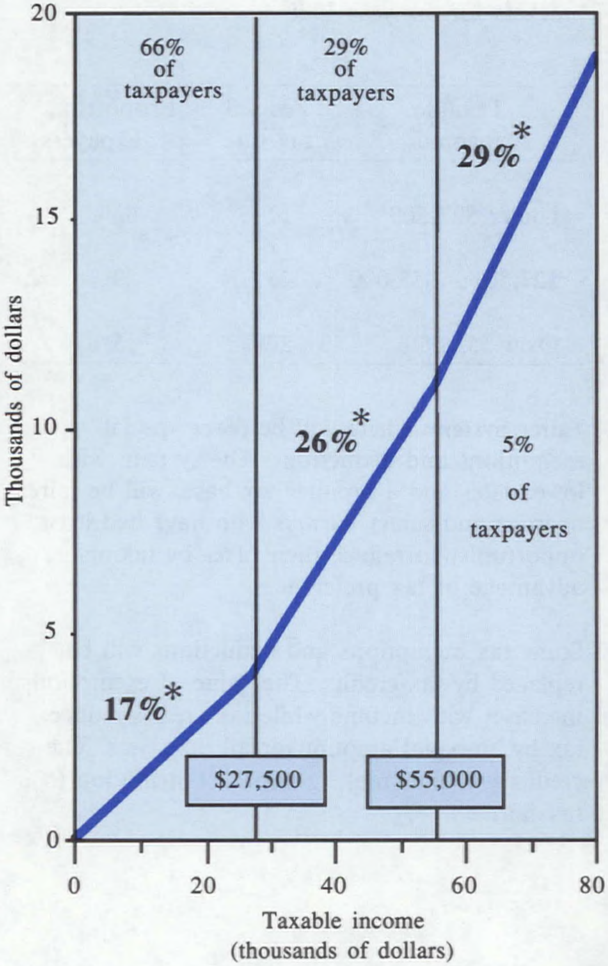
Lower Rates: Most Canadians will pay a lower rate of income tax over all and a lower rate of tax on each additional dollar of income. The present 10 tax brackets, with federal rates as high as 34 per cent, will be reduced to three brackets for tax year 1988.

Taxable income	Federal tax rate	Proportion of taxpayers
Under $27,500	17%	66%
$27,501 - $55,000	26%	29%
Over $55,000	29%	5%

Fairer System: There will be fewer special exemptions and deductions. The system, with lower rates and a broader tax base, will be fairer to wage and salary earners who have had least opportunity to reduce their taxes by taking advantage of tax preferences.

Some tax exemptions and deductions will be replaced by tax credits. The value of exemptions increases with income while tax credits reduce tax by an equal amount for all taxpayers. The credits will thus make a major contribution to tax fairness.

Federal Income Tax Payable Under the New Rate Structure



* These rates apply to the portion of a taxpayer's income that falls within the income brackets.

Benefits for Taxpayers

People Pay Less

The tax reform measures will reduce personal income tax:

- to zero for about 850,000 lower-income individuals;
- for almost nine out of ten Canadians aged 65 and over;
- for eight out of ten Canadian households;
- by an average of $470 or roughly 6 per cent for eight out of ten households with incomes between $30,000 and $50,000.

Tax reform will reduce the variations in the amount of tax paid by individuals in similar financial circumstances. Fewer higher-income individuals will pay little or no tax. More lower-income individuals will pay no tax.

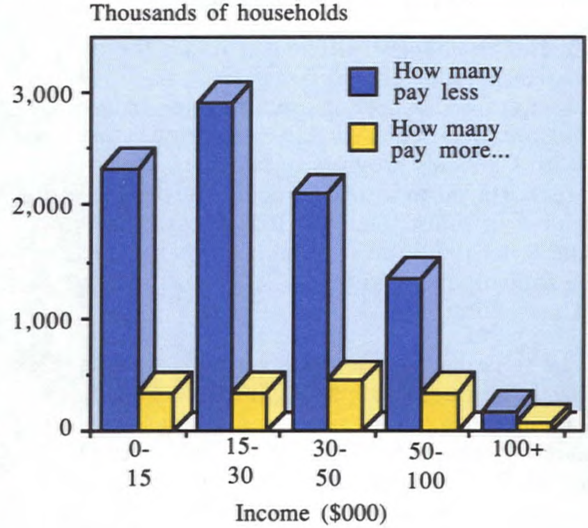
Corporations Pay More

Profitable corporations will pay more in income tax.

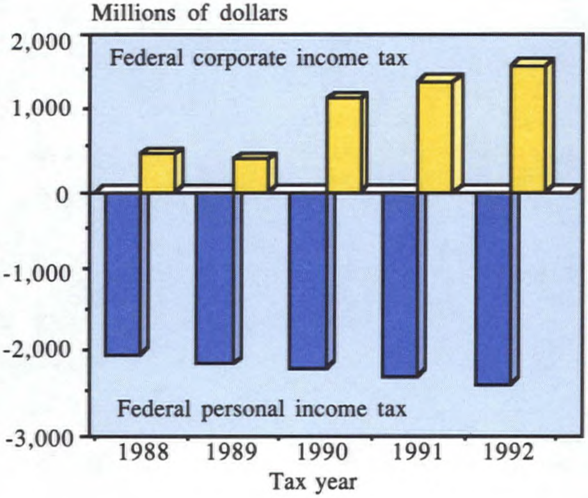
The bottom chart on the opposite page shows that the net personal income tax reduction is made possible in part by shifting some of the tax burden to profitable corporations. The lower half of the chart shows a reduction in personal income tax revenue of $2 billion or more annually. The top half shows revenues from corporate income tax rising annually: by $470 million in 1988 and $1.39 billion in 1991.

In order to proceed now with tax reform while maintaining progress in reducing Canada's deficit, additional revenues will be raised through the existing federal sales tax pending full reform of the sales tax system. The refundable sales tax credit is being increased to protect lower-income Canadians from the cost of changes to the federal sales tax. This credit will be significantly increased and extended to more Canadians in stage two of tax reform, when the federal sales tax is replaced by a more broadly based sales tax.

The Effects of Personal Income Tax Reform



Corporations Pay More... People Pay Less



Fairness Measures in More Detail

Credits Instead of Exemptions

One of the biggest differences under the new system is that tax credits replace many exemptions. Exemptions reduce one's *taxable income*; tax credits directly reduce one's *tax*. With Canada's progressive tax rates, exemptions are worth more in tax reduction to people with higher incomes. The new federal tax credits, on the other hand, provide the same tax reduction to individuals regardless of their income level. That's fairer.

The table below lists the tax credits that replace basic personal exemptions. It shows that many taxpayers do better with the new credits, which directly reduce tax, than they would with exemptions. It also shows that higher-income taxpayers will no longer receive preferred treatment through exemptions that are deductible from taxable income.

	New tax credits - 1988	Federal tax savings from current exemptions	
Type of credit	Federal tax savings for all taxpayers	Under $27,500 of taxable income	More than $55,000 of taxable income
Basic personal	$1,020	$ 725	$1,240
Married or equivalent	850	635	1,085
Age (65 and over)	550	455	775
Disability	550	495	845
Dependent child under 18*	65	65	115
Infirm dependant 18 and over	250	250	425

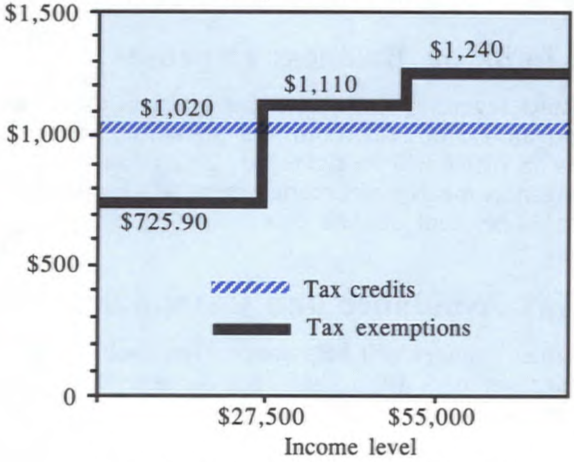
*Under present law, the child exemption is scheduled to equal the value of the family allowance by 1989. The new credit has been set at a level equal to 17 per cent of the estimated family allowance payable in 1988.

Many other deductions will be converted into federal tax credits at 17 per cent of their value. These include employees' Canada and Quebec pension plan contributions and unemployment insurance premiums; tuition fees and education deduction (transferable up to $600); eligible medical expenses above 3 per cent of net income, and the first $1,000 of pension income. Charitable giving is encouraged by a federal tax credit of 17 per cent of the first $250 of donations and 29 per cent of each additional dollar.

These credits will provide the same tax reduction to all Canadian taxpayers, regardless of their income.

Tax Credits Are The Same For All

Tax Exemptions Are Not



The 1988 personal tax exemption would have been $4,270. At different income levels, it would have been worth different amounts in actual tax credit, as shown by the black line. The 1988 tax credit {blue} gives all taxpayers the same break.

New Treatment of Investment Income

Capital Gains

The lifetime exemption will remain at the 1987 level of $100,000 except for qualified farm property and shares of small business corporations, which will benefit from a $500,000 lifetime exemption. The proportion of capital gain above the lifetime exemption included in taxable income will rise from 50 per cent to 66 2/3 per cent in 1988, and to 75 per cent in 1990.

Dividend Tax Credit

The combined federal-provincial tax credit on dividend income will drop from about 33 1/3 per cent to 25 per cent of cash dividends to take account of lower tax rates.

Other measures will reduce write-offs for investments in films and MURBs.

Limits on Business Expenses

Rules regarding deductions for business use of a private car or of a room in a private home used as an office will be tightened. Deductions for business meals and entertainment will be limited to 80 per cent of their cost.

Tax Avoidance and Compliance

Other changes will help ensure that each taxpayer pays a fair share. A new general anti-avoidance rule will apply to artificial tax-avoidance arrangements, and new compliance measures will help identify cases of tax avoidance and evasion.

Some Deductions Dropped

The $1,000 investment income deduction, the $500 employment expense deduction, and the deduction for children over 18 have been dropped. Federal personal tax credits have been set at a level to ensure that most taxpayers in the 17-per-cent bracket do not pay more as a result.

Tax Assistance for Retirement Savings

Contributions to registered pension plans (RPPs) and registered retirement savings plans (RRSPs) remain deductible from taxable income. Maximum RRSP contributions will remain at $7,500 for 1988. Higher limits will be phased in more slowly than originally proposed, to reach $15,500 in 1995.

Let's See How It Works

On the following several pages, you will find representative tax profiles to illustrate the kinds of changes Canadians will experience when tax reform is implemented. The examples are not designed to be comprehensive. The actual impact of tax reform on any household will depend on many variables, including, for example, the amount and type of investment income they earn, special deductions claimed, and the breakdown of earnings in two-earner households.

Note that the refundable sales tax credit will increase from $50 to $70 for adults and from $25 to $35 for children, payable in full to families with net incomes below $16,000. This change is not reflected in the examples which follow.

Comparing New and Old Systems

The first example shows the detailed steps of calculating tax under the new system compared with the old. All calculations assume all the measures that make up the new system are in place.

This single-earner family - a worker earning the average wage, with a spouse and two children under 18 - gets a substantial tax cut. There will be about 310,000 one-earner families with income between $20,000 and $30,000 in 1988.

Arriving at Taxable Income

	Current	New
Employment earnings	$26,100	$26,100
Family allowance	776	776
Total	**26,876**	**26,876**
Standard deductions		
Employment expense	500	0
Canada/Quebec Pension Plan	468	0
Unemployment insurance	613	0
Non-standard deductions		
Registered Pension Plan	800	800
Registered Retirement Savings Plan	500	500
Union dues	200	200
Net income	23,795	25,376
Exemptions		
Basic	4,270	0
Married	3,740	0
Dependent children	776	0
Taxable income	**15,009**	**25,376**

Arriving at Tax Payable

	Current	New
Tax on taxable income	$2,575	$4,314
Credits		
Canada/Quebec Pension Plan	0	80
Unemployment insurance	0	104
Basic credit	0	1,020
Married	0	850
Two children under 18	0	130
Sub-total	0	2,184
Basic federal tax	2,575	2,130
Federal tax calculation		
Surtax	77	64
Child tax credit*	– 1,048	– 980
Net federal tax	1,604	1,214
Provincial tax	1,416	1,172
Total federal-provincial tax	**$3,020**	**$2,386**
Tax reduction under reform		– 634**
Reduction as a percentage of previous tax		**21%****

*The value of the child tax credit is not changed in tax reform. It declines in this example because family net income is higher as a result of the conversion of some standard deductions to credits. The increase in the refundable sales tax credit is not included in the above calculations.

**The federal tax reduction is about two-thirds of the total reduction shown. The federal-provincial calculation approximates the average impact of provincial rates.

The example illustrates the shift from exemptions to credits and the new tax rates. While taxable income increases from $15,009 to $25,376, taxes payable drop by 21 per cent or $634 under tax reform.

Single Persons Under Age 65

A. Income of $10,000, all from employment. This individual claims only standard deductions and exemptions. Tax is lower after reform due to the enhanced basic personal tax credit. In 1988, there will be about 150,000 single taxpaying employees with less than $10,000 in income. This individual will also qualify for an additional refundable sales tax credit, increased from $50 to $70 as a result of tax reform.

Income	
Employment earnings	
Interest on CSBs	
Non-standard deductions	
Charitable donations	
Union dues	
RPP contributions	
RRSP contributions	
Estimated 1988 federal-provincial income tax	
Pre-reform tax	
Change in tax	
Post-reform tax	
Percentage change in tax	

B. Income of $25,000. Tax is lower due to the new tax credits and lower tax rates. In 1988, there will be about 1 million single wage-earners with incomes between $20,000 and $30,000.

C. Income of $40,000. Tax is lower after tax reform as lower tax rates offset the removal of the $1,000 investment income deduction. In 1988, there will be about 275,000 single wage-earners with incomes between $35,000 and $45,000.

A	B	C
$10,000	$24,500	$39,000
–	500	1,000
10,000	25,000	40,000
–	200	350
–	250	–
–	1,200	1,500
–	1,000	2,000
1,049	4,403	9,212
–77	–283	–171
972	4,120	9,041
–7.3%	**–6.4%**	**–1.9%**

Single Parents With Two Children Under Age 18

A. Income below $10,000. This individual pays no tax before or after tax reform, and receives a child tax credit of $524 for each child. In 1988, there will be about 84,000 single parents with incomes below $10,000 with income only from employment. This family will also be eligible for an increase in the refundable sales tax credit from $100 to $140.

B. Income of $25,000. This individual receives some interest income, which no longer qualifies for the $1,000 deduction after tax reform. Tax is substantially reduced,

Income	
Employment earnings	
Family allowance	
Interest income	
Non-standard deductions	
Child care expenses	
Charitable donations	
RPP contributions	
Union dues	
Estimated 1988 federal-provincial income tax	
Pre-reform tax	
Change in tax	
Post-reform tax	
Percentage change in tax	

however, due to the new tax credits. In 1988, there will be about 160,000 single parents with incomes primarily from employment between $20,000 and $30,000.

C. Income of $40,000. Tax is almost unchanged as a result of reform because lower tax rates offset removal of the $1,000 investment income deduction and because of the impact of the changes which increase net income and thus reduce the child tax credit for persons with family income in this range. In 1988, there will be about 55,000 single-earner parents with incomes between $35,000 and $45,000.

A	B	C
$9,224	$23,724	$38,624
776	776	776
–	500	600
10,000	25,000	40,000
1,000	3,000	4,000
–	200	240
–	1,600	2,600
–	250	200
–1,048	1,362	5,862
0	–371	–163
–1,048	991	5,699
	–27.3%	**–2.8%**

One-Earner Couples With Two Children Under Age 18

A. Income of $10,000. The income earner works for six months and receives unemployment insurance for half the year. Before reform, this family has an income tax liability of $35, and a child tax credit refund of $1,048 resulting in a net tax refund of $1,013. After reform, the family pays no tax, and continues to receive the full child tax credit. In 1988, there will be about 110,000 one-earner couples with children and with income under $10,000. In addition, this family will receive an increase in the refundable sales tax credit from $150 to $210.

Income

Employment earnings ....
Family allowance ....
Unemployment insurance ....
Interest income ....
Capital gains on shares (cash) ....

Non-standard deductions

Charitable donations ....
RPP contributions ....
Union dues ....
Uninsured medical expenses ....
RRSP contributions ....
Moving expenses (unreimbursed) ....

Estimated 1988 federal-provincial income tax

Pre-reform tax ....
Change in tax ....
Post-reform tax ....

Percentage change in tax ....

B. Income of \$25,000. As a result of reform, tax is reduced mainly because tax credits provide larger tax savings for this family than tax exemptions and deductions. In 1988, there will be about 310,000 one-earner couples with children and with income between \$20,000 and \$30,000.

C. Income of \$40,000. Overall tax is reduced, with lower tax rates offsetting the fact that tax credits provide less tax savings at this income level than exemptions and deductions. In 1988, there will be about 320,000 one-earner couples with children and with incomes between \$35,000 and \$45,000.

A	B	C
\$5,724	\$23,724	\$37,224
776	776	776
3,500	–	–
–	500	–
–	–	2,000
10,000	25,000	40,000
150	350	200
–	800	–
–	300	–
–	1,500	–
–	–	2,000
–	–	1,000
–1,013	2,078	6,757
–35	–452	–324
–1,048	1,626	6,433
–3.5%	**–21.8%**	**–4.8%**

Three Families with Income of $75,000

These examples show the impact on three families with two children: one family earns mainly employment income, one is self-employed and one has income from investments. Tax reform narrows, but does not remove, the differences in tax paid by these families.

Income
Salary
Net self-employed income
Family allowance
Interest income
Dividends (cash)
Capital gains on shares (cash)
Rental loss
Non-standard deductions
RRSP contributions
Charitable donations
Carrying charges
Reduced lifetime capital gains exemption(3)
Estimated 1988 federal-provincial income tax
Pre-reform tax
Change in tax
Post-reform tax
Percentage change in tax

(1) Deductible business expenses are assumed to be reduced by $3,700 as a result of tax reform.

(2) The rental loss includes a loss created by capital cost allowance of $8,500 on an investment in a MURB. In addition, $2,100 of home office expenses are assumed to become non-deductible as a result of tax reform.

Family A has reduced tax because lower tax rates offset the base broadening measures. Tax for family B increases mainly because of reduced business expense deductions, the removal of $1,000 investment income deduction and the reduced dividend tax credit. Family C's pre-reform income is fully sheltered from tax, and its tax rises because of changes to the dividend tax credit and lifetime capital gains exemption, the removal of the MURB provisions and reduced deductions for home office expense.

A	B	C
$71,500	–	–
–	$65,000(1)	–
776	776	$ 776
1,224	1,224	29,224
1,500	3,000	20,000
–	5,000	35,000
–	–	– 10,000(2)
75,000	75,000	75,000
7,000	7,000	–
700	700	950
–	–	15,000
–	–	9,224
20,902	18,571	–
– 313	1,157	7,705
20,589	19,728	7,705
– 1.5%	**6.2%**	**N/A**

(3) This reflects the assumed reduction in the family's lifetime capital gains exemption because of cumulative net investment losses deducted previously.

Couples Aged 65 and Over

A. Income under $15,000. The couple receives no private pension or investment income and claims only standard deductions. The couple pays no tax before or after tax reform. In 1988, there will be about 210,000 elderly couples with GIS benefits and income under $15,000. This couple will also benefit from an increase in the refundable sales tax credit from $100 to $140.

B. Income of $25,000. This couple's tax is reduced due to the new tax credits and lower rates. In 1988, there will be about 160,000 elderly couples with income between $20,000 and $30,000.

Income	
OAS	
GIS	
C/QPP	
Pension income	
Interest income	
Dividends	
Non-standard deductions	
Charitable donations	
Estimated 1988 federal-provincial income tax	
Pre-reform tax	
Change in tax	
Post-reform tax	
Percentage change in tax	

C. Income of $40,000. This couple has investment income. Their tax is higher after reform because of the reduced dividend tax credit and the removal of the $1,000 investment income deduction, and these impacts are not fully offset by the lower tax rates. In 1988, there will be about 65,000 couples aged 65 and over with income between $35,000 and $45,000.

A	B	C
$7,480	$7,480	$7,480
4,525	–	–
2,520	6,600	–
–	8,000	26,260
–	2,920	3,760
–	–	2,500
14,525	25,000	40,000
–	400	500
0	1,858	6,085
0	–374	84
0	1,484	6,169
	–20.2%	**1.4%**

What Tax Reform Does for You

The following pages present five tables showing tax cuts by different levels of salary, wage, or retirement income. To find out roughly how much less of your income you will pay in combined federal and provincial income tax, pick the table for the household closest to your situation:

1. Couple with one earner, two children;
2. Couple with two earners, two children;
3. Single earner;
4. Couple, 65 and over;
5. Single, 65 and over.

For taxpayers under 65, the tables assume that most income consists of wages or salary. For those 65 and over, the tables assume the mix of income most seniors are likely to have, based on profiles drawn from income tax statistics. A typical range of credits and deductions has been assumed in each case.

Most taxpayers whose income consists of salary or wages, family allowance, or standard pension and retirement revenue will receive tax *reductions*.

Taxpayers claiming large special tax preference deductions or credits and some taxpayers with substantial investment income or self-employment earnings subject to the new fairer expense-deduction rules will experience tax *increases*.

Couple With One Earner, Two Children Under 18

Income level	Tax payable* Old system	New system	Tax cut
$10,000	–$1,015	–$1,050	$ 35
15,000	80	–335	415
20,000	1,470	955	515
25,000	2,925	2,285	640
30,000	4,705	4,150	555
40,000	9,010	8,755	255
50,000	13,465	13,110	355
75,000	25,345	24,290	1,055

* The top two lines show negative numbers. These represent refunds from the tax system due to the refundable child tax credit. At $10,000 the refund will be $35 more as a result of reform. At $15,000, $80 in tax becomes a $335 refund under tax reform.

The income level nearest your own will give an approximation of what will happen to your taxes. But remember, the more special credits or deductions you have, the less accurate the figure in the last column will be for you.

Couple, Both Earning Income, Two Children

Income level	Tax payable* Old system	New system	Tax cut
$10,000	– $1,050	– $1,050	$ 0
15,000	– 455	– 665	210
20,000	415	240	175
25,000	1,415	1,180	235
30,000	2,510	2,295	215
40,000	5,810	5,365	445
50,000	9,460	8,635	825
75,000	18,595	17,385	1,210

* The top two lines show negative numbers. These represent refunds from the tax system due to the refundable child tax credit. At $15,000, a $455 tax refund becomes a $665 refund under tax reform.

This example assumes that 60 per cent of income is earned by one spouse and 40 per cent by the other.

Single Earner Under 65

Income level	Tax payable: Old system	Tax payable: New system	Tax cut
$10,000	$ 1,050	$ 975	$ 75
15,000	2,430	2,260	170
20,000	3,880	3,540	340
25,000	5,415	4,825	590
30,000	7,180	6,485	695
40,000	11,130	10,595	535
50,000	15,605	14,700	905
75,000	27,770	25,915	1,855

Say your income is $11,500. Choose the $10,000 line and follow it across to find the approximation of how your tax situation will change.

Couple, 65 and Over

Income level	Tax payable: Old system	Tax payable: New system	Tax cut
$15,000	$ 0	$ 0	$ 0
20,000	855	280	575
25,000	2,275	1,620	655
30,000	3,785	2,960	825
40,000	7,210	6,895	315
50,000	11,160	11,005	155
75,000	22,755	22,045	710

This example assumes that the only income of one spouse is an OAS pension. The levels at which couples aged 65 and over start paying tax will rise from $16,945 to $19,010 as a result of tax reform.

Single Person, 65 and Over

Income level	Tax payable: Old system	Tax payable: New system	Tax cut
$10,000	$ 0	$ 0	$ 0
15,000	1,385	1,280	105
20,000	2,855	2,620	235
25,000	4,400	3,965	435
30,000	6,095	5,665	430
40,000	9,950	9,770	180
50,000	14,190	13,880	310
75,000	26,170	25,100	1,070

Say your income is $19,300. Choose the $20,000 line and work across it for an approximation of your tax situation.

Stage Two - Sales Tax Reform

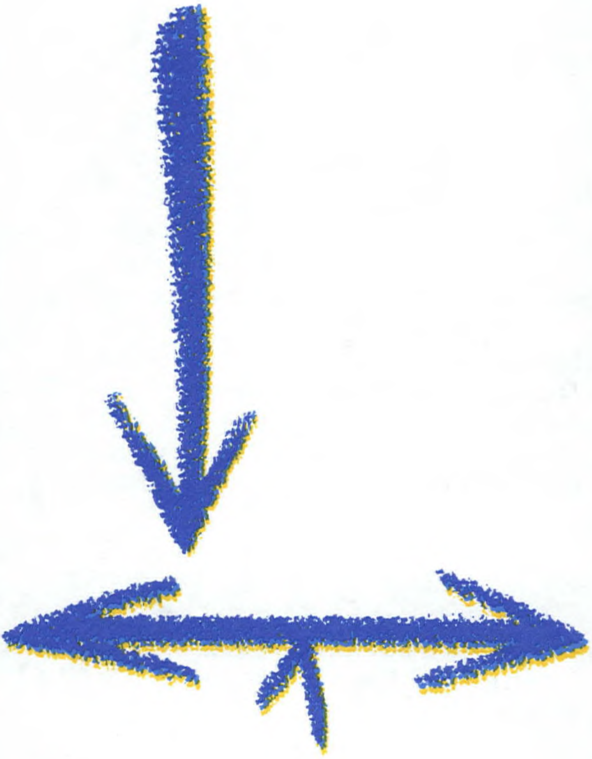
Comprehensive tax reform is an integrated set of proposals covering the full tax system. The changes described in this booklet, along with important changes to the corporate income tax system, make up stage one of tax reform.

In stage two, the existing federal sales tax will be replaced by a new system with a broader base and a lower rate. Further important changes will be made to the personal income tax system:

- The refundable sales tax credit will be significantly enriched and extended to more taxpayers to benefit lower-income Canadians.
- The tax rate structure will be adjusted to reduce income taxes further for middle-income earners.
- The existing 3-per-cent income surtax will be removed for all taxpayers.

Canada needs a better sales tax system. The present federal sales tax is a narrowly-based tax that weighs heavily on a limited range of manufactured goods. It favours imports over goods we produce, and hurts our exports in competitive world markets. It discriminates against certain sectors and products. Its price impact pyramids through to the consumer in a hidden and unfair way. The system has become increasingly complicated and more difficult to comply with and administer. It is hurting Canada's ability to grow and create jobs.

The government is committed to replacing the current sales tax system with a broadly-based, multi-stage tax similar to those in more than 30 other countries. Three variations have been put forward: a national sales tax system which would combine the federal and provincial sales tax systems into one; and two federal-only systems, one that requires sale invoices and one that does not but does require a more comprehensive base. Each variant would eliminate the distortions of the present system.



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