GOVERNMENT OF CANADA PERSONAL INCOME TAX EXPENDITURES

December 1992

Canada

GOVERNMENT OF CANADA PERSONAL INCOME TAX EXPENDITURES

December 1992

Department of Finance Canada
Ministère des Finances Canada

Cette publication est également disponible en français.

TABLE OF CONTENTS

INTRODUCTION

The principal function of personal income taxes is to raise the revenues necessary to finance government operations. In addition, the personal income tax system is often used to implement government policy objectives by providing monetary assistance to particular groups of individuals or certain types of activities. These measures, which take the form of preferential income exclusions, deductions, deferrals or credits, are typically referred to as tax expenditures. This document provides estimates of the cost of these items for 1988 and 1989.

In November 1988, a conference on *Tax Expenditures and Government Policy* was sponsored by the John Deutsch Institute at Queen's University on behalf of the Department of Finance. The conference produced a number of useful insights, the most notable of which was that, while tax expenditures suffer from significant problems, there is no better alternative for providing information on how the government allocates its financial resources. Accordingly, this report highlights many of the difficulties associated with tax expenditures raised at the conference.

In order to identify personal income tax expenditures (including those pertaining to unincorporated business), it is necessary to establish a "benchmark" tax structure which does not contain any specialized tax provisions. Tax expenditures are defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the identification of the benchmark tax system, and hence the identification of tax expenditures. This report takes a broad approach. As a result, measures which are specifically targeted to a limited number of individuals, such as the age credit or the non-taxation of veterans' allowances, would not be included in the benchmark. This inclusive approach is adopted since the primary purpose of this document is to provide information. It should be emphasized that the report does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various provisions in achieving these objectives.

There are several tax provisions identified in the document that are not tax expenditures even though they reduce the amount of personal income tax revenue collected. These measures are denoted as "memorandum items". They include measures which are considered to be part of the benchmark system such as the dividend tax credit which reduces the double taxation of income earned by corporations and distributed to individuals through dividends. In a number of other circumstances, such as the deduction for certain employment expenses, the available data do not permit identification of the portion of the expenses which were required to earn income. As the deduction of such expenses is considered to be an essential part of defining income, and hence integral to the benchmark tax system, only part of these measures could be considered to be tax expenditures. The inclusion of estimates for these items is warranted given the informational intent of the document even though it is not possible to separate the benchmark and tax expenditure components.

The federal government collects personal income taxes on behalf of the provinces (other than Quebec) which levy their income taxes as a percentage of basic federal tax. While there are provincial revenue costs associated with the tax measures contained in this report, the estimates do not incorporate these impacts.

This report on tax expenditures differs from previous documents in several respects. Some of these modifications, such as the change in methodology for the RRSP/RPP estimates, are a result of the discussion at the John Deutsch conference. The presentation of the tax expenditure estimates has also been modified to improve clarity.

One of the most notable differences between this report and its predecessors is that previous tax expenditure documents have provided information on personal, corporate and commodity taxes. This report is restricted to personal income taxes because of the lack of statistical information on sales taxes due to the recent introduction of the Goods and Services Tax (GST) and lags in the receipt of post-1988 tax reform data for corporations. While preliminary post-reform data are available for corporations, they do not accurately reflect the impact of tax reform because of the transitional measures in the package and the carry-over of accelerated deductions and credits from previous years. Additional years of data are required in order to construct a meaningful report on corporate tax expenditures.

There have been significant changes to personal income taxes in Canada since the last report on cost of tax measures was published in 1985. The most significant of these occurred in the 1988 tax reform which resulted in a major overhaul of the personal income tax system. Many personal income tax expenditures were eliminated, reduced, or changed from deductions to credits in order to support a reduction in tax rates. Tax reform affected not only the number of tax expenditures, but also their revenue impact because it changed the marginal rate structure upon which they are calculated.

The first part of the report provides a discussion of the tax expenditure concept in order to facilitate understanding of the quantitative estimates. This discussion is followed by a table which provides estimates of both tax expenditures and memorandum items. An appendix provides descriptions of the tax measures as well as information on data sources and the methodology used in constructing the estimates. Two additional appendices provide a brief summary of changes to the personal income tax system from 1983 to 1989 and a cross-reference with the classification system used in the previous (1985) report.

DEFINING PERSONAL INCOME TAX EXPENDITURES

There are many ways for the government to achieve its social and economic objectives. The most visible is through direct government spending on programs, grants and subsidies. The government can also pursue some of these same policy objectives through measures contained in the personal income tax system. Methods of providing relief from the payment of taxes include income exclusions, deductions, credits, and tax deferrals. Since in many ways these reliefs represent an alternative form of government financial assistance with similar financial implications as direct expenditures, they are generally referred to as tax expenditures.

Tax expenditures are used to support a variety of goals ranging from promoting savings and investment, to assisting Canadians with disabilities, to partially defraying education expenses. Some measures, such as the age credit, are based on the specific characteristics of the taxpayers. Others, such as the pension income credit, are tied to the source of income. A third possibility is that the tax relief is linked to the use of the funds. An example is the immediate deduction for research and development expenditures.

What are tax expenditures?

Tax expenditures represent an alternative to direct spending for achieving government policy objectives. They are defined as deviations from a benchmark tax system. Typically, they take the form of income exclusions, deductions, credits, or tax deferrals that are available to select groups of individuals or types of activity. Given the informational intent of this report, estimates are also provided for some tax measures that are considered to be part of the benchmark tax system and are thus not tax expenditures. These tax measures are referred to as memorandum items.

ELEMENTS OF THE BENCHMARK SYSTEM

In order to identify tax expenditures, it is necessary to establish a broadly based "benchmark" tax structure which does not contain specialized tax preferences. Tax expenditures are then defined as deviations from this benchmark. It should be stressed that income is the base on which income taxes are computed and hence on which income tax expenditures are measured. Tax provisions which provide allowances for expenses incurred to earn that income, such as the deductibility of union and professional dues, are considered to be part of the benchmark system and hence not tax expenditures.

Some tax provisions, such as the disability tax credit or the child tax credit, recognize non-discretionary reductions in a taxpayer's disposable income. The required nature of these expenses might lead one to conclude that such measures are not tax expenditures. However, these credits provide a method of delivering financial assistance to a limited group of individuals and one of the functions of a tax expenditure report is to furnish information on the ways in which the tax system is used to provide such assistance.

Consequently, whether or not a tax measure recognizes a taxpayer's ability to pay is not used as a criterion in establishing the benchmark tax structure, and hence in identifying tax expenditures.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective in nature. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, unemployment insurance (UI) premiums could be viewed either as an expense of earning income or as a tax used to finance an income transfer from employed individuals to the unemployed. Under the first approach, the current system of taxing UI benefits and providing a tax credit for contributions would not be a tax expenditure because the credit for UI premiums recognizes an expense of earning income which is part of the benchmark tax structure. On the other hand, if UI premiums are viewed as a tax, one could argue that the tax credit for UI contributions represents a tax expenditure because other taxes paid by individuals are generally not deductible against personal income taxes. Discussions of other measures which are the subject to debate are provided in Appendix A.

To ensure that the tax expenditure estimates provide meaningful information on the cost of government operations, the basic structural features of the current personal income tax system are taken as given under the benchmark. Specifically, the existing tax rates and income brackets are used in valuing tax expenditures, the individual is the unit of taxation, income taxes are imposed on a calendar year basis, income is measured without adjustments for inflation and the measures which avoid double taxation are taken as part of the benchmark.

Tax rates and income brackets

A rate structure is essential in order to estimate the cost of tax expenditures because the amount of revenue which would have been collected in the absence of a particular measure depends upon the marginal tax rate faced by taxpayers. The existing progressive rate structure, including surtaxes, is taken to be part of the benchmark system in this report. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax to an initial level of income. An alternative to this would be to specify a flat tax rate (say, the average or maximum rate) as the benchmark and measure benefits derived from the lower (higher) tax rates as positive (negative) tax expenditures. Such an approach is rejected since the purpose of this report is to provide information on the cost of specific government measures.

Tax unit

Personal income taxes in Canada are based on the individual. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various dependant-related provisions, such as the married and child credits, as tax expenditures.

Taxation period

The benchmark taxation period in this document is the calendar year. Accordingly, any measures which provide reductions in tax revenues through deferrals of taxable income to a subsequent year are considered to be tax expenditures. For example, farmers are permitted to defer the receipt of income from the sale of grain through the use of special cash purchase tickets.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, they are treated as part of the benchmark tax system in this report because the relatively "lumpy" nature of business and investment income means that such income should be viewed over a number of years. Consequently, they are considered part of the normal tax system. Estimates for these items are provided in the memorandum items section of the report.

Treatment of inflation

The personal income tax system is based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Where *ad hoc* measures, such as the partial exclusion of capital gains from taxable income, partly serve to compensate individuals for inflation, they are identified as tax expenditures.

Avoidance of double taxation

Conceptual difficulties arise with respect to the benchmark system in deciding whether corporations and their shareholders should be viewed together or as separate tax units. For example, the complete separation of the personal and corporate income tax systems would suggest that the dividend tax credit is a tax expenditure. However, the dividend tax credit is an essential feature of the overall income tax structure (i.e., both corporate and personal) which serves to avoid double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure. However, the personal income tax cost of the dividend gross-up and credit is provided in the memorandum section of the report. Similar reasoning is applied in categorizing the foreign tax credit as a memorandum item since it serves to avoid the double taxation of foreign-source income.

The benchmark tax system

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective in nature. The benchmark income tax system used in this report is a broadly based one which taxes all forms of income equally. The essential features are:

- the existing tax rates and income brackets are taken as given;
- the tax unit is the individual;
- taxation is imposed on a calendar year basis;
- nominal income (i.e., no adjustment for inflation) is used in defining income;
- it incorporates structural features of the overall tax system such as the dividend gross-up and credit; and
- it incorporates federal/provincial financing arrangements.

CALCULATION AND INTERPRETATION OF TAX EXPENDITURES

The estimates in this document reflect the amount by which federal personal income tax revenues were reduced due to independent tax provisions assuming all other factors remain unchanged. They do not represent the amount of revenue that would have been generated if a particular tax expenditure were eliminated because the methodology does not account for possible behaviourial responses of taxpayers, consequential government policy changes, or changes in tax collections due to altered levels of economic activity resulting from the elimination of a particular tax measure. That is, they show only the initial impact of changes.

INDEPENDENT ESTIMATES

The estimate for each tax expenditure is computed separately, assuming that all other provisions remain unchanged. For example, if the deferral available through the five-year capital gains reserve were to be eliminated, an argument could be made that the ten-year reserve period for farm property should also be adjusted. That is, maintaining the five-year deferral advantage for farmers would mean that the farm deferral should be reduced to five years. While such arguments are not without merit, the five- and ten-year reserve provisions are considered to be separate tax measures for the purposes of this report.

The implications of estimating each item separately are that the individual tax expenditure estimates must be interpreted separately. That is, the estimates cannot be aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined. This arises from the fact that the marginal rate structure is progressive and the fact that the tax measures interact with each other.

Impact of progressive tax rates

The overall effect of claiming a number of exemptions and deductions can push a taxpayer into a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the marginal tax expenditure estimates may under represent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer who moves into the lowest personal income tax bracket by claiming deductions for both a home relocation loan and contributions to a registered retirement savings plan. Some portion of the cost of each of these measures would be calculated using the lowest marginal tax rate even though the taxpayer could have been in a higher marginal rate bracket had these provisions not existed. Aggregating the tax expenditure estimates for these two items would therefore provide a misleading figure.

Interaction of tax measures

As noted above, the tax expenditure estimates are computed assuming all other provisions remain unchanged. However, where the amount of tax collected is affected by the concurrent application of several tax measures, the value of each tax expenditure could differ depending on the order in which the items are evaluated. For example, in measuring the cost of the partial inclusion of capital gains, the result depends critically upon the fact that many capital gains would already be exempt under the lifetime capital gains exemption. If the capital gains exemption were evaluated first, the estimate for the partial inclusion of capital gains in income could be relatively low. Alternatively, if the partial inclusion of capital gains in income were valued in the absence of the lifetime capital gains exemption, the tax expenditure estimate would be significantly higher. This further supports the notion that tax expenditure estimates cannot be meaningfully aggregated.

Aggregation of tax expenditure estimates

The individual tax measure estimates cannot be added together to determine the total cost of tax expenditures. This occurs for two reasons:

- The simultaneous elimination of more than one tax expenditure would generate different estimates because of progressive tax rates.
- The approach of estimating the revenue forgone for each measure separately, assuming all other provisions remain unchanged, does not account for the interaction of tax provisions.

RESTRICTION TO INITIAL IMPACT

Absence of behaviourial responses

In many instances, the removal of a tax expenditure would cause taxpayers to rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behaviourial responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated. For example, consider the case of the partial exclusion of capital gains from income. Eliminating this provision would have resulted in the federal revenue forgone as indicated in the report only if the same amount of capital gains continued to be realized. However, individuals might have further deferred their gains or avoided activities that would generate capital gains. If such a response occurred, then eliminating this measure would have resulted in a smaller increase in revenues than that indicated and could even have caused a decrease in revenues.

Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief. Similarly, the estimates make no allowance for consequential government policy changes. For example, if lottery winnings were to be subject to tax, an argument could be made that the cost of tickets should be a deductible expense of earning taxable income. However, in calculating the cost of exempting lottery winnings from income, no allowance is made for such deductibility since to do so would require a separate policy decision.

Impact on economic activity

The tax expenditure estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus tax revenues. For example, while eliminating the tax assistance provided to registered pension plans could generate a significant amount of revenue for the government, the amount of capital available to Canadian firms would decline resulting in possible job losses and hence a reduction in taxable income. In combination with possible impacts on equity markets, these effects could reduce the level of taxable income in the economy and hence the aggregate amount of tax revenue collected. Furthermore, the estimates do not speculate on how the government might use the additional funds available to it and the possible impacts this could have on revenues.

Restriction of tax expenditure estimates to initial impact

The tax expenditure estimates in this report represent the amount by which federal tax revenues were reduced due to the existence of tax expenditures assuming that all other factors remain unchanged. They do not take into account changes in taxpayer behaviour, consequential government actions or feedbacks on tax collections through induced changes in economic activity.

CALCULATION OF SPECIFIC ESTIMATES

The majority of the estimates in this report were computed with the T1 personal income tax model which uses the methodological approach discussed above. This model computes simulated changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada, Taxation for its annual publication *Taxation Statistics*. The T1 model estimates the revenue impact of possible tax changes by re-computing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would not only result in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures that could not be estimated using the T1 model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Appendix A.

Estimating the cost of tax deferrals presents a number of difficulties since, even though the tax is not currently received, it will be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the government of providing such a tax deferral while at the same time ensuring comparability with the other estimates presented here.

In this report, personal income tax deferrals are estimated on a "cash-flow" basis. That is, the cost is computed as the forgone tax revenue associated with the additional net deferral in the year (deductions for the current year less the income inclusion from previous deferrals). The estimates thus computed provide a reasonably accurate picture of the ongoing costs of maintaining a particular tax provision in a mature tax system. They can be aggregated over time without double counting and are comparable to estimates of the costs associated with tax credits and deductions.

One of the largest tax deferrals in terms of value is that associated with registered retirement savings plans (RRSPs) and registered pension plans (RPPs). The methodology for calculating the tax expenditures associated with these provisions has changed slightly relative to the 1985 tax expenditure report. In that report, the estimates were computed as if the provision had never existed. More specifically, in computing the forgone revenue associated with the non-taxation of income earned within the plans, the stock of pension assets was adjusted to the level it would have been if the investments had grown at after-tax rates of return instead of having been tax-sheltered. In this report, the stock of pension assets is not adjusted in this manner. The methodology used for estimates of the forgone revenue associated with deductible contributions and the revenue collected from taxable withdrawals has remained unchanged. As a result, the estimates are somewhat larger than those which would have been generated if the 1985 approach had been followed.

COMPARISON WITH DIRECT EXPENDITURES

In comparing the cost of the tax expenditure estimates in this report to direct spending estimates, it should be noted that a dollar of tax preference to the taxpayer is often worth substantially more than a dollar of direct spending. This results from the fact that, in most cases, government grants (i.e. direct spending) are taxable to the recipients. For example, consider an individual who faced a marginal tax rate of 29 per cent. A deduction of $100 would generate a tax expenditure of $29. If, instead, the government were to provide the individual with a taxable grant of $29, his/her disposable income would increase by only $20.59 since (he/she would face an income tax liability of $8.41 ($29 x 29%).

TAX EXPENDITURE ESTIMATES

There have been significant changes to the Canadian personal income tax system since *The Account of the Cost of Selective Tax Measures* was published in 1985. The most substantial of these was the 1988 tax reform which resulted in a major overhaul of the personal income tax system. The result of this reform was that many tax expenditures were eliminated, reduced, or changed as part of the base broadening that was necessary to support the reduction in tax rates. Details on personal income tax changes since publication of the last tax expenditure report are provided in Appendix B.

Tax reform affected not only the number, and in some cases the nature, of the expenditures (i.e., the switch from exemptions to credits), but also the progressive rate structure used to calculate the cost of the measures. The lower rates under the post-reform system result in reductions in the estimated values for some items even though the specific amount of expenditure in a particular area remained relatively unchanged.

The tables provide estimates of the cost to the federal government of personal income tax expenditures for 1988 and 1989 grouped according to functional categories. This grouping is not intended to provide a policy justification for the specific provisions nor is it the case that all tax measures fall neatly into one of the categories. They are provided solely for organizational purposes. All estimates in the account are reported in millions of dollars. The letter "S" indicates that the cost is less than $2.5 million while "n.a." signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not possible to provide a quantitative estimate. In most cases, it is expected that the cost of these items is small.

The cost of many tax measures has grown relative to earlier reports while a number of others have declined. The increase in some measures may be attributed largely to the growth in the taxpayer population and economic activity as well as to the impact of inflation. For many measures where the cost decreased, the primary reasons were the reductions in marginal tax rates and the changes from deductions to credits in the 1988 tax reform. Some measures for which estimates were not available in earlier reports are estimated here. This is due to improvements in data availability and estimating methodologies.

Readers will note that the organization of the tax expenditure tables is different from that in earlier reports. The categories are now in alphabetical order for ease of reference. Those former categories with only a single tax expenditure (e.g. Support for Indians, Housing and Urban Renewal) have been added to the "Other Item" category. A new category called "Family" has been added in light of the number of tax expenditures in this area. In the previous report, the majority of family-related measures were classified under "Income Maintenance". The "Labour Force" category has been renamed "Employment". In addition, several specific measures have been reclassified to facilitate reference. Appendix C provides a cross-reference with the 1985 report.

Personal income tax expenditures

	1988	1989
	(millions of dollars)	
Culture and recreation		
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.
Non-taxation of lottery and gambling winnings	705	755
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S
Deductions for clergy residence	38	40
Flow through of *CCA* on Canadian films	36	20
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.
Assistance for artists	n.a.	n.a.
Education		
Exemption on first $500 of scholarship, fellowship and bursary income	14	12
Deduction of teachers' exchange fund contributions	S	S
Tuition fee credit	96	125
Education credit	29	32
Education and tuition fee credits transferred	210	230
Registered education savings plans	n.a.	n.a.
Employment		
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.
Non-taxation of strike pay	7	13
Non-taxation of allowances for volunteer firefighters	4	4
Northern benefits deductions	205	215
Deduction of home relocation loans	4	5
Deferral of salary through leave of absence/ sabbatical plans	n.a.	n.a.
Employee benefit plans	n.a.	n.a.
Overseas employment credit	17	11
Employee stock options	21	23
Family		
Deferral of capital gain through spousal rollover	n.a.	n.a.
Married credit	1,105	1,050
Equivalent-to-married credit	470	530
Dependant credit	380	385
Refundable child tax credit	1,965	2,065

n.a.: Not available.
S: Revenue impact under $2.5 million.

	1988	1989
	(millions of dollars)	
Farming and fishing		
$500,000 lifetime capital gains exemption for farm property	225	300
Cash basis accounting	n.a.	n.a.
Deferral on income from destruction of livestock	S	S
Deferral on income from grain sold through cash purchase tickets	29	–25
Deferral of capital gain through intergeneration rollovers of family farms	n.a.	n.a.
Exemption from making quarterly tax instalments	n.a.	n.a.
Deferral through ten-year capital gain reserve	29	96
Flexibility in inventory accounting	n.a.	n.a.
Federal/provincial financing arrangements		
Quebec abatement	1,725	1,830
Transfers of income tax room to provinces	8,145	8,720
General business and investment		
$1,000 capital gain on personal-use property	n.a.	n.a.
$200 capital gain on foreign exchange transactions	n.a.	n.a.
$100,000 lifetime capital gains exemption	855	985
Partial inclusion of capital gains	1,010	1,425
Taxation of capital gains upon realization	n.a.	n.a.
Deduction of research and development expenditures	32	11
Deduction of limited partnership losses	125	170
Deduction of accelerated tax depreciation not reported elsewhere	n.a.	n.a.
Deferral through capital gains rollovers	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.
Deferral through reporting of certain investment income	n.a.	n.a.
Deferral through five-year reserve	27	40
Investment tax credit	125	84
Health		
Non-taxation of employer-paid insurance premiums for group private health and welfare plans	980	1,140
Disability credit	105	130
Medical expenses credit	130	150

n.a.: Not available.
S: Revenue impact under $2.5 million.

	1988	1989
	(millions of dollars)	
Income maintenance and retirement		
Non-taxation of guaranteed income supplement and spouse's allowance payments	205	220
Non-taxation of social assistance payments	210	235
Non-taxation of worker's compensation payments	525	565
Non-taxation of certain income from personal injury awards	S	S
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.
Non-taxation of employer-paid premiums for group term insurance of up to $25,000	n.a.	n.a.
Non-taxation of RCMP pension/compensation for injury, disability or death	7	7
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)	53	48
Non-taxation of veterans' disability pension and support for dependants	115	125
Non-taxation of investment income on life insurance policies	190	210
Treatment of alimony and maintenance payments	145	165
Age credit	815	935
Pension income credit	205	230
Saskatchewan pension credit	S	S
Registered retirement savings plans		
Deduction for contributions	2,470	2,830
Non-taxation of investment income	1,680	1,975
Taxation of withdrawals	–565	–580
Registered pension plans		
Deduction for contributions	3,385	3,615
Non-taxation of investment income	6,240	6,975
Taxation of withdrawals	–2,460	–2,890
Deferred profit sharing plans	n.a.	n.a.
Resource sector		
Deduction of resource-related expenditures	235	105
Assistance for prospectors and grubstakers	S	S
Small business		
$500,000 lifetime capital gains exemption for small business shares	415	595
Non-taxation of capital dividends	n.a.	n.a.

n.a.: Not available.
S: Revenue impact under $2.5 million.

	1988	1989
	(millions of dollars)	
Small business *(cont'd)*		
Deduction of allowable business investment losses	50	66
Labour-sponsored venture capital credit	13	14
Stock options for CCPC employees	n.a.	n.a.
Other Items		
Non-taxation of income of Indians on reserves	n.a.	n.a.
Non-taxation of War Savings Certificates/Victory Bonds	S	S
Non-taxation of capital gains on principal residences		
Two-thirds inclusion rate	2,375	3,000
Full inclusion rate	3,680	4,655
Non-taxation of gifts and bequests	n.a.	n.a.
Non-taxation of income from the Office of the Governor General	S	S
Charitable donations credit	670	750
Gifts to Crown credit	10	11
Political contribution credit	11	9
Memorandum items		
Non-taxation of allowances to certain public officials	9	9
Non-taxation of allowances for diplomats and other government employees posted abroad	8	8
Child care expense deduction	245	265
Moving expense deduction	61	69
Deduction of carrying charges incurred to earn income	385	530
Deduction of farm losses for part-time farmers	32	37
Farm and fishing loss carry-overs	8	9
Deduction for logging	S	S
Capital loss carry-overs	21	39
Non-capital loss carry-overs	24	36
Deduction of other employment expenses	425	500
Deduction of union and professional dues	315	355
Unemployment insurance		
Unemployment insurance contribution credit	700	640
Non-taxation of employer-paid premiums	1,515	1,400
Canada and Quebec pension plan credit		
Canada and Quebec pension plan credit	595	680
Non-taxation of employer-paid premiums	810	940
Foreign tax credit	115	130
Dividend gross-up and credit	590	655
Federal sales tax credit	400	585
Basic personal credit	14,905	15,830

n.a.: Not available.
S: Revenue impact under $2.5 million.

APPENDIX A
DESCRIPTION OF PERSONAL TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a quick reference. It should be noted that the explanations refer to the 1988 and 1989 taxation years. Since that time, a number of provisions have been altered.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the T1 personal income tax model.

CULTURE AND RECREATION

Non-taxation of capital gains on gifts of cultural property

Certain objects certified as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery.

While the gross amount of such donations is available, and amounted to $41 million in 1988 and $43 million in 1989, there is no information on the proportion of the value which is attributable to capital gains.

Non-taxation of lottery and gambling winnings

Lottery and gambling winnings are excluded from income for tax purposes.

The estimate for the non-taxation of winnings in government lotteries is based on information provided by Statistics Canada. Values for the non-taxation of winnings from horse racing are estimated using data provided by Agriculture Canada.

The values may underestimate the true cost of this provision since there are no accurate data available on income from other types of gambling such as bingo. No adjustments are made for the deductibility of ticket purchases.

Deduction for certain contributions by individuals who have taken vows of perpetual poverty

Where a person has taken a vow of perpetual poverty as a member of a religious order, that person may deduct donations to the religious order up to his/her total employment and pension income (but not investment or other income) in lieu of the charitable donations credit.

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. Housing allowances provided by employers are not included in income.

The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow through of CCA on Canadian films

The capital cost allowance (CCA) rate generally available on films is 30 per cent subject to the half-year rule. On "certified Canadian films", the half-year rule does not apply. The

CCA may be flowed through to investors and deducted against their other sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film is deductible against an investor's income from certified Canadian films. Investments in television commercials may be depreciated at a rate of 100 per cent.

The estimate for this item is computed by eliminating the film-related CCA claimed by individuals. Accordingly, the value may overestimate the true cost of the measure to the extent that some CCA might otherwise have been claimed at the corporate level.

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by both incorporated and unincorporated businesses for display in an office may be depreciated on a 20 per cent declining balance basis even though art depreciates very slowly and often appreciates.

No data are available.

Assistance for artists

Visual artists may exclude the value of inventory in computing income instead of including the cost or the fair market value of such inventory. Thus, artists benefit from a deferral since they may write off the costs involved in a work of art in the year they are incurred rather than waiting until the work is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is then used to determine the artist's income and the amount that qualifies as a charitable donation. The restriction that donations eligible for the credit cannot exceed 20 per cent of income does not apply.

No data are available.

EDUCATION

Exemption on first $500 of scholarship, fellowship and bursary income

The first $500 of scholarship, fellowship and bursary income is exempt from tax.

The value reported is understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

Teachers may deduct up to $250 per year in contributions to a fund established by the Canadian Education Association for the benefit of teachers from Commonwealth countries visiting Canada under a teachers' exchange agreement.

Tuition fee credit

A 17 per cent tax credit is available for tuition fees paid to specified educational institutions. The credit is not available if the total tuition fees paid to that institution are $100 or less.

Education credit

Students who are enrolled at designated educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of $60 for every month of full-time attendance.

Education and tuition credits transferred

The unused amounts of the education credit and the tuition fee credit, up to 17 per cent of $3,529, may be transferred to a supporting spouse, parent or grandparent.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan on behalf of a designated beneficiary (usually the taxpayer's child). The investment return on these funds is not taxable until it is withdrawn by the beneficiary for educational purposes. It is taxable in the hands of the beneficiary rather than the contributor.

No data are available.

EMPLOYMENT

Non-taxation of certain non-monetary employment benefits

Certain fringe benefits provided to employees by their employers are not taxable. Examples include subsidized meals in staff cafeterias, subsidized recreational facilities and special clothing.

No data are available.

Non-taxation of strike pay

Strike pay is non-taxable.

The estimate is based on data extracted from Statistics Canada's *Annual Report of the Minister of Regional and Industrial Expansion under the Corporations and Labour Unions Return Act Part II, Labour Unions* (Cat. 71-202).

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters may receive up to $500 per year of allowances which are not taxable.

The estimate is based on census data.

Northern benefits deduction

Individuals living in prescribed areas in Canada for a specified period may claim a monthly deduction of up to $450, as well as deductions for two employer-provided vacation trips per year and unlimited employer-provided medical travel.

Deduction of home relocation loans

Employees may receive a subsidized home relocation loan from their employers on up to $25,000 for five years without having to include the benefit in income.

Deferral of salary through leave of absence/sabbatical plans

Employees may be entitled to defer salaries through a leave of absence/sabbatical plan. These amounts are not subject to tax until received.

No data are available.

Employee benefit plans

Employers may make contributions to an employee benefit plan on behalf of their employees. The employee is not required to include in income either the contributions to the plan or the investment income earned within the plan until amounts are actually withdrawn.

No data are available.

Overseas employment credit

An 80 per cent tax credit is available to Canadian employees working abroad for more than six months in connection with a resource, construction, installation, agricultural or engineering project. The credit applies on Canadian tax otherwise payable on up to $100,000 of net overseas employment income taxable in Canada.

Employee stock options

Employees are not generally required to report any employment benefit on employer-provided stock options until the option is exercised. At that time, a deduction of one-third (currently one-quarter) of the difference between the option price and exercise price is provided. This provides both a deferral of tax and a preferential rate.

The estimate is computed by eliminating the one-third deduction.

FAMILY

Deferral of capital gains through spousal rollover

Individuals may transfer capital property to their spouse or a spousal trust at the adjusted cost base of the property rather than the fair market value. This provides a deferral of the capital gain until the subsequent disposition.

No data are available.

Married credit

A married taxpayer supporting a spouse was entitled to a tax credit of 17 per cent of $5,000 in 1988. This was reduced by the amount by which the dependent spouse's income exceeded $500. The levels were increased to $5,055 and $506 in 1989.

Equivalent-to-married credit

An "equivalent-to-married" tax credit may be claimed by single parents for a dependent child. The amount was 17 per cent of $5,000 in 1988. This was reduced by the amount by which the dependant's income exceeded $500. The levels were increased to $5,055 and $506 in 1989.

Dependant credit

Taxpayers may claim a credit in respect of children and other qualified dependent relatives who are either under the age of 18 or mentally or physically infirm. In 1988, the tax credit was $388 for each of the first two dependants, $776 for each additional dependant and $1,471 for each infirm dependant. These amounts are reduced by the dependant's income in excess of $2,500. The amounts for 1989 were $392, $748, $1,487 and $2,528, respectively.

Refundable child tax credit

Individuals receiving family allowances were entitled to a refundable child tax credit. The basic amount was $559 in 1988. A supplement of $100 was available for each child under the age of seven. This supplement was reduced by 25 per cent of all child care expenses claimed as a deduction. The combined credit was reduced by 5 per cent of the amount of the parents' net income in excess of $24,090. In 1989, the basic credit was increased to $565, the supplement was doubled to $200, and the phase-out began at a combined income of $24,355.

FARMING AND FISHING

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property and qualified small business shares ($100,000 standard lifetime capital gains exemption plus an additional $400,000 for farms and small business). The exemption is available only to the extent that the gains exceed cumulative net investment losses incurred after 1987.

The estimate represents that portion of the exemption which is attributable to qualified farm property.

Cash basis accounting

Generally, taxpayers must use accrual accounting for calculating their business income. However, individuals engaged in farming and fishing may elect to use the cash basis of accounting for tax purposes except in respect of depreciable assets. Under cash accounting, receipts are included in income only when received and expenses are deductible when actually paid. This permits a deferral of tax, in that costs paid are deductible immediately despite the fact that the resulting income may not arise until a later year.

No data are available.

Deferral of income from destruction of livestock

Where there has been a forced destruction of livestock due to disease, farmers may elect to include the resulting compensation in income in the following year.

Deferral of income on grain sold through cash purchase tickets

Under the cash purchase ticket program of the Canadian Wheat Board, farmers may make deliveries of grain before the year-end and receive payment in the form of a ticket that may be cashed in subsequent years. The payment is included in taxable income only when the ticket is cashed.

In 1988, the amount of cash tickets outstanding declined and so gave rise to a negative cost estimate.

Deferral of capital gain through intergenerational rollovers of family farms

Sales or gifts of business assets to children or grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the cost base of the property. Capital gains on intergenerational transfers of farm property within the immediate family are not taxed. The accrued capital gain is subject to tax when disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. Individuals engaged in farming and fishing 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.

No data are available.

Deferral through ten-year capital gain reserve

If proceeds from a sale of a farm property are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year.

Flexibility in inventory accounting

Under cash basis accounting, net additions to livestock inventory are treated as a cost which is deducted in computing income. Consequently, farmers who are expanding their herds may find themselves in a loss position for tax purposes. However, at the farmer's discretion, an amount may be added to income each year of up to the fair market value of livestock on hand at year-end. This amount must then be deducted from income the following year. This provision allows farmers to avoid the time limit associated with loss carry-overs and make the fullest use of other available tax measures.

No data are available.

FEDERAL/PROVINCIAL FINANCING ARRANGEMENTS

Quebec abatement

Under certain federal transfer programs, provinces can elect to receive cash or tax point transfers. Quebec has elected the latter resulting in a 16.5 percentage points abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

In 1967, the federal government transferred tax points to the provinces in place of direct cash transfers under the cost-shared program for post-secondary education. As a result, the personal income tax abatement was increased by 4 percentage points. In 1977, an additional 9.5 percentage points of individual income tax were provided to the provinces in respect of post-secondary education, hospital insurance, and medicare programs.

GENERAL BUSINESS AND INVESTMENT

$1,000 capital gains exemption on personal-use property

The first $1,000 of capital gains on personal-use property (e.g. automobiles, stamp collections) is exempt from tax. Personal-use property is primarily for the use and enjoyment of the owner.

No data are available.

$200 capital gains exemption on foreign exchange transactions

The first $200 of net capital gains on foreign exchange transactions is exempt from tax.

No data are available.

$100,000 lifetime capital gains exemption

The first $100,000 of lifetime capital gains realized by individuals are non-taxable. The exemption is available only to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Partial inclusion of capital gains

Net realized capital gains accrued since 1972 were included in income at a rate of two-thirds in 1988 and 1989 (current rate of inclusion is three-quarters).

Taxation of capital gains upon realization

Capital gains are taxed upon the disposition of property and not when they accrue. This provides a tax deferral.

No estimates are available.

Deduction of research and development expenditures

All research and development (R&D) expenditures may be deducted immediately, despite the fact that some of these expenditures are capital in nature (i.e., designed to produce future income).

The estimate is calcuated by assuming that 15 per cent of R&D expenditures are of a capital nature. In the absence of this R&D provision, these amounts would have been depreciated over several years (subject to CCA rules) rather than immediately. The estimate of the proportion of R&D that is of a capital nature is derived from Statistics Canada, *Industrial Research and Development Statistics.*

Deduction of limited partnership losses

Losses generated through partnerships which limit the liability of the investor are deductible against other income up to the amount of investment at risk. Unused losses may be carried back three years or forward seven years and are deductible up to the amount of investment at risk.

Deduction of accelerated tax depreciation not reported elsewhere

The depreciation allowable for tax purposes is called capital cost allowance (CCA). It may be greater than true economic depreciation. A tax deferral is thus created since the tax deductions in the early years of the life of an asset exceed the actual deterioration in the value of the asset. The difference is captured upon subsequent disposition of the asset.

No data are available.

Deferral through capital gains rollovers

In certain circumstances, taxpayers may defer the reporting for tax purposes of capital gains. General business rollover provisions may be categorized into three groups:

Involuntary dispositions

Capital gains resulting from an involuntary disposition (e.g., insurance proceeds received for an asset destroyed in a fire) may be deferred if the funds are reinvested in a replacement asset within a specified period. The capital gain is taxable upon disposition of the replacement property.

Voluntary dispositions

Capital gains resulting from the voluntary disposition of land and buildings by unincorporated businesses may be deferred if replacement properties are purchased soon thereafter (for example, a business changing location). The rollover is not available for properties used to generate rental income.

Transfers to a corporation for consideration including shares

Individuals may sell an asset to a corporation controlled by them or their spouses and elect to roll over the capital gain into the corporation instead of paying tax in the year of sale.

No data are available.

Deferral through billed-basis accounting by professionals

In computing their income for tax purposes, professionals may elect to use either an accrual or a billed-basis accounting method. Using the latter means that costs of work in progress may be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment is not typically available for other businesses but is analogous to cash basis accounting for farmers.

No data are available.

Deferral through reporting of certain investment income

Normally, investment income is taxed annually as it accrues. Certain investment income, such as that earned on compound interest Canada Savings Bonds purchased between 1982 and 1989, need only be declared every three years.

No data are available.

Deferral through five-year reserve

If proceeds from a sale of capital property are not all receivable in the year of the sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds are received. A minimum of 20 per cent of the gain must be brought into income each year.

Investment tax credit

A tax credit is available for investments in research and development, exploration activities and certain regions. The tax credits ranged from 15 per cent to 60 per cent of the investment in 1988 and from 15 per cent to 45 per cent in 1989.

HEALTH

Non-taxation of employer-paid insurance premiums for private health and welfare plans

Employer-paid premiums for private health and welfare insurance plans, including dental plans, are not taxable.

The estimates are based on data from Statistics Canada.

Disability credit

Canadians who are markedly restricted in the basic activities of daily living are entitled to a tax credit. The credits were 17 per cent of $3,326 in 1988 and $3,272 for 1989.

Medical expenses credit

Taxpayers are entitled to a 17 per cent credit on eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit was available for expenses which exceeded the lesser of 3 per cent of net income or $1,500 in 1988 ($1,517 in 1989).

INCOME MAINTENANCE AND RETIREMENT

Non-taxation of guaranteed income supplement and spouse's allowance payments

The guaranteed income supplement (GIS) is paid to old age security (OAS) pensioners who have low incomes. If the spouse of an OAS recipient is between the ages of 60 and 64 years then that person may be eligible for the spouse's allowance. Payments under both the guaranteed income supplement and the spouse's allowance programs are non-taxable.

The non-taxation of income-tested programs such as the guaranteed income supplement or provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax". On the other hand, a broadly based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in the account, these items are considered to be tax expenditures.

The estimate is based on data from *Statistics Canada, Yearbook.*

Non-taxation of social assistance payments

Social assistance payments received by low-income Canadians must be included in income. However, an offsetting deduction is provided. This approach effectively exempts such assistance from taxation while continuing to affect income-tested credits.

The estimate is based on data from *Statistics Canada, Yearbook.*

Non-taxation of worker's compensation payments

Worker's compensation payments must be included in income. However, an offsetting deduction is provided. This approach effectively exempts such payments from taxation while continuing to affect income-tested credits.

The estimate is based on data from *Statistics Canada, Yearbook.*

Non-taxation of certain income from personal injury awards

Investment income earned on certain capital amounts that were received as personal injury awards is not included in income for years prior to that when the recipient became 22 years old.

No data are available.

Non-taxation of up to $10,000 of death benefit

Up to the first $10,000 of death benefit paid by an employer to the spouse of a deceased employee is non-taxable.

No data are available.

Non-taxation of employer-paid premiums for group term life insurance of up to $25,000

Employer-paid premiums for group term life insurance coverage of up to $25,000 per employee are not taxable.

No data are available.

Non-taxation of RCMP pensions/compensation for injury, disability or death

Pension payments, allowances and other compensation received in respect of an injury, disability or death, associated with service in the Royal Canadian Mounted Police, are non-taxable.

The estimate for this item is based on Public Accounts data.

Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)

These amounts are non-taxable.

The estimate is based on Public Accounts data.

Non-taxation of veterans' disability pension and support for dependants

These amounts are non-taxable.

The estimate for this item is based on Public Accounts data.

Non-taxation of investment income on life insurance policies

The investment income earned inside some life insurance policies is not taxed until the policy is surrendered.

The estimate is based on data from the Office of the Superintendent of Financial Institutions.

Treatment of alimony and maintenance payments

Payments by a taxpayer to a divorced or separated spouse are deductible to the payer and taxable in the hands of the recipient.

The revenue estimate for this item is computed as the value of the deduction to the payer less the tax collected from the recipient.

Age credit

Individual taxpayers aged 65 or over were entitled to claim a tax credit of 17 per cent of $3,236 in 1988. Unused portions may be transferred between spouses. The levels on which the credit was based was $3,272 in 1989.

Pension income credit

A 17 per cent tax credit is available on up to the first $1,000 of certain pension income. The unused portion of the credit may be transferred between spouses.

Saskatchewan pension credit

Contributions to the Saskatchewan Pension Plan are deductible up to the lesser of $600 or the amount of unused RRSP room in a particular year.

Registered retirement savings plans/registered pension plans

The federal revenue forgone due to the provisions pertaining to registered retirement savings plans (RRSPs) and registered pension plans (RPPs) is a function of three components: the deductibility of contributions to such plans, the income inclusion of RRSP/RPP withdrawals, and the non-taxation of investment income accrued within the plan. Accordingly, individuals benefit from both a deferral of tax on investment income and an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contribution.

In 1988 and 1989, the annual RRSP contribution limits were the lesser of $7,500 and 20 per cent of earned income for those individuals who were not part of a pension plan or deferred profit sharing plan. For individuals who were members of such plans, the RRSP contribution limits were $3,500 (or 20 per cent of earned income) less employee RPP contributions. The contribution limits for defined benefit RPPs were $3,500 for the employer and $3,500 for the employee, for a total contribution limit of $7,000. There were no fixed limits on employee contributions to defined benefit plans although deductible employer contributions are limited to the amounts necessary to provide for full funding of the promised benefit, after taking employee contributions into account.

It should be noted that the RRSP/RPP estimates do not reflect a mature system because contributions currently exceed withdrawals. Assuming a constant tax rate, if contributions equalled withdrawals, only the non-taxation of investment income would contribute to the tax expenditure. As time goes by and more retired individuals have had the opportunity to contribute to RRSPs throughout their lifetime, the gap between contributions and withdrawals will shrink and possibly even become negative. The upward bias in the current estimate can therefore be expected to decline.

The estimate may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual one could calculate the difference in disposable income between an individual who invests in an RRSP/RPP and one who invests in a non-sheltered savings instrument. Under this approach, the RRSP benefits to individuals were $1.4 billion in 1988 and $1.7 billion in 1989. The corresponding figures for RPPs are $4.8 billion in 1988 and $5.3 billion in 1989.

Data used to estimate the value of these measures were extracted from the T1 personal income tax model, unpublished data from Statistics Canada, Statistics Canada publications *Trusted Pension Funds* (Cat. 74-201) and *Pension Plans in Canada* (Cat. 74-401), as well as the Bank of Canada *Review*.

Deferred profit sharing plans

Employers may make tax deductible contributions to a profit sharing plan on behalf of their employees. These amounts are taxable in the hands of the employees when withdrawals are made from the plan. The employer's contribution cannot exceed the lesser of $3,500 per employee (less any contributions by the employer to an RPP in respect of the employee) or 20 per cent of the employee's earnings.

No data are available.

RESOURCE SECTOR

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses may be deductible by virtue of the individual either personally engaging in resource-related activities or by providing financing to another party who "flows through" the related tax deductions to the individual.

The available data do not permit a separation of expenses which are flowed through to passive investors and those which are incurred directly. The estimate should be interpreted as an upper bound since some amounts incurred directly may be incurred for the purposes of earning income and thus are not a tax expenditure.

Assistance for prospectors and grubstakers

Where a prospector or grubstaker disposes of mining property to a corporation in exchange for shares in that corporation, the tax liability is deferred until the subsequent disposition of the shares. At that time, only two-thirds (currently three-quarters) of the amount for which the mining property was transferred to the corporation need be included in income.

SMALL BUSINESS

$500,000 lifetime capital gains exemption for small business shares

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares and qualified farm property ($100,000 standard lifetime capital gains exemption plus an additional $400,000 for farms and small business). The exemption is available only to the extent that the gains exceed cumulative net investment losses incurred after 1987.

The estimate represents that portion of the exemption which is attributable to small business shares.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-third of any realized capital gains accumulated in their "capital dividend account" to their shareholders in the form of a capital dividend. This dividend is non-taxable.

No data are available.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, if the capital loss is in respect of shares or debts of a small business corporation, it may be used to offset other income.

Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to a capital loss and may be carried forward indefinitely.

Labour-sponsored venture capital credit

A 20 per cent tax credit was available on up to the first $3,500 (currently $5,000) invested in Labour-Sponsored Venture Capital Corporations.

Stock options for CCPC employees

Employees of Canadian-controlled private corporations (CCPCs) are not generally required to report any employment benefit on employer-provided stock options until the share is sold. The difference between the exercise price and the fair market value of the share at the time the option was exercised was included in income at a rate of two-thirds (currently three-quarters) provided the shares were held for at least two years. This provides both a deferral of tax as well as a preferential tax rate.

No data are available.

OTHER ITEMS

Non-taxation of income of Indians on reserves

The income of Indians is exempt if located on a reserve.

No data are available.

Non-taxation of income from War Savings Certificates/Victory Bonds

Income earned on these instruments is non-taxable.

The estimates are based on Bank of Canada data.

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable.

The capital gains were determined using Multiple Listing Service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations obtained from Statistics Canada's *Consumer Expenditure Survey*. The holding period for principal residences was derived from 1981 Census data.

Estimates for this item are provided for both a partial and full inclusion rates for capital gains.

Non-taxation of gifts and bequests

Gifts and bequests are not included in the income of the recipient for tax purposes.

No data are available.

Non-taxation of income from the Office of the Governor General

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Charitable donations credit

A tax credit is available for donations of up to 20 per cent of net income made to registered charities. Donations in excess of 20 per cent of net income may be carried forward for up to five years. The 20 per cent restriction does not apply to gifts of cultural property to museums and art galleries. The credit is 17 per cent on the first $250 of donations and 29 per cent on donations in excess of $250.

Gifts to the Crown credit

A tax credit is available for gifts to the Crown. The credit is 17 per cent on the first $250 of donations and 29 per cent on donations in excess of $250. Unused contributions may be carried forward for up to five years.

Political contribution credit

A credit is available for donations to registered federal political parties. The credit is 75 per cent of the first $100 of contributions, 50 per cent on the next $450 of contributions and 33⅓ per cent on the next $600. The maximum credit claimable in any year is $500.

MEMORANDUM ITEMS

Non-taxation of allowances for certain public officials

Members of Parliament (MPs) and provincial legislatures (MPPs), senators and some other public officials receive a flat amount per annum in addition to their salaries. These amounts are not included in income for tax purposes.

The only data available are the non-taxable allowances provided to MPs, MPPs and Senators. It is derived from the publication *Canadian Legislatures*.

This provision is a memorandum item because the allowances are designed to cover the additional expenses associated with holding public office.

Non-taxation of allowances for diplomats and other government employees posted abroad

Diplomats and other government employees posted abroad receive a non-taxable income supplement to cover the additional costs associated with living outside Canada.

Estimates are based on information obtained from Treasury Board.

Child care expense deduction

Child care expenses are deductible if incurred for the purpose of earning employment income, taking an occupational training course or carrying on research for which a grant is received. In 1988-89, the deduction could not exceed $4,000 per child if the child was under seven or was disabled, $2,000 per child between seven and 14 years of age, or two-thirds of earned income for the year. The deduction must generally be claimed by the spouse with the lower income. However, the higher income parent may claim a deduction if the lower income parent is infirm, confined to a bed or wheelchair, in prison, or attending a designated educational institution on a full-time basis.

This provision is a memorandum item because it is considered an expense of earning taxable income.

Moving expense deduction

All reasonable moving expenses (e.g. transportation, meals and temporary accommodations) are deductible from income if the taxpayer moves 40 kilometres closer to the place of employment. Moving expense reimbursements provided by employers are not included in income.

The estimate does not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

Interest and other carrying charges, such as investment counselling fees and safety deposit box charges, incurred to earn business or investment income are deductible.

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral associated with the up-front deductions and subsequent taxation of certain investment income. Others would hold that carrying charges are incurred for the purposes of earning income and therefore represent part of the benchmark income tax system.

Deduction of farm losses for part-time farmers

Individuals whose major source of income is not farming are allowed to deduct farm losses up to a maximum of $8,750 against other income.

Part-time farm losses which are not deductible in the current year may be carried back three years and forward ten years to deduct against farm income. The estimate includes the cost of these carry-overs.

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward ten years and deducted against other income.

The only data which are available are the amount of prior years' losses carried forward to the current year. In this regard, the estimates do not include current year losses carried forward to the future or back to the past, nor do they include future losses carried back to the taxation year in question. The estimates also do not include losses carried over by part-time farmers.

Deduction for logging

Individuals may deduct some portion of provincial logging tax paid when computing federal income tax.

Capital loss carry-overs

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years.

The only data which are available are the amount of prior years' losses carried forward to the current year to reduce taxes payable. In this regard, the estimates do not include current year losses carried forward to the future or back to the past, nor do they include future losses carried back to the taxation year in question.

Non-capital loss carry-overs

Non-capital losses may be carried back three years and forward seven years to offset other income.

The only data which are available are the amount of prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost figures underestimate the true amount of revenue forgone because they do not include current year losses carried forward to the future or back to the past, nor do they include future losses carried back to the taxation year in question.

Deduction of other employment expenses

Certain specific employment expenses (e.g. automobile expenses incurred by self-employed individuals) are deductible in the computation of income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

Unemployment insurance contribution credit/non-taxation of employer-paid premiums

A 17 per cent tax credit is provided for unemployment insurance contributions. Employer-paid premiums are not included in income.

The mandatory nature of unemployment insurance contributions leads to their classification as expenses incurred to earn income.

Canada and Quebec Pension Plan credit/Non-taxation of employer-paid premiums

A 17 per cent tax credit is provided for Canada/Quebec Pension Plan contributions. Employer-paid premiums are not included in income.

The mandatory nature of CPP/QPP contributions leads to their classification as expenses incurred to earn income.

Foreign tax credit

In order to avoid double taxation, a tax credit is provided in recognition of income taxes paid in foreign countries.

Dividend gross-up and credit

In order to avoid double taxation, dividends received from taxable Canadian corporations are "grossed-up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided.

Federal sales tax credit

Eligible individuals could claim a refundable federal sales tax credit for themselves, their spouse and "qualified relations". In 1988, the credits were $70 for both the individual and their spouse, and $35 for qualified relations. The credit was phased out for incomes in excess of $16,000. In 1989, the self and spousal credits were increased to $100 and the qualified relations credit was $50. The income at which these credits were phased out remained unchanged.

Basic personal credit

All taxpayers receive a 17 per cent basic personal credit calculated on a base of $6,000 in 1988 and $6,060 in 1989.

APPENDIX B
CHANGES TO THE PERSONAL INCOME TAX SYSTEM 1983-1989

	Year
Provisions eliminated	
$100 standard deduction for charitable donations and medical expenses	1984
Income splitting through interest-free loans between family members	1985
Scientific research tax credit	1985
Deferral through $120,000 farm capital gains transfer to RRSP	1985
Capital gains treatment of stock dividends of public corporations	1985
Indexed security investment plans	1986
Non-taxation of various homeowner grants	1986
Registered home ownership savings plan:	
contribution deduction disallowed	1985
income on plans taxable	1986
3 per cent inventory valuation adjustment	1986
Deduction of up to $2,000 of allowable capital losses against other income (phased out)	1986
Federal tax reduction	1986
Multiple-unit residential buildings	1987
$1,000 investment income deduction	1988
Deduction of resource-related expenditures: earned depletion (phased out)	1988
Deferral of up to $200,000 of capital gains on intergenerational transfers of small business	1988
Employment expense deduction	1988
Employment tax credit	1988
Exemption for dependants over 18 years old which are not infirm	1988
Five-year block averaging for individuals engaged in farming and fishing	1988
Forward averaging	1988
Provisions reduced or restricted	
Rollover of pension benefits: no tax-free transfer for unregistered plans	1984
Federal tax reduction:	
phased out for high income	1984
reduced	1985
3 per cent inventory valuation adjustment: denied to inventories of currency	1985

$1,000 investment income deduction: capital gains no longer qualify	1985
Child tax credit: reduced income threshold at which the credit is phased out	1986
Exemption for dependants 18 years old and over other than mentally or physically infirm dependants:	
reduced income threshold	1986
reduced amounts	1987
Exemption for dependants under 18 years old:	
amount no longer indexed	1984
reduced amount	1987-1988
reduced to equal family allowance amounts	1989
Investment tax credit	1987-1988-1989
100 per cent write-off for Canadian films	1988
Capital gains:	1988
inclusion rate increased to two-thirds cumulative net investment loss rules introduced lifetime capital gains exemption restricted to $100,000 for non-farm, non-small business property	
Deductions converted to tax credits	
Overseas employment deduction	1984
$1,000 pension income deduction	1988
Age exemption	1988
Basic personal exemption	1988
Charitable donations deduction	1988
Child tax exemption for dependent children	1988
CPP/QPP contribution deduction	1988
Disability deduction	1988
Education deduction	1988
Equivalent-to-married exemption	1988
Exemption for infirm dependants	1988
Marital exemption	1988
Medical expense deduction	1988
Tuition fee deduction	1988
UI contribution deduction	1988
Provisions added	
Listed personal property loss carry-overs	1984
Employee stock option: partial inclusion rate in income	1984
$500,000 lifetime capital gains exemption (phased in)	1985

Deferred profit sharing plan: partial inclusion rate in income	1985
Employee stock option for CCPC employees	1985
Flexibility arising from artists' inventories: valuation and value of charitable donations	1985
Home relocation loan	1985
Labour-sponsored venture capital tax credit	1985
Federal sales tax credit	1986
Salary deferral through a leave of absence/sabbatical plan	1987

Provisions enriched or extended

Moving expense deduction: extended to individuals unemployed immediately before moving to new job	1984
Alimony and maintenance deduction: includes amounts paid to a third party	1984
Disability deduction: extended to:	
individuals confined to a bed or wheelchair	1984
markedly restricted individuals	1986
increased amounts	1986
Tax credit for research and development: increased refunding from 40 per cent to 100 per cent	1985
Investment tax credit: for investments in Cape Breton	1985
Old age security	1986
RPP eligible contributions for deduction	1986
RRSP contribution limits	1986
Northern benefits: monthly deduction extended to all residents	1987
Child care expense deduction: increased amounts and family limit removed	1988
Education tax credit	1988
Child tax credit:	
increased amount	1986-1987-1988
supplement	1988
prepayment for low family income	1986
partial indexation	1989
Labour-sponsored venture capital tax credit extended to nationally registered LSVCCs	1988
Medical expense tax credit: cap for high income eligibility	1988
Deduction of restricted farm losses by part-time farmers	1989
Increased federal sales tax credit	1988-1989
Flexibility in inventory accounting	1989

APPENDIX C
CROSS-REFERENCE WITH *ACCOUNT OF THE COST OF SELECTIVE TAX MEASURES* (1985)

Category and item in this report	1985 classification
Culture and recreation	
Non-taxation of capital gains on gifts of cultural property	**VIII.** 3.
Non-taxation of lottery and gambling winnings	**VIII.** 5.
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	**VIII.** 7.
Deductions for clergy residence	**VIII.** 6.
Flow through of CCA on Canadian films	**VIII.** 2.
Write-off of Canadian art purchased by unincorporated business	**VIII.** 4.
Assistance for artists	N.A.
Education	
Exemption on first $500 of scholarship, fellowship and bursary income	**VII.** 1.
Deduction of teachers' exchange fund contributions	**VII.** 4.
Tuition fee credit	**VII.** 3.
Education credit	**VII.** 2.
Education and tuition fee credits transferred	N.A.
Registered education savings plans	**VII.** 5.
Employment	
Non-taxation of certain non-monetary employment benefits	**V. H.** 4.
Non-taxation of strike pay	**V. H.** 7.
Non-taxation of allowances for volunteer firefighters	**I.** 4.
Northern benefits deduction	**V. H.** 8.
Deduction of home relocation loans	**V. H.** 2.
Deferral of salary through leave of absence/sabbatical plans	N.A.
Employee benefit plans	**V. H.** 5.
Overseas employment credit	**II.** 2.
Employee stock options	N.A.
Family	
Deferral of capital gain through spousal rollover	**VI. B.** 17.
Married credit	**VI. B.** 9.
Equivalent-to-married credit	**VI. B.** 9.
Dependant credit	**VI. B.** 10. and 11.
Refundable child tax credit	**VI. B.** 12.

Farming and fishing	
$500,000 lifetime capital gains exemption for farm property	N.A.
Cash basis accounting	**V. A.** 2.
Deferral on income from destruction of livestock	**V. A.** 6.
Deferral on income from grain through cash purchase tickets	**V. A.** 5.
Deferral of capital gain through intergeneration rollovers of family farms	**V. A.** 4.
Exemption from making quarterly tax instalments	**V. A.** 8.
Deferral through ten-year capital gain reserve	N.A.
Flexibility in inventory accounting	**V. A.** 3.
Federal/provincial financing arrangements	
Quebec abatement	**IX.** 1.
Transfers of income tax room to provinces	**IX.** 2.
General business and investment	
$1,000 capital gain on personal-use property	**V. I.** 6.
$200 capital gain on foreign exchange transactions	**V. I.** 7.
$100,000 lifetime capital gains exemption	N.A.
Partial inclusion of capital gains	**V. I.** 2. and 3.
Taxation of capital gains upon realization	**V. I.** 9.
Deduction of research and development expenditures	**V. F.** 1.
Deduction of limited partnership losses	N.A.
Deduction of accelerated tax depreciation not reported elsewhere	**V. A.** 11. and **I.** 13.
Deferral through capital gains rollovers	**V. I.** 8.
Deferral through billed-basis accounting by professionals	**V. I.** 18.
Deferral though reporting of certain investment income	**V. I.** 11.
Deferral through five-year reserve	N.A.
Investment tax credit	**V. A.** 10., **C.** 1., and **I.** 1.
Health	
Non-taxation of employer-paid insurance premiums for private health and welfare plans	**V. H.** 3.
Disability credit	**VI. C.** 2.
Medical expenses credit	**VI. A.** 1.
Income maintenance and retirement	
Non-taxation of guaranteed income supplement and spouse's allowance payments	**VI. B.** 3.
Non-taxation of social assistance payments	**VI. C.** 1.
Non-taxation of worker's compensation payments	**VI. B.** 14.

Non-taxation of certain income from personal injury awards	**VI. B.** 15.
Non-taxation of up to $10,000 of death benefit	**VI. B.** 16.
Non-taxation of employer-paid premiums for group term insurance of up to $25,000	**V. H.** 3.
Non-taxation of RCMP pension/compensation for injury, disability or death	**I.** 3.
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)	**III.** 1. and 2.
Non-taxation of veterans' disability pension and support for dependants	N.A.
Non-taxation of investment income on life insurance policies	**V. I.** 12.
Treatment of alimony and maintenance payments	**VI. B.** 7.
Age credit	**VI. B.** 2.
Pension income credit	**VI. B.** 1.
Saskatchewan pension credit	N.A.
Registered retirement savings plans	**VI. B.** 4.
Registered pension plans	**VI. B.** 4.
Deferred profit sharing plans	**VI. B.** 6.
Resource sector	
Deduction of resource-related expenditures	**V. B.** 1.
Assistance for prospectors and grubstakers	**V. B.** 2.
Small business	
$500,000 lifetime capital gains exemption for small business shares	N.A.
Non-taxation of capital dividends	**V. I.** 4.
Deduction of allowable business investment losses	**V. G.** 3.
Labour-sponsored venture capital credit	**V. G.** 4.
Stock options for CCPC employees	**V. G.** 2.
Other items	
Non-taxation of income of Indians on reserves	**VI. D.** 1.
Non-taxation of War Savings Certificates/Victory Bonds	**III.** 3.
Non-taxation of capital gains on principal residences	**VI. E.** 1.
Non-taxation of gifts and bequests	N.A.
Non-taxation of income from the Office of the Governor General	**I.** 2.
Charitable donations credit	**VIII.** 1.
Gifts to Crown credit	N.A.
Political contribution credit	**I.** 1.

Memorandum items

Non-taxation of allowances to certain public officials	**XII.** 8.
Non-taxation of allowances for diplomats and other government employees posted abroad	**II.** 1.
Child care expense deduction	**VI. B.** 13.
Moving expense deduction	N.A.
Deduction of carrying charges incurred to earn income	N.A.
Deduction of farm losses for part-time farmers	**XII.** 7.
Farm and fishing loss carry-overs	N.A.
Deduction for logging	**C.** 39. (Corporate)
Capital loss carry-overs	N.A.
Non-capital loss carry-overs	N.A.
Deduction of other employment expenses	N.A.
Deduction of union and professional dues	N.A.
Unemployment insurance contribution credit and non-taxation of employer-paid premiums	**XII.** 4.
Canada and Quebec pension plan credit and non-taxation of employer-paid premiums	**XII.** 5.
Foreign tax credit	N.A.
Dividend gross-up and credit	**XII.** 6.
Federal sales tax credit	N.A.
Basic personal credit	**XII.** 1.