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TAX MEASURES AND SMALL BUSINESS FINANCING

Prepared for the Small Business Financing Review
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INTRODUCTION

Since the early 1970's numerous changes have been made to the Income Tax Act to allow businesses to retain a greater portion of their profit, hopefully for use in developing their businesses. Among the more important tax measures are the small business tax credit, the manufacturing and processing profits deduction, the investment tax credit, the three percent inventory allowance and accelerated depreciation. Each of these will be examined in some detail in this study.

This myriad of deductions and credits reduced corporate taxes by over $1.7 billion in 1977, making government tax expenditures the largest of all business assistance programs. How this assistance affects the financing of small business, and who are the beneficiaries is one of the concerns of this paper. This is not a definitive study of tax policies, nor are we concerned with the tax system's efficiency in raising revenues or redistributing income. Such a task is beyond the scope of the Review.

Many of these tax expenditures have been directed at small businesses in the belief that they have received "unfair" treatment by the tax system. However, to discuss the "fairness" or neutrality of the tax system the question of the appropriate tax unit becomes an important concern. Are corporations and invididuals separate and equivalent tax units? In the case of "large" widely held corporations one could argue that management is sufficiently divorced from shareholders that ownership provides no effective control over the company. Thus the shareholder is very similar to a debt holder, and the corporation has the appearance of a separate tax entity.

The same argument cannot be made for tightly held (mainly small) businesses. Here, corporate and personal taxes are usually arranged to minimize the overall tax payable. Hence corporate income should be considered taxed in the hands of the owner, just as in the case of unincoporated business. The present tax system has little in the way of integration between corporate and personal income taxes. A fully integrated tax system is likely to be distinctly different from the present system and in any event, difficult to "simulate" using current data.

Thus for practical reasons incorporated businesses are considered to define a "tax base" distinct from individuals. Loans, grants, subsidies and tax credits therefore, will be considered as accruing to firms rather than the owners of firms. With this assumption, neutrality of the corporate tax system can be defined as the equality of effective tax rates and the system can then be regarded as "fair" if all firms pay the same taxes per dollar of income.

The effective tax rate faced by small business may be higher if, for example, small businesses are less capital intensive than larger businesses and can therefore make less use of such tax-saving devices as accelerated depreciation. If this were, in fact, the case and it was deemed desirable that all business face the same effective tax rate, there would be a case for special credits, allowances or subsidies for which only small businesses were eligible.

Fairness notwithstanding, it may be desirable on efficiency grounds for all businesses to face the same effective tax rate. In general a market economy will allocate resources to equalize after-tax rates of return. If after-tax rates of return are also equalized across sectors and effective tax rates are the same in each sector, before-tax rates of return are also equalized. In this case there is no reallocation of resources which can increase the output of the economy.

If, however, effective tax rates differ across sectors, being lower, for example, in sectors where small businesses are found, the equalization of after-tax rates of return will not bring about equality of before-tax rates of return. In this case the before-tax return in the small business dominated sector would be lower than elsewhere and output could be increased by moving resources into other sectors. Moreover, any subsidies awarded to small business would be output reducing (allocatively inefficient) in that they would draw resources to a lower valued use.

An analysis of inter-sectoral and inter-size class differences in effective tax rates reveals, first, whether the tax system is "fair" and allocatively neutral and, second, whether, other things being equal, measures which encourage additional small business activity will make the best use of the nation's resources.

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PRINCIPAL OBSERVATIONS AND CONCLUSIONS

1. Over one half of all incorporated firms did not pay tax in 1977. More than 60 percent of the smallest firms did not have any taxable income in the same year. Thus for a significant majority of firms there is no question of unfair taxation since they pay no tax.

2. As it stands, the tax system is obviously an inappropriate device for conveying assistance to firms which do not and may never pay taxes.

3. In 1977 smaller taxpaying firms had an average tax rate on book profits 10 percentage points lower than the largest firms.

4. The tax measures studied provided tax savings of $1.7 billion in 1977. The largest components of this were: (a) The small business tax credit, $748 million; (b) The manufacturing and processing profits deduction, $264 million; and (c) The three percent inventory allowance, $260 million.

5. At least $780 million in taxes was deferred in 1977 due to the use of the capital cost allowance rather than book depreciation in the determination of taxable income. This deferral of taxes provided a benefit of approximately $55 million in 1977. The total benefit will depend upon the length of time the tax is deferred.

6. Most tax credits and deductions favour larger firms; the small business tax credit more than corrects for this. A small business tax credit of three to five percentage points would be enough to equalize effective tax rates in most industries.

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THE DATA

The source of taxation data presented in this report is the Statistics Canada unweighted sample of 1977 T-2 Corporate Taxation returns. The data include all corporations reporting total assets of $5 million or more. Below the $5 million threshold, corporations were sampled. A detailed discussion of the sampling techniques may be found in Statistics Canada, Corporation Financial Statistics, 1977 Catalogue 61-207.

The data file used in the analysis was provided by the Economic Council of Canada. Their version of the file excluded financial institutions, all levels of government corporations and public utilities. The remaining 14,563 businesses were stratified into twenty-four industries (See Appendix B). Firms within each industry were sorted by total revenue into six size classes, and the characteristics measured on each firm were summed across firms. Thus only aggregated data was available for analysis, thereby preserving taxpayer confidentiality.

Data for each size class within an industry included income and expense items as recorded on the profit and loss statement including current and deferred tax provisions; items required to reconcile book profits to taxable income (i.e. capital cost allowance, three percent inventory allowance etc.) and tax deductions such as the small business deduction, the manufacturing and processing deduction and investment tax credits. A detailed list may be found in Appendix B.

To facilitate analysis the Review had the sample file stratified into tax paying corporations and non-tax paying corporations before making the industry and size class breakdown. The importance of this will be seen in the subsequent analysis.

It should be noted that virtually all the percentages presented in the paper are subject to sampling variation. While confidence intervals have not been presented it is generally the case that inferences drawn from comparison of the point estimates reported in this paper would be supported by a comparison of the relevant interval estimates.

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DEFINITIONS

The following definitions of Book Profits, Net Cash Revenue and Taxable Income were used in the study.

Book Profits

Book profits was determined as total revenue less total expenses. Total revenue includes sales of products and services, interest income, capital gains, royalties and dividends. Total expenses include costs of material, wages and salaries, and other legitimate costs of business but excludes current and deferred income taxes, (See Appendix B).

Net Cash Revenue

An approximate net cash revenue was calculated by adding back depreciation, depletion, book capital losses and twice taxable capital gains to book profits. From this, book capital gains were subtracted to arrive at net cash revenue. There are, however, some non-cash items still included in this definition; distortions are minimal as the major items have been removed.

Taxable Income

Taxable income is net cash revenue less capital consumption allowances, taxable capital gains, 3% inventory allowance, tax exempt income (dividends and subvention income), prior year losses and other special allowances. Taxable income/loss was available directly on the data file.

Effective Tax Rates

The effective tax rate of the corporation is the ratio of current taxes payable (federal and provincial) to Book Profits.

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TAXPAYERS AND NON-TAXPAYERS

Table 1 presents the percentage of firms paying tax and not paying tax by size class. The percentage of firms not paying tax declines from just over 60 percent in the smallest size class to about 29 percent of the largest firms. Tax statistics based on all corporations showed that 53 percent did not pay taxes in 1977.

These firms did not pay taxes because they had no taxable income. The important fact to determine is whether or not they made use of any, or all, of the available tax credits and allowances to achieve this tax-free status. In aggregate non-taxpayers did not make use of all available credits and allowances to attain their tax-free status.

TABLE 1

All Industries

1977 T-2 Sample File

	Percentage of Firms Not Paying Tax	Percentage of Firms Paying Tax
Less than 250,000	60.5	39.5
250,000-500,000	42.3	57.7
500,000-1,500,000	37.7	62.3
1,500,000-5,000,000	37.3	62.7
5,000,000-25,000,000	35.7	64.3
25,000,000 Plus	28.9	71.1
Corporate Tax Statistics*	53.2	46.8

* This includes industries excluded from the sample file.

Non-Taxpayers

Looking at net cash revenue, which is essentially book profit before the application of CCA (or depreciation) half the size classes (54%) in the non-taxpaying population had a loss. These firms obtained their tax-free status without the application of any tax based deductions. If we consider book profits, which includes depreciation, 75% of the size classes had a loss on operations, and thus did not require "accelerated depreciation" to reduce their taxable income to zero.

As Table 2 shows most non-taxpayers in the largest size class did not have a loss. After taking some or all of their capital cost allowances, inventory deductions and

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losses carried forward, they were able to report zero taxable income. These firms did not use any of the small business deduction to which they might have been entitled.

The finding that over 60% of the businesses in the smallest size class and over one-third of all businesses with sales revenue below $25 million pay no income tax has a number of implications. First, for a significant majority of the smallest firms, there can be no question of unfair taxation since they pay no tax.

Secondly, for the non-taxpayers before and after-tax returns are the same. These firms must be earning lower before-tax rates of return than tax-paying firms. They are, therefore, making relatively poor use of the resources at their disposal. To the extent that the non-taxpayers are concentrated in the smaller size classes there is evidence that resources devoted to these businesses are not in their highest valued use.

Third, to the extent that non-taxpayers are more prevalent in the smaller size classes, there is no case on either fairness or efficiency grounds for additional assistance to such businesses.

Fourth, the majority of the smallest businesses and a significant fraction of businesses with annual sales revenue under $25 million make no use of either capital cost allowance or the small business deduction. Changing these measures will not induce this group of firms to change their behaviour in any way. The majority of the smallest incorporated businesses simply remain untouched by changes in the capital cost allowance or the corporate tax rate.

TABLE 2

Non-Taxpaying Population

	Percentage Of Cells With Negative Net Cash Revenue	Percentage Of Cells With Negative Book Profits
Less than 250,000	79%	96%
250,000-500,000	61	73
500,000-1,500,000	68	90
1,500,000-5,000,000	55	76
5,000,000-25,000,000	33	76
25,000,000 Plus	5	26

Finally, it has been shown in "A Profile of Small Business in Canada" that some 56% of the firms which fall into the smallest size category are in transition, that is, either starting up or are going out of business. The other 44% of the smallest firms are small because the goods and services they provide are most efficiently produced by small

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businesses. Thus, what is normally regarded as the small business sector is, in fact, composed of two sectors, a small business core and a periphery. The core small business will generally be paying income tax, may well be earning before-tax returns equal to those earned by larger businesses and may not require "assistance" of any kind.

The peripheral or transition small business is virtually certain not to be paying income tax. This periphery is composed of two types of firms, those which are not earning and never will earn their opportunity cost, and those which are not earning but may eventually earn their opportunity cost. Because these firms have no taxable income, tax measures of the type described above can not be used to support them.

Taxpayers

For taxpayers the concern is effective tax rates. Do smaller firms pay higher taxes? As Table 3 illustrates smaller firms have lower effective tax rates than larger firms when only the taxpaying population is considered. Far too often statistics based on both taxpayers and non-taxpayers are reported as evidence that smaller firms have higher effective tax rates than large firms. The figures in the table are based on the sample data. Note how insensitive the tax rate of the large corporations is compared to that of small corporations when calculated on the wrong population. This follows from the previous discussion of non-taxpayers where it was shown that smaller non-taxpayers generally have a loss on operations while large non-taxpaying firms have a profit.

Table 3

Effective Tax Rates by Firm Size:
Correct and Incorrect Methods

Population	Firm Size $250,000 to $500,000	Firm Size Over $25,000,000
Correct:		
Taxpayers Only	19.5	31.2%
Incorrect:		
Taxpayers and Non-Taxpayers	30.1	28.2%

As reported in Table 4 for the sample of taxpaying firms as a whole, the effective tax rate on the book profits increases almost continuously as firm size increases. The effective tax rate paid by the largest firms (1977 sales revenue greater than $25 million) exceeds that paid by the smallest firms (1977 sales revenue under $250,000) by 10 percentage points. The effective tax rate paid by firms in the second largest size class (1977 sales revenues between $5 million and $25 million) exceeded the effective tax rate paid by the smallest firms by 13 percentage points.

When the data are examined on an industry basis very little deviation from the aggregate pattern appears. Of the 21 completely represented sectors the effective tax rate paid by firms in the largest size class exceeds the effective tax rate paid by firms in the smallest size class in 20 cases. The same is true of the effective tax rates of firms in the second largest and smallest size classes respectively.

Although there are a few exceptions, the general picture is one of an effective tax rate on book profits which is at its lowest for firms with annual sales under $250,000 and increases steadily with firm size.

This pattern of effective tax rates has a number of implications. The tax system can not be regarded as being unfair to small business. Smaller businesses face lower effective tax rates than do larger businesses and the smallest businesses face the lowest tax rates of all.

If after-tax rates of return tend to equalize across sectors and size classes, the before-tax rate of return to small business will be lower than the before-tax rate of return to large business. Society is, in effect, devoting too much of its resources to small business. Some of the resources currently allocated to small business activity could be used to greater advantage elsewhere. Subsidy programs which have the effect of drawing additional resources to the small business sector are drawing them to a lower valued use. Such a policy is only defensible on grounds other than the efficient allocation of resources.

To this point we have seen that, compared to large businesses, a greater proportion of small businesses do not pay taxes and, for those that do pay taxes, the effective tax rates are about 10 percentage points lower. We next investigate why small business pays less tax per dollar of profit. Also of interest is the extent of the tax-saving resulting from each of the tax measures and the manner in which tax-savings are distributed across firm size classes.

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TABLE 4

Effective Tax Rates by Industry And
Size Class: 1977 T02 Sample File - Taxpayers

Industry	Percent Not Paying Tax	Size Groups: Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
All Industry	43.1	20.9	19.5	24.5	30.7	34.1	31.2
Mining and Mine Products	45.2	33.4	14.3	12.4	23.9	26.2	29.6
Food and Beverage	38.7	16.4	18.2	18.9	28.6	31.8	36.9
Forest Products and Other	46.8	20.3	10.0	20.3	27.5	28.4	26.1
Textile II	46.3	18.7	24.8	22.2	34.0	33.9	25.9
Furniture	43.7	18.2	15.5	14.9	26.2	37.9	-
Construction	46.0	13.4	24.0	28.8	34.9	33.3	46.3
Wholesale	37.7	25.9	21.8	29.5	29.8	41.2	35.5
Hotels, Motels, Restaurants	57.6	15.3	8.3	24.6	30.0	41.9	34.6
Fabricating	38.0	17.5	19.9	23.2	32.8	35.1	32.5

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Industry	Percent Not Paying Tax	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Agricultre	52.2	15.7	16.2	22.5	20.3	27.0	-
Business Services	42.4	21.9	28.7	36.4	38.3	41.2	48.2
Chemical	41.2	19.5	19.3	26.9	34.8	40.3	30.6
Transport	52.4	23.7	21.0	45.1	34.6	37.0	39.4
Retail Trade II	48.1	21.8	24.8	22.0	28.3	37.0	41.9
Paper and Printing	40.9	15.3	22.2	25.9	24.0	34.9	32.9
Other Services	53.8	26.1	23.2	32.3	31.8	34.9	41.2
Retail Trade III	37.6	21.3	24.8	24.1	37.0	40.7	43.2
Retail Trade I	39.7	22.9	24.6	23.4	23.4	25.4	40.8
Machinery and Electrical	42.4	20.4	19.3	30.6	34.4	35.7	39.6
Leather and Textile I	28.4	21.7	18.8	20.3	26.2	39.7	34.8
Transport Equipment	47.9	13.8	27.5	28.6	29.5	32.2	33.5
Oil and Petroleum	35.3	-	-	26.4	32.5	41.5	25.7
Tobacco	N/A	-	-	-	-	-	31.3
Fisheries	N/A	22.6	-	-	-	-	-

Note: - indicates insufficient data, or no firms in the sample.

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TAX BASED ASSISTANCE AND SMALL BUSINESS FINANCING

The tax expenditures studied here affect a firm in one of two ways. The capital cost allowance and the three percent inventory allowance reduce a firm's taxable income, possibly to zero. Tax credits such as the small business tax credit and the manufacturing and processing profits credit reduce but cannot eliminate taxes payable.

Firms may have achieved a non-taxpaying status with or without the use of any of the available allowances. It is therefore impossible to determine the value of these allowances to non-taxpayers because of the aggregated nature of the data.

Taxpayers, on the other hand, can be assumed to have made full use of all allowances and credits available to them. The tax-saving they have been able to effect can therefore be calculated.

For this reason the analysis is confined to taxpayers. The study of this group reveals the tax saving (per thousand dollars net cash revenue) that these measures have provided this group of firms. The aggregate tax saving resulting from all tax measures examined is reported in Table 5.

TABLE 5

Business Financing Assistance
of Tax Measures - 1977

Source	Amount ($ millions)
Small Business Tax Credit	748
Manufacturing and Processing Profits Deduction	264
Investment Tax Credit	190
Other Tax Credits	149
3% Inventory Allowance	260
Excess of CCA Over Depreciation*	55
Total	1666

Source: Statistics Canada, Corporation Taxation Statistics.

* 1 year benefit estimated by the authors; actual taxes were reduced by at least 780 million.

Three Percent Inventory Deduction

In March 1977 the 3 percent inventory deduction was introduced as a partial compensation to offset the effect of inflation on the cost of carrying inventory. The allowance is calculated on the value of inventories held at the beginning of the tax year for tax years commencing after December 31, 1976. Thus the full effect of the deduction is not reflected in the 1977 data.

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Taxable income was reduced by almost $700 million giving an estimated tax relief of $240 million. In 1978 the tax relief was about $391 million on a $1.25 billion reduction in taxable income.

The three percent inventory deduction is subtracted from net cash revenue when determining taxable income. Without the deduction taxable income would be higher, more taxes payable, and hence les funds would be retained in the firm. Table 6 presents estimates of the extra dollars retained per $1,000 of net cash revenue due to this measure. Because the presence or absence of a deduction affects taxable income and hence the tax rate, it is not possible to determine the actual benfit of this deduction with these data. Instead the marginal effect of the deduction (that is, in the presence of all other deductions) is calculated assuming:

a) a marginal tax rate of 48% - an approximate upper bound,

b) total taxes paid as a percent of taxable income when all deductions are present - a lower bound.

The larger the firm (in terms of revenue) the larger the absolute deduction, rising from 0.2% of net cash revenue for the smallest size class to 2.2% for those in the $5-$25 million revenue class. Since the effective tax rate of small firms is significantly lower (mainly because of the small business tax credit) than that of larger firms they do not appear to "benefit" as much from the deduction. One doubts, however, that small firms would offer to pay a higher tax rate in order to increase their benefit from the 3% inventory deduction.

The firms benefiting most from the deduction are those in manufacturing, wholesaling and retailing industries. For instance the largest size class in the wholesale industry retained $26 more per 1,000 of net cash revenue because of the deduction. On average, though, the benefit ranged from 54 cents to just over $9.00, as illustrated in Table 6.

TABLE 6

The Contribution of the Three Percent Inventory Deduction to After-Tax Profits Per $1,000 NCR
All Corporations Paying Tax, 1977

	Size Class					
Item	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Deduction as Percent Of Net Cash Revenue	.2%	.6	1.0	1.6	2.2	2.0
Maximum Contribution to After-tax Profit Per $1,000 Net Cash Revenue	$1	$3	$5	$8	$11	$10
Minimum Contribution to After-tax Profit Per $1,000 Net Cash Revenue	$.5	$2	$3	$6	$9	$9

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Capital Consumption Allowance

The Capital Cost Allowance (CCA) provides corporations with a deduction against income to reflect the wear on fixed assets. Each type of depreciable asset is depreciated at a rate of the asset class to which it belongs. These tax rates generally exceed the economic or book decay rates used by companies and hence the term accelerated depreciation. Accelerated depreciation reduces the tax liability of the company when the asset is relatively new thereby placing more funds in the hands of the company earlier than would otherwise have been the case. Ultimately CCA charged will be less than actual depreciation and more taxes will be payable. Thus the net effect of fast asset write-off is the deferral of income tax. Tax can be deferred indefinitely if a company continues to make capital investments.

The deferral of taxes can be viewed as an interest free loan from the government. Suppose that a company's book depreciation is $D and its CCA charge is $C. If the effective tax rate is t then the size of the loan in the current year is:

$$S = t(C-D) \qquad (1)$$

Investing the tax-saving, S, for a year at an after-tax yield of i(1-t) brings the firm additional income of:

$$B = i(1-t)S = i(1-t)t(C-D) \qquad (2)$$

Expression (2) is the one period benefit to the tax-payer resulting from the excess of the capital cost allowance over the rate of economic depreciation during that period.

Suppose now we take an investment of $I and determine the present value of both the total tax saving and the total benefit to the taxpayer resulting from the acceleration of deductions available under the capital cost allowance. If investment I is depreciated according to the declining balance method at the capital cost allowance rate of ϕ rather than the economic decay rate δ, the present value of the tax-saving involved is:

$$PS = [tr(\phi - \delta)/(r+\phi)(r+\delta))]I \qquad (3)$$

where r = the discount rate.

The tax-saving PS is an asset which will yield the after-tax return i(1-t) per period in perpetuity. The present value of this benefit is

$$PB = \frac{i(1-t)}{r} \quad \frac{tr(\phi - \delta)}{(r+\phi)(r+\delta)} \quad I \qquad (4)$$

Notice that where the discount rate is equal to the after-tax return of the tax-saving "asset", the present value of the benefit from the tax-saving is just equal to the tax-saving itself.

In 1977, capital cost allowance claimed by all corporations exceeded book depreciation by 25% ($12.6 billion versus $10.0 billion). Assuming that firms had an average tax rate of 30% the tax saved would be about $780 million.

This figure is misleading for a number of reasons. First, smaller firms tend to use CCA rates for both tax and book

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purposes. As a result, the difference between total CCA and total depreciation for all taxpayers is understated. Secondly, corporations may use CCA only as required. For instance, if a firm has a prior year loss on operations, then less CCA will be claimed since a loss can only be carried forward five years while CCA may be deferred indefinitely. Thus CCA charges will be saved until a firm has taxable profits. Also, a firm will only use as much CCA as necessary to reduce its taxable income to zero. This amount may be less than book depreciation.

As a consequence only tax-paying firms can be deemed to have used the maximum amount of CCA claimable. Even among tax-paying firms, CCA claimed may be less than book depreciation if the firm's assets are relatively old. The $780 million tax-saving noted above is, in fact, only a deferral of taxes. If these taxes were payable the following year, the benefit resulting from this tax deferral could be calculated using expression (1). If i = 10% and t = 0.30 then the one year deferral would result in an increase in after-tax income of (.10)(.70)(780) = $55 million for the firms involved.

Table 7 summarizes the excess of the capital cost allowance over book depreciation by size class for taxpaying firms in 1977. The sample of taxpayers, despite being just over 8,000 in number, represents about 40% of all CCA claimed in Canada in 1977.

For the two smallest size classes depreciation actually exceeds CCA. These firms may be regarded as paying their deferred taxes. This implies that the assets of the firms are relatively old, that is, they are no longer adding significantly to their asset base. It should be noted, however, that firms in these two classes often use the CCA claimed as their book depreciation figure. If this does not occur randomly, the CCA-depreciation difference will be systematically misstated. It would therefore be unwise to read too much into the excess of depreciation over CCA in the smallest two size classes.

In the larger size classes CCA claimed exceeded depreciation by a large margin in 1977. The tax-saving (expression (1)) for firms with annual revenues of more than $25 million was over $38 per $1,000 Net Cash Revenue in 1977 (see lines 5 and 6, Table 7). The one period benefit resulting from this deferral would be (.10)(.70)($38) = $2.66 per $1,000 net cash revenue if deferred taxes could be invested at 10% and the effective tax rate were 30%.

The present values of the total tax-saving and total benefit resulting from accelerated depreciation could be calculated using exprssions (3) and (4) respectively. Since we have no information on the differences between ϕ and δ in each size class, our PS and PB estimates would be linear functions of the one period savings and benefits values and would, therefore, convey no additional information.

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TABLE 7

The Tax Benefit of Accelerated Depreciation
1977 T-2 Sample
Taxpayers Only

Item	Size Groups: Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
1. CCA Claimed ($,000)	6,541	9,045	36,639	135,678	647,594	4,224,915
2. Depreciation ($,000)	8,543	10,954	35,536	118,321	508,858	3,017,889
3. Net Excess: 1-2 ($,000)	-2,002	-1,909	103	17,357	138,736	1,207,026
4. 3 As a Percent of Net Cash Revenue	-4.3	-4.1	0.1	3.4	5.2	8.6
5. Maximum Contribution To After-Tax Profits Per $1,000 NCR	-$21	-$20	$.50	$16	$25	$42
6. Minimum Contribution To After-Tax Profits Per $1,000 NCR	-$12	-$11	$.25	$13	$22	$38

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TAX CREDITS

The largest tax expenditures on business are in the form of two tax credits, the small business tax credit and the manufacturing and processing profits deduction. Table 8 illustrates the distribution by size class of those claiming the small business tax credit or the manufacturing and processing profits deduction. Each will be discussed in turn.

TABLE 8

Percentage of Firms Claiming The Small Business Tax Credit or Manufacturing and Processing Profits Deduction
All Taxpayers 1977 T-2 Sample File

	Percent of Firms			
Size Class	SBTC %	MPPD %	Both %	Neither %
Less than 250,000	76.1	6.4	6.1	23.5
250,000-500,000	83.4	20.4	19.6	15.8
500,000-1,500,000	83.6	34.2	30.1	12.3
1,500,000-5,000,000	62.0	43.0	24.2	19.2
5,000,000-25,000,000	20.0	51.2	6.3	34.8
25,000,000 Plus	3.6	55.2	1.0	41.1

Small Business Tax Credit (SBTC)

The small business deduction is a credit against corporate tax payable which is available to Canadian controlled private corporations with active business income. The deduction is 21% of the first $150,000 of taxable income for each company or associated group of companies (except when the cumulative deduction account is close to the total limit of $750,000).

The deduction may not be claimed once a company (or group of associated companies) has reached a cumulative business limit of $750,000 since its 1971 taxation year. However, the cumulative deduction account may be reduced by the distribution of dividends to shareholders. Thus many small businesses should continue to qualify for the small business deduction if they arrange their affairs accordingly. The November 12 Budget of 1981 has modified some of these conditions.

The total reduction in tax payable due to the small business tax credit has grown from $636 million in 1974 to $748 million in 1977. Department of Finance officials have estimated that the total credit in 1980 may be as much as $1.2 billion. Some of this growth can be attributed to changes in the limits in 1976 while a portion may also be due to a "learning effect".

Of firms with sales of less than $1.5 million, four in five claimed the small business tax credit in 1977. One in five firms with sales between $5 million and $25 million received

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some tax relief from the SBTC. Indeed, at least some of the largest firms in Canada had part of their taxable income taxed at the small business rate (Table 8). Thus, virtually all firms with revenues of less than $25 million benefited to some extent from the SBTC. The smallest two size classes in industries such as Forest Products, Textiles, Furniture, Fabricating, Machinery and Electrical, and Printing and Paper achieved close to the full 21 points deduction in tax payable.

Table 9 illustrates what the tax rates would have been without the SBTC. It is possible that owners of closely held firms would make adjustments to mitigate the effect of the elimination of the tax credit. Such adjustments have not been taken into account here.

TABLE 9

Effective Tax Rates Without the Small Business Tax Credit
All Taxpayers - 1977

Item	Size Groups					
	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Tax Rate Without SBTC	32.1	30.5	35.4	35.0	34.4	31.1
Tax Rate With SBTC	20.7	19.5	24.5	30.7	34.1	31.2
Contribution to After-Tax Profit Per $1,000 NCR	$104	$109	$96	$34	$7	$0

If the SBTC were eliminated, but all other deductions and credits preserved, then effective tax rates on book profits across size classes in the aggregate would be approximately equalized. The $748 million tax expenditures on the SBTC is clearly more than necessary to equalize effective tax rates. In this sense it has had the effect of raising the after-tax profits of "successful" small firms relative to those of larger firms.

The Small Business Deduction and Dividend Payments

Until the recent budget, a firm could have retained eligibility for the small business deduction as long as its cumulative deduction account did not exceed $750,000. The cumulative deduction account is essentially the retained earning of the firm, and it can be reduced by paying out dividends.

The small business tax deduction therefore contains an incentive which is somewhat perverse from the point of view of small business financing. The deduction has the effect of encouraging small businesses to pay out earnings rather than retain them. As a result leverage ratios will be higher and growth slower than it might otherwise be.

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In order to determine whether the small business deduction has encouraged larger dividend payouts, the ratio of dividends to net cash income was calculated for each size class for firms that claimed the small business deduction and for all taxpaying firms. As reported in Table 10 firms claiming the small business deduction paid out a smaller fraction of their net cash income than firms which did not claim the deduction. This difference is often quite large and it indicates, albeit in a crude fashion, that the incentive to pay out dividends in order to retain eligibility for the small business deduction was of little practical importance in 1977.

It should be noted, however, many small tightly held firms have equity capital in the form of loans from shareholders. Thus some of the firm's interest payments should be "dividends", thereby making the figures in Table 10 closer to the all taxpayer figures. Of course, for the closely held small firm the owner could reinvest the dividends in the form of loans or equity thereby keeping the funds in the business.

TABLE 10

Dividends as a Percentage of Net Cash Revenue

	Size Groups					
Item	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Taxpaying Firms Claiming the SBTC	7.6	6.7	11.9	8.7	6.5	7.8
All Taxpayers	8.8	19.7	12.0	19.8	14.3	18.3

Manufacturing and Processing Profits Deduction

A corporation engaged in the manufacturing or processing of goods in Canada for sale or lease will pay tax of 20 percent on that portion of its taxable income eligible for the small business tax credit and 40 percent on the balance of its taxable income, to the extent that the taxable income represents Canadian manufacturing and processing profits (income from farming, fishing, construction, transportation and retailing are excluded). This credit has declined in importance since 1974, falling from $374 million to $264 million by 1977, a decrease of 30 percent (in nominal terms).

Despite the exclusion criterion some firms in every industry qualified for the tax credit. This may reflect problems with SIC coding or merely a wide interpretation of manufacturing and processing.

As indicated in Table 11 the percentage of firms utilizing the tax credit increases with increasing firm size. If the allocation of firms to SIC industries is accurate, then it is difficult to explain why small "manufacturers" do not utilize the deduction, except perhaps because they are not aware of its existence.

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Table 11 also demonstrates that the elimination of the manufacturing and processing profit tax credit would increase the effective tax rate disparity between large and small business in the presence of all other deductions and tax credits. The table also indicates that firms with sales between $1.5 million and $25 million benefit most in relative terms from the MPPD.

TABLE 11

The Effect of Eliminating the Manufacturing and Processing Profits Tax Credits
All Taxpayers, 1977

	Size Groups					
Item	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Effective Tax Rate Without MPD	21.2	20.3	25.6	32.2	36.0	32.7
Effective Tax Rate With MPD	20.9	19.5	24.5	30.7	34.1	31.2
Contribution To Profit Per $1,000 NCR	$3	$8	$11	$27	$16	$12

Investment Tax Credit

The investment tax credit is for qualified expenditures on scientific research, new buildings or machinery and certain transportation equipment. Rates were for 5%, 7⅓% or 10% in 1977 depending upon the region of the country where the investment took place.

Corporate taxes were 190 million less in 1977 because of the credit. As with the MPPD the investment tax credit claimed increases with firm size. Effective tax rates with, and without, the credit are presented in Table 12. Elimination of this credit would also increase the disparity in effective tax rates across firm size. Note that this conclusion is only true if all other deductions and credits are preserved, and the firm does not alter its activities to mitigate the increase in taxes payable. Since much effort by corporations, and individuals is devoted to minimizing taxes, the long run result of eliminating a tax credit are not readily discernible.

TABLE 12

The Effect of Eliminating the Investment Tax Credit on Effective Tax Rates

Item	Size Groups					
	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Effective Tax Rate Without Investment Tax Credit	21.2%	19.8	24.9	31.4	34.9	32.5
Effective Tax Rate With the Investment Tax Credit	20.9%	19.5	24.5	30.7	34.1	31.2
Contribution to After-Tax Profit Per $1,000 NCR	$2	$2	$4	$6	$7	$10

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SUMMARY

While most of the deduction and credits "favour" large businesses the small business tax credit more than compensates small businesses. The tax-savings due to these measures is summarized in Table 13. Tax-savings are greatest in relative terms for those with sales between $1.5 million and $5 million. The largest small firms receive about the same benefit per $1,000 NCR as the very largest firms.

TABLE 13

Extra Dollars Retained in a Firm Due To Tax Credits and Deductions All Taxpayers, 1977

	Size Groups					
Item	Less Than $250K	$250K-$500K	$500K-$1.5M	$1.5M-$5M	$5M-$25M	More Than $25M
Excess CCA Over Depreciation	-12	-11	0	13	22	38
3% Industry	0	2	3	6	9	9
SBTC	104	109	96	34	7	0
MPPD	3	8	11	27	16	12
ITC	2	2	4	6	7	10
Total Per $1,000 NCR	97	110	114	86	61	69

Changes in the tax system which have characterized fiscal policy during the last twenty years have generally conferred a disproportionate benefit on large business. While the small business tax credit has offset these advantages, the measure has more than corrected for the differential impact of accelerated depreciation, the three percent inventory deduction and other deductions. Indeed, the evidence is that a small business deduction of three to five percentage points would be sufficient, in most sectors, to equate the effective tax rates of the largest and the smallest businesses.

APPENDIX A

THE TOTAL TAX BURDEN OF CORPORATE STOCKHOLDERS

It has been concluded that, insofar as corporation tax is concerned, small businesses face lower effective tax rates than large businesses. The real question is, however, whether the effective tax rates faced by the owners of small and large businesses differ and, if so, in what manner. It is therefore necessary to demonstrate that when dividend taxes and tax credits, and capital gains taxes are taken into account the effective tax rate faced by the ultimate recipients of corporate income varies between large and small businesses in the same way that the effective corporate tax rate varies.

Corporate profits are actually taxed both at the corporate level and as dividend income when paid out or as a capital gain if not paid out. In recognition of the fact that this would constitute double taxation of stockholder's income, the stockholder is allowed to claim a dividend tax credit, and capital gains are taxed at one-half the stockholder's marginal tax rate.

The computation of the stockholder's tax liability on the dividend component one dollars worth of corporate profit is as follows:

$$TxD = 1.5\delta(1-t_c)t_p - .25(1.5\delta(1-t_c)) \qquad (1)$$

where

δ = The fraction of after-tax profits paid out in dividends.

t_c = The effective corporate tax rate.

t_p = The stockholder's average personal tax rate.

The first term in (1) is the tax payable on dividend income. The second term is the dividend tax credit.

The tax liability on the capital gain component of one dollar's worth of corporate profit is more difficult to compute. If capital gains were taxed on an accrual basis, the liability would be

$$TxG = .5(1-\delta)(1-t_c)t_p \qquad (2)$$

In Canada, however, capital gains are taxed only upon realization so that the tax can be postponed as long as shares in the corporation are not sold. In this case the present value of the capital gains tax liability on one dollar of corporate profit earned in the current period will be smaller the longer realization is postponed. If realization is postponed for T periods, then the capital gains tax liability would be

$$TxG' = .5(1-\delta)(1-t_c)t_p\, e^{-rT} \qquad (3)$$

where

r = The shareholder's discount rate = after-tax rate of return to private saving.

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If it is assumed that capital gains are realized after T periods and are taxed on realization, the total tax burden on one dollar in corporate profits, TxT, is

$$\begin{aligned} TxT &= TxD + TxG' + t_c \\ &= 1.5\delta(1-t_c)t_p - .25(1.5\delta(1-t_c)) \\ &\quad + .5(1-\delta)(1-t_c)t_p \; e^{-rT} + t_c \end{aligned} \qquad (4)$$

The first question that can be answered using expression (4) is whether a reduction in a corporation's effective tax rate also results in a reduction in the total tax liability at the levels of both the corporation and its shareholders. This will be the case if $d(TxT)/dt_c$ is greater than zero. It turns out that this is so for a set of t_p values which include all relevant average personal tax rates. It can therefore be concluded that regardless of the time taken to realize capital gains, the owners of a corporation facing a lower effective corporate tax rate also pay lower taxes.

The second question which may be addressed using expression (4) is whether the total tax burden of a corporation's owners increases more or less than proportionally with the corporate tax rate. If, for example, a change in t_c brings about a less than proportionate change in TxT, then a reduction in t_c such as that observed in the case of small business involves a less than proportionate reduction in the total or integrated tax burden of the corporation and its owners. A simple comparison of the effective corporate tax rates of large and small corporations would then overstate the net advantage to the owners of the corporations facing the lower effective corporate tax rate.

The proportionality question can be examined by evaluating (4) for the two polar values of t_c, one and zero. If t_c = 1, all profits are taxed away at the corporate level and TxT is, of course, also one.

If t_c = 0, there is no tax at the corporate level. If TxT and t_c are to be proportional, it must also be the case that TxT = 0. If TxT is greater than zero, then changes in TxT are less than proportional to changes in t_c. If TxT is less than zero when t_c = 0, then changes in TxT are more than proportional to changes in t_c.

In order to calculate TxT when t_c = 0, it is necessary to make some assumption about the realization of capital gains. The first assumption is that equity is held indefinitely so that the present value of the capital gains tax liability on the retained portion of one dollar in current profit approches zero. This turns out to be equivalent to assuming that all after-tax profits are paid out in dividends (δ=1). Under either of these assumptions TxT will change proportionately with t_c for t_p = 25%.

To elaborate, if the average personal tax rate of the stockholders is 25% a decline in t_c implies a proportionate decline in TxT. If the average personal tax rate of the stockholders is less than 25%, a decline in t_c implies a more than proportionate decline in TxT. If the average personal tax rate of the stockholders is more than 25%, a decline in t_c will bring about a less than proportionate decline in TxT.

For an Ontario resident, an average personal tax rate of 25% or more implies taxable income of $12,000 or more. Thus, under the first set of assumptions (which effectively eliminate capital gains considerations), the lower effective corporate tax rate for small business overstates the advantage obtained by small business owners (shareholders)

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if their personal taxable income exceeds $12,000 and understates the advantage if their taxable personal income is less than $12,000.

It is worthwhile to note that under this set of assumptions, there can be an "over-integration" of personal and corporate income in the sense that for t_p less than 25% there are t_c values for which TxT is zero or negative, that is, for which the corporation and its owners taken together pay no tax on corporate income. Thus, if t_p = 10%, and all after-tax profits are paid out, TxT = 0 for $t_c \leq$ 18.4%.

A second assumption that might be made when evaluating (4) given t_c = 0 is that capital gains are realized during the tax year. This is equivalent to assuming that capital gains are taxed on an accrual basis.

Under this assumption, setting t_c = 0 implies that TxT is

$$TxT = 1.5\ t_p - .375 + .5(1-\delta)t_p \qquad (5)$$

If the payout ratio is zero then there is no t_p value at which (5) holds and thus TxT = 0. It will always be the case that TxT changes less than proportionately with t_c. It will always be the case, therefore, that the total tax burden on corporate income rises or falls less than proportionately with the corporate tax rate.

If the pay-out ratio is non-zero, there are t_p values for which the proportionality of TxT and t_c is maintained. Indeed, proportionality is maintained for any combination of t_p and values such that the following equality holds:

$$t_p = (.375)/(\delta+.5) \qquad (6)$$

To illustrate, the following combination of δ and t_p values would yield TxT-t_c proportionality:

t_p	δ
6.25%	.10
10.71%	.20
14.06%	.30
16.67%	.40

When δ = 1, of course, proportionality occurs at t_p = .25. The introduction of capital gains considerations therefore serves simply to reduce the average personal tax rate at which the proportionality of TxT and t_c occurs. For δ = .30 and Ontario resident shareholders, for example, proportionality exists for a taxable income of $1400. Taxable incomes higher than this imply that TxT changes less than proportionally with t_c.

Depending on the weight attached to capital gains, then, a decline in t_c implies a less than proportional decline in TxT for all likely taxable incomes of shareholders. The implication is that, although the owners of small businesses benefit from the lower effective corporate tax rates they face, this benefit is not likely to be as large as the corporate tax rates themselves would imply.

To what extent does our conclusion that small businesses are less heavily taxed than large businesses have to be altered as a result of our analysis of the taxation of dividend and capital gain income? The answer is hardly at all. As is illustrated in Table 14, a 15 point difference in the effective corporate tax rate implies a 14.6 point difference in the total burden assuming 100% pay-out and shareholders with $15,000 taxable incomes. If a 30% pay-out, and immediate

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realization of capital gains is assumed a 15 point difference in t_c results in a 13.4 point difference in TxT.

TABLE 14

TxT and t_c Assuming Shareholders Have $15,000 Taxable Incomes

t_c	TxT with a 100% Pay-out	TxT with a 30% Pay-out and Immediate Realization of Capital Gains
.35	.370	.417
.30	.321	.372
.25	.273	.328
.20	.224	.283

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APPENDIX B

DATE FILE: INDUSTRY AND VARIABLE DEFINITIONS

Table I

The industry structure is different than that used in "A Profile of Small Business in Canada". Because of time constraints it was necessary to accept the Economic Council's 24 industry groupings. Note that Agriculture and Fishing were not analyzed elsewhere in the Review by the Small Business Financing Review.

Table II

The items observed for each industry size class are self explanatory. The data are totals for all firms in that particular cell.

Table III

The components of total revenue and total expenses are illustrated.

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TABLE I

Economic Council Industry	SIC	SIC Industry
Mining and Mine Products	058	Iron Mines
	059	Other Metal Mines
	061	Coal Mines
	063	Petroleum & Gas Wells
	065	Natural Gas Plants
	066	Oil Shale and Bituminous Sand Pits
	071	Asbestos Mines
	073	Gypsum Mines
	077	Salt Mines
	079	Other Non-metal Mines
	083	Stone Quarries
	087	Sand Pits or Quarries
	092	Petroleum Processing
	094	Other Prospecting
	096	Contract Drilling for Petroleum
	098	Other Contract Drilling
	099	Other Services to Mining
	291	Iron & Steel Mills
	292	Steel Pipe & Tube Mills
	295	Smelting & Refining
	296	Aluminum Rolling, Casting & Extruding
	297	Copper and Alloy Rolling, Casting & Ext.
	298	Metal Rolling Casting & Ext. n.e.s.
	341	Cement Manufacturers
	347	Concrete Prod. Manufacturers
	348	Ready-mix Concrete
	351	Clay Products
	356	Glass & Glass Products
	343	Lime Manufacturers
	345	Gypsum Products Manufacturers
	352	Refractories Manufacturers
	353	Stone Products
	354	Mineral Wool
	355	Asbestos Products
	357	Abrasives
	359	Other Non-metallic Mine Products
Food & Beverage	101	Slaughtering & Meat Processors
	103	Poultry Processors
	105	Dairy Factories
	107	Process Cheese
	111	Fish Products
	112	Fruit & Veg. Canners, Preservers
	123	Feed
	124	Flour Mills
	125	Breakfast Cereal
	128	Biscuit
	129	Bakeries
	131	Confectionery

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	133	Sugar Refineries
	135	Vegetable Oil Mills
	139	Misc. Food
	141	Soft Drink
	143	Distilleries
	145	Breweries
	147	Wineries
Forest Products & Other	031	Logging
	039	Forestry Services
	251	Sawmills
	259	Miscellaneous Wood Industries
	271	Pulp and Paper
Textile II	183	Cotton Yarn & Cloth Mills
	193	Wool Yarn Mills
	197	Wool Cloth Mills
	211	Fibre Preparing Mills
	212	Thread Mills
	213	Cordage & Twine
	214	Narrow Fabric Mills
	215	Pressed & Punched Felt
	216	Carpet Mat & Rug
	218	Textile Dyeing & Finishing
	219	Linoleum & Coated Fabrics
	239	Other Knitting
Furniture	261	Household Furniture
	268	Electric Lamp & Shade
	264	Office Furniture
	266	Other Furniture
Construction	404	Building Const.
	406	Highway, Bridge & Street
	409	Other
	421	Special-trade Contractors
Wholesale	602	Livestock
	606	Coal & Coke
	608	Petroleum Products
	611	Paper & Paper Products
	613	General Merchandise
	614	Food
	615	Tobacco Products
	616	Drug & Toilet Products
	617	Apparel & Dry Goods
	618	Furniture & House Furniture
	619	Motor Vehicles & Accessories
	621	Electrical Machinery
	622	Farm Machinery & Equip.
	623	Mach. & Equip. n.e.s.
	624	Hardware Plumbing & Heating
	625	Metal & Metal Products
	626	Lumber & Building
	627	Scrap & Waste Material
	629	Wholesalers, n.e.s.

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Hotel	875	Hotels, Rest. & Taverns
	876	Lodging Houses & Residential Clubs
Fabricating	302	Fab. Struct. Metal
	303	Ornamental & Architectural
	304	Metal Stamping, Pressing & Coating
	305	Wire & Wire Products
	306	Hardware, Tool & Cutlery
	307	Heating Equipment
	308	Machine Shops
	309	Misc. Metal
	381	Scientific & Prof. Equip.
	382	Jewellry & Silverware
	383	Broom, Brush & Mop
	384	Venetian Blind
	385	Plastic Fabricators
	393	Sporting Goods & Toy
	395	Fur Dressing & Dyeing
	397	Signs & Displays
	399	Misc. Mfg. Industry
Agriculture	001	Experimental & Univ. Farms
	003	Institutional Farms
	006	Residential
	011	Livestock Farms
	013	Field Crop Farms
	015	Fruit & Veg. Farms
	017	Other Crop & Livestock
	019	Misc. Specialtry Farms
	021	Services to Agriculture
Business Services	864	Eng. & Scientific
	866	Legal Services
	869	Other Services to Business
	861	Accounting
Chemical & Rubber	161	Rubber Footwear
	163	Tire & Tube
	169	Other Rubber
	201	Synthetic Textiles
	371	Explosive & Ammunition
	373	Plastic & Synthetic Resins
	374	Pharmaceuticals & Medicines
	375	Paint & Varnish
	376	Soap & Cleaning Compounds
	377	Toilet Preparations
	378	Industrial Chemicals
	379	Other Chemicals
Transport	501	Air Transport
	502	Service to Air Transport
	504	Water Transport
	505	Services to Water Transport

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	506	Railway Transport
	507	Truck Transport
	508	Bus Transport
	509	Urban Transit
	512	Taxicab
	516	Highway & Bridge Maintenance
	517	Other Services to Transport
	519	Other Transportation
Retail Trade II	647	Variety Stores
	654	Gasoline Service Station
	658	Motor Vehicle Repair Ships
	692	Florist Shops
Paper & Printing	273	Paper Box & Bag
	272	Asphalt Roofing
	274	Other Paper Converters
	286	Commercial Printing
	287	Engraving, Stereotyping
	288	Publishing
	289	Printing & Publishing
	252	Veneer & Plywood Mills
	254	Sash & Door Planning
	256	Wooden Box
	258	Coffins & Casket
Other Services	859	Other Rec. Services
	874	Laundries, Cleaners, Pressers
	877	Funeral Directories
	879	Other Personal Services
	891	Labour & Trade Org.
	893	Photography
	894	Blacksmith & Welding
	896	Misc. Repair Shops
	897	Services to Bldgs. & Dwellings
	899	Other Misc. Services
Retail Trade III	663	Shoe Stores
	665	Mens Clothing
	667	Womens Ready-to-Wear
	669	Clothing & Dry Goods, n.e.s.
	673	Hardware Stores
	676	Household Furn. & Appl.
	681	Drug Stores
	694	Jewellry Stores
	695	Watch & Jewellry Repair
	696	Liquor, Wine & Beer
	699	Retail, n.e.s.
Retail Trade I	631	Food Stores
	649	Other Gen. Merch. Stores
	652	Tire & Battery
	656	Motor Vehicle Dealers
	691	Book & Stationary
	693	Fuel Dealers
	697	Tobacconists

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Machinery & Electrical	301	Boiler & Plate Works
	311	Agricultural Implements
	315	Misc. Machinery & Equip.
	316	Commercial Refrig. & Air Cond.
	318	Office & Store Machinery
	331	Small Appliances - Electric
	332	Major Appliances - Electric
	334	Household Radio & T.V.
	335	Communications Equip.
	336	Industrial Equip. - Electric
	337	Battery
	338	Electric Wire & Cable
	339	Misc. Electric Products
Leather & Textile I	172	Leather Tanneries
	174	Shoe Factories
	175	Leather Glove
	179	Luggage, Handbag
	221	Canvas Products
	223	Cotton & Jute Bag
	229	Misc. Textile
	243	Misc. Clothing
	244	Womens Clothing
	245	Childrens Clothing
	246	Fur Goods
	247	Hat & Cap
	248	Foundation Garment
	249	Other Clothing
Transport Equipment	323	Motor Vehicle Manufacturers
	325	Motor Vehicle Parts, Acc.
	324	Truck Body & Trailer
	326	Railroad Rolling Stock
	327	Shipbuilding & Repair
	328	Boat Building & Repair
	329	Misc. Vehicle
Oil & Petroleum	365	Pet. Refineries
	369	Other Petroleum and Coal Products
Tobacco	151	Leaf Tobacco Processing
	153	Tobacco Products Mfg.
Fisheries	041	Fishing
	045	Fishery Services
	047	Hunting & Trapping

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TABLE II

DATA FILE CHARACTERISTICS

SBFR Code	Description
EX1	Cost of Materials
EX21	Bad Debt Provision
EX2	Salaries and Wages
EX3	Repairs and Maintenance
EX4	Employee Benefits
EX5	Rent from Real Estate
EX6	Bond Interest and Discount
EX7	Mortgage Interest & Discount
EX8	Other Interest
EX9	Charitable Donations
EX10	Taxes, Other Than Direct
EX11	Royalty Expense
EX12	Depreciation
EX13	Depletion and Amortization
EX14	Provincial Mining and Logging Taxes
RE13	Capital Losses
EX15	Management and Administration Fees
EX22	Canadian Income Taxes Current
EX23	Total Deductions
EX17	Asset Write-Off and Write Downs
EX18	Rent Other than Real Estate
EX19	Deferred Canadian Income Taxes
EX20	Other Deductions
EX16	Advertising
RE1	Sales of Products
RE3	Rent Other than Real Estate
RE4	Rent from Real Estate
RE5	Royalty Income, Other than Natural Resources
RE6	Commissions
RE7	Bond Interest and Premium
RE8	Mortgage Interest
RE9	Other Interest
RE10	Foreign Dividend (net)
RE11	Canadian Dividend (gross)
RE17	Net Foreign Bond Interest & Premiums
RE12	Capital Gains
RE18	Other Foreign Interest (net)
RE21	Subvention Payments Received
RE20	Interest Capitalized
RE22	Other Revenues
RE14	Total Revenues
RE16	Royalities - Natural Resources
RE19	Securities Trading Profits
RE2	Sales of Services
ES3	Earned Surplus - Opening Balance
ES1	Cash Dividends Paid
ES2	Stock Dividends Paid
ES4	Earned Surplus - Closing Balance
NR4	Net Profit/Loss
NR5	Taxable Income/Loss
TX1	3% Inventory Deduction

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TX7	CCA (total)
RE15	Taxable Capital Gains (net of losses)
TX25	Net Federal Taxes
TX26	Quebec Provincial Taxes
TX28	Other Provincial Taxes
TX17	5% Current Year Credit
TX4	Foreign and Other Federal Tax Deduction
TX6	R&D Expenses on T2038
TX16	Opening Balance c/f Inventory Tax Credit
TX3	Manufacturing and Production Profit Deduction
TX27	Ontario Provincial Taxes
TX19	10% Current Year Credit T2038
TX18	7½% Current Year Credit T2038
TX20	Non-Capital Losses Carried Back
TX5	Investment Tax Credit
TX8	CCA - Class 24 Assets
TX9	CCA - Class 12 Assets
TX10	CCA - Class 34 Assets
TX11	CCA - Class 20 Assets
TX12	CCA - Class 21 Assets
TX13	CCA - Class 28 Assets
TX14	CCA - Class 27 Assets
TX15	CCA - Class 29 Assets
CE1	Land Expenditure
CE2	Building Expenditure
CE3	Equipment and Other Depreciable Assets Expenditure
CE4	Depletable Assets Expenditures
TX2	Small Business Deduction
TX24	1976 Non-Capital Losses Carried Forward
TX23	1975 Non-Capital Losses Carried Forward
TX22	1974 Non-Capital Losses Carried Forward
TX21	1973 Non-Capital Losses Carried Forward

TABLE III

DEFINITIONS

Total Revenue Equals:		Example
RE1	Sales of Products	117,205
RE3	Rent, Exc. Real Estate	4,820
RE4	Real Estate Rent	1,556
RE5	Royalty Income	19
RE6	Commissions	7,238
RE7	Bond Interest & Premium	1,148
RE8	Mortgage Interest	885
RE9	Other Interest	2,690
RE10	Foreign Dividends (Net)	21
RE11	Canadian Dividends (Gross)	4,361
RE12	Capital Gains	9,841
RE2	Sales of Services	52,531
RE22	Other Revenues	10,955
RE16	Natural Resource Royalties	326
RE19	Securities Trading Profits	65
RE17	Foreign Bond Interest	0
RE18	Other Foreign Interest	13
RE21	Subvention Payments Received	1,046
RE20	Interest Capitalized	0
RE14	Total Revenues	214,724

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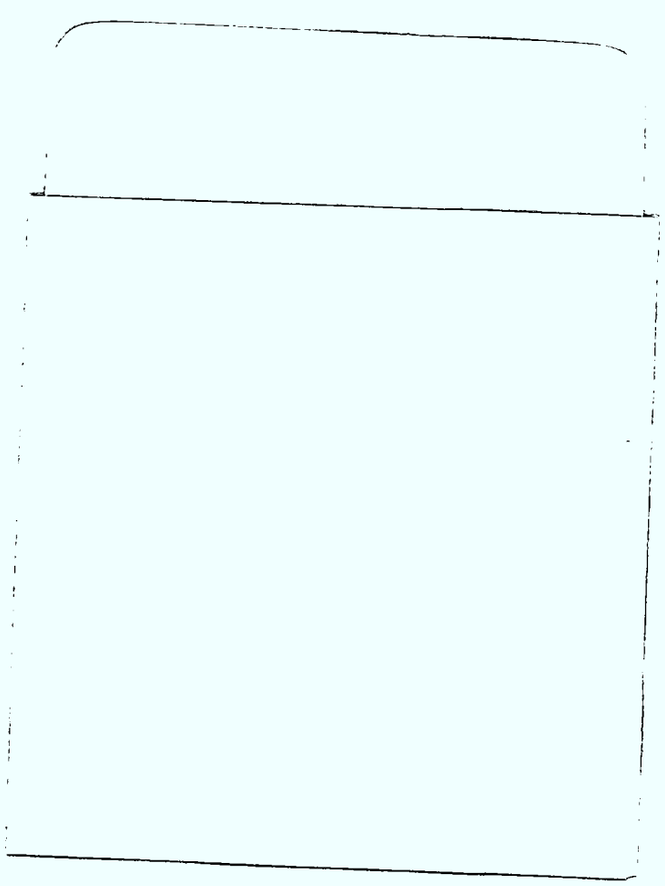

DEFINITIONS

Total Expenses Equals:		Example
EX1	Cost of Materials	52,852
EX2	Salaries & Wages	60,576
EX3	Repairs & Maintenance	3,967
EX4	Employee Benefits	3,037
EX5	Rent for Real Estate	4,530
EX6	Bond Interest & Discount	37
EX7	Mortgage Interest & Discount	759
EX8	Other Interest	4,027
EX9	Charitable Donations	133
EX10	Other Than Direct Taxes	1,778
EX11	Royalty Expense	193
EX12	Depreciation	8,543
EX13	Depletion & Amortization	67
EX14	Prov. Mining & Logging Taxes	1
EX15	Mngt. & Admin. Fees	603
EX17	Asset Write-Off & Write Downs	227
EX18	Rents, Other Than Real Estate	1,299
EX19	Other Deductions	26,598
EX16	Advertising	1,845
RE13	Capital Losses	383
EX21	Bad Debt Provision	216
	Total*	171,671

* EX23 Total Deductions Less The Sum Of EX22 Current Canadian Income Taxes, And EX19 Deferred Income Taxes).

i.e. 171,671 = EX23 - (EX22 + EX19)
= 180,698 - (9011 + 16)