

Res
HJ2449
C365a
1987

Reform 1987

December 16, 1987

Speech by the
Honourable Michael H. Wilson
on Tabling of a Notice of
Ways and Means Motion to Amend
the Income Tax Act

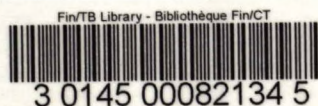


Res 449
HJ 2449
C3659
1987

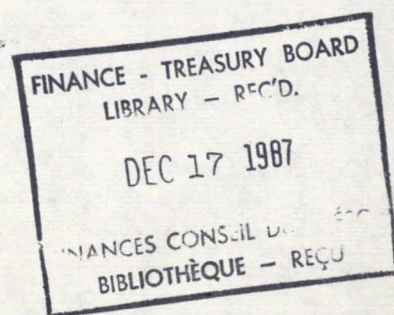
Tax Reform 1987

December 16, 1987

Speech by the
Honourable Michael H. Wilson
on Tabling of a Notice of
Ways and Means Motion to Amend
the Income Tax Act



Canada





Department of Finance
Canada

Ministère des Finances
Canada

Introduction

Six months ago, I proposed comprehensive reforms to ensure that Canada's tax system serves the interests of all Canadians.

I set out clearly for public discussion and consultation the objectives of tax reform and a carefully-balanced package of specific proposals to achieve those objectives.

The response was clear.

- Canadians want a fair and progressive tax system that imposes little or no burden on those least able to pay; a system that levies similar amounts of tax on individuals in similar economic circumstances.
- Canadians want a tax system with a broader base and lower rates; a system that encourages individual initiative and in which all high-income individuals and profitable corporations pay their fair share of tax.
- Canadians want a tax system that supports Canada's ability to compete in world markets and to create increased employment opportunities; a system that supports the ability of Canada's regions to grow and prosper.
- Canadians want a more understandable and reliable tax system that assures the revenues to finance public programs.

Today, I am presenting measures to implement the far-reaching changes to Canada's income tax system that I proposed in the White Paper in June. The proposals meet those objectives with lower tax rates and a fairer system for all.

During the extensive consultation process, broad support was repeatedly expressed for the main thrust and the framework of the proposed income tax reforms. A number of proposals were put forward by the House of Commons Standing Committee on Finance and Economic Affairs, by the Senate Committee on Banking, Trade and Commerce and by others. I am tabling today a formal response to the recommendations of the House committee.

As a result of these consultations with Canadians, we have incorporated improvements that further the objectives of the White Paper. In my remarks I will touch only on some features of the measures which are of broader interest. Details on all the measures that I am bringing forward are contained in the supplementary information that I will table.

Personal Income Tax

To achieve the objectives of personal income tax reform, the three fundamental proposals of the White Paper will be implemented:

- One, a simplified structure of lower personal income tax rates. There will be three federal tax brackets instead of 10. The rates will be 17, 26 and 29 per cent.
- Two, conversion of personal exemptions and many deductions to tax credits. The new credits will be worth the same to all taxpayers regardless of their income. This is a major improvement in fairness.
- Three, the reduction or elimination of many special tax breaks. This helps to pay for lower tax rates and makes the system fairer.

As a result of these reforms, personal income tax will be reduced for 9.7 million households – 85 per cent of the total. Income taxes will be reduced for 90 per cent of those aged 65 and over. About 850,000 Canadians, including 250,000 senior citizens, will have their income tax reduced to zero.

Families with Children

The vast majority of families with children will pay substantially less personal income tax as a result of the White Paper proposals.

Today I am announcing further improvements to the tax treatment of families with children.

- To provide further assistance to lower- and middle-income families, the refundable child tax credit will be increased by an additional \$35 per child to \$559 on January 1, 1988. This will directly benefit 2.3 million Canadian families, including 300,000 below the income tax threshold.

- To target additional assistance to larger families, the child credit for the third and each subsequent child in the family is being doubled to \$130.
- A dependent child will be able to earn up to \$2,500 before the basic credit will begin to phase out.

In addition, children who reach the age of 18 during the year will be eligible for the dependant credit and the refundable child tax credit for the full year.

Family allowance payments will be reported on the tax return of the higher-income spouse. There is no change to the provisions which determine who receives the family allowance payment.

These measures incorporate a number of suggestions from the House Committee on Finance and Economic Affairs.

The impact of these measures is to reduce further the taxes paid by families with children. In combination with the new child care initiative announced earlier this month by the Minister of National Health and Welfare, these measures will bring about a major strengthening of tax assistance for Canadian families.

Automobile Expenses

In keeping with the objectives of fairness and base-broadening, the White Paper proposed to limit deductions for automobile expenses to reflect more accurately the element of personal consumption in these expenses.

As a result of suggestions received during the consultation process, changes have been incorporated to meet a number of concerns that were raised. For those drivers using personal automobiles for business use of more than 24,000 kilometers per year, the existing system will remain. Deductions will be restricted only for those who drive personal automobiles for relatively modest amounts of business use. These measures will ensure that deductible automobile expenses more accurately reflect business use.

Farm Losses

The White Paper proposed measures to provide objective tests for determining the extent to which farm losses could be deducted against other sources of income. As part of these measures, new accounting rules were proposed.

During the consultation process, a number of suggestions were received on ways that the objectives underlying the White Paper proposal could be achieved without asking all farmers to adopt modified accrual accounting. I am thus issuing today amended proposals which will retain cash accounting for farmers. The government will continue consultations on these amended proposals which would address the tax treatment of farm losses, but which would allow farmers to continue to account on a cash basis. Implementation will follow completion of these consultations.

I have made a limited number of modifications to other proposals. For example, adjustments have been incorporated in measures dealing with investments in Canadian films and in multiple-unit residential buildings.

Corporate Income Tax

The corporate income tax proposals will achieve the three major objectives set out in the White Paper.

- Corporate tax rates will be reduced. The general federal rate will fall to 28 per cent in 1988 and the manufacturing rate will be reduced to 23 per cent by 1991. The rate for small business will fall to 12 per cent. This will promote growth and job creation in Canada by maintaining a corporate tax system that is competitive with other countries, particularly the United States.
- The elimination or reduction of many special tax breaks will pay for lower corporate and personal tax rates. It will return the profit motive to investment by rewarding success. And it will encourage investment decisions based more on economic initiative and opportunity than on tax considerations.
- A broader tax base with fewer preferences will mean that profitable corporations will pay a bigger share of the total tax burden. The corporate income tax will also be a more predictable and reliable source of revenues.

Supporting Key Priorities

At the same time, important tax incentives have been retained for key priorities such as small business growth, research and development (R&D) and regional development.

The corporate tax measures will be implemented substantially as put forward in the White Paper. Adjustments have been incorporated to moderate the impact of tax reform in a number of areas.

To support the development that is vital to regional economic growth and to isolated communities, the White Paper proposed to retain important incentives in the resource sector. In particular, improvements are being made in the proposed regime for flow-through shares. The period during which resource expenditures will qualify for the 16 2/3 per cent rate of depletion will be extended to the end of 1989. In addition, changes are being made in the investment loss rules to ensure that flow-through shares remain an attractive investment vehicle for junior resource companies.

The White Paper proposals recognized the vital role of research and development in the future of our economy. To ensure that Canada's tax regime for R&D continues among the world's best, the proposed limitation on claimable investment tax credits has been increased to 75 per cent.

In addition, the proposal for the capitalization of interest on vacant land will be modified so as not to affect small firms in the homebuilding industry.

Across the entire economy, corporate tax reform will strengthen the incentive for firms to invest in profitable ventures. The rate of tax on the return from new investment will be reduced. The tax treatment of capital in this country will continue to encourage risk-taking, initiative, growth and job creation.

Taxation of Profitable Corporations

One of the key principles of tax reform is that all corporations should pay a fair amount of tax on their economic income. The existing tax base fails to achieve this goal. Tax reform broadens the tax base so that it more closely measures the true income of corporations. This directly addresses the problem of profitable corporations paying little or no tax.

The changes being proposed will reduce by one-half the number of profitable corporations that pay no tax. Those that remain will either be firms in cyclical industries that have experienced significant economic losses in prior years, or will be firms in industries which receive incentives directed at important national priorities. These priorities include promoting regional development, ensuring a healthy and active resource sector and encouraging research and development to provide jobs in the future.

Financial Institutions

However, there has been some concern that many large banks and life insurance companies have not paid significant tax over the past decade. To respond to this concern, the Commons committee has suggested that it might be appropriate to levy a minimum tax.

I share this concern. This has motivated the proposals in the White Paper affecting the taxation of financial institutions. I am confident that the combination of all the proposals in tax reform will ensure that financial institutions will pay their fair share of tax in the future. It is expected that over the next five years the base-broadening measures being applied to the larger financial institutions will raise substantial amounts of revenue, estimated to be almost \$4 billion. In the meantime, I will be reviewing various mechanisms which could be used in achieving this objective should that be necessary.

Before tax reform is fully effective, a number of banks are not expected to be taxable in 1988. Accordingly, I will implement a tax on the capital of larger banks and trust companies. This tax will be creditable against future income tax.

Corporate tax reforms will ensure that life insurance companies pay appropriate tax on their regular corporate income. However, without further action, investment income earned by life insurers on funds accumulated in respect of life insurance policies would have remained untaxed.

I therefore intend to tax this income in the hands of the insurance company at a rate of 3 per cent in 1988 rising to 15 per cent in 1992. This measure will include some modifications to the original White Paper proposal. It will remove a major tax preference for the life insurance sector. In conjunction with reforms to the regular corporate income tax, this will ensure that insurance companies are appropriately taxed.

Anti-avoidance

To deal with the increasing problem of abusive tax avoidance and evasion, the White Paper proposed a number of measures including a general anti-avoidance rule. As a result of consultations, changes will be incorporated in the proposal to deal with concerns that were raised about the possible unintended scope and effects of such a rule. Draft legislation is being released today for further discussion. Implementation will follow consultations.

Fiscal Balance

Fiscal responsibility was a major constraint that we imposed on ourselves in evaluating proposed changes to the tax reform package. We would not and we will not abandon the principle that tax reform must pay its own way. Nor did we accept the notion that the bill for changes in the first stage of tax reform can be held over until the second stage. That is why we have rejected suggestions for larger personal income tax cuts now to be financed by sales tax reform later. Tax reform is not a reform-now-pay-later proposition.

Therefore, improvements such as child benefits have to be paid for now. To maintain the fiscal balance of the package, I am taking the following measures:

- Additional taxes will be levied on banks and trust companies, including a capital tax on large deposit-taking institutions.
- Effective January 1, 1988, the federal sales tax on alcoholic beverages and tobacco products, currently 15 per cent, will be increased by three percentage points.

We are proceeding with the changes to the existing sales tax as announced in the White Paper, according to the schedule set out in November.

These measures will ensure that the first stage of tax reform is fully consistent with responsible fiscal management.

Over all, the White Paper proposals and the measures I have announced today will reduce personal income taxes by \$12 billion over the next five years. This will be paid for by roughly equal increases in corporate and sales tax revenues.

I am tabling the Notice of Ways and Means Motions that will enable us to proceed with the measures that make up the first stage of tax reform. Most of the measures will come into effect on January 1, 1988. Personal income tax reductions will be reflected in payroll deductions beginning July 1, 1988. This will provide employers with adequate time to make the necessary adjustments.

Sales Tax Reform

The measures presented today deal with the first stage of tax reform. In the second stage, the outdated federal sales tax system will be replaced by a

multi-stage tax and a number of further adjustments will be made to the income tax system. The refundable sales tax credit will be substantially enriched, paid in advance and extended to more households. There will be further income tax reductions for middle-income Canadians. And the income surtaxes will be removed.

The consultation process has indicated there is support among a wide range of interest groups for a new sales tax system: one that is fairer, more reliable and more supportive of efforts to strengthen competitiveness, growth and job creation.

A multi-stage sales tax system has been the subject of ongoing discussions. A multi-stage tax can be implemented either at the federal level alone or on an integrated basis in conjunction with the provinces. Currently, the opportunity presented by combining both federal and provincial sales taxes under one system is under discussion with the provinces.

Last week, after meeting with my provincial colleagues, I announced that we had agreed that work on the National Sales Tax should continue based on the following considerations:

- Municipalities, hospitals, school boards, colleges and universities should not bear a greater tax burden under the National Sales Tax than they would under the existing sales tax regimes.
- Basic groceries, prescription drugs and certain medical devices should not be subject to tax.

These considerations reflect our commitment to ensuring that the design of the tax is consistent with the views of Canadians. They provide a foundation for further discussion of the National Sales Tax with the provinces.

While much more work must be done before we can be sure that a national sales tax system can be achieved, I am encouraged by the progress to date with these and other discussions.

Conclusion

These proposals are the result of extensive consultations. This dialogue has been a clear improvement in the process of implementing taxation proposals. The flexibility of this government has served Canadians well in achieving a better balance among the competing objectives and priorities

that make tax reform the challenge it is. The result is an improved set of proposals for tax reform that retains the structure and principles established in the White Paper.

The measures before the House today will put more money into the hands of Canadians. The freedom to make their own decisions, as individuals and families, on how best to use that money is at the heart of the government's philosophy of economic renewal.

Building a stronger, more resilient economy is the best way to ensure that Canadians have the resources to sustain and enhance their social and cultural identity, key elements in the high quality of life we enjoy. It is the best way to strengthen the distinctive elements of national life that make Canada a unique and uniquely successful nation.

The government will continue building a stronger Canada by moving forward on the full range of initiatives designed to unlock our potential as individuals and as a nation – initiatives such as tax reform, free trade, regulatory reform and child care.

Last June 18, I said that, in the final analysis, this package must be judged on whether the proposals would give to our senior citizens more peace of mind and security; to those in 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 can say today – with even greater confidence – that we are meeting those tests.