Budget in brief

November 12, 1981

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From the Budget speech
November 12, 1981

"The key which can open the door to our future is a change in our attitudes and expectations. We will move much more quickly to non-inflationary growth if the conviction spreads that we are heading back towards stable prices and lower interest rates. The whole process will be much easier if everyone feels he is being treated fairly. That is why I have put so much emphasis on restraint with equity. I have also emphasized the promise of renewal. There are great opportunities for us to exploit. It is time to overcome our anxieties and regain our confidence in ourselves and in Canada."

Allan J. MacEachen
Deputy Prime Minister and
Minister of Finance

The Economic Strategy

Budget policy is based on the fact that inflation must be brought down if interest rates are to be reduced and other economic problems resolved.

> *"... we will generate less employment and growth if we attempt to live with inflation than if we resolve once and for all to see it steadily reduced."*

The three underlying themes of the budget are:

- Restraint, by both government and Canadians generally. In fiscal policy this involves reducing the deficit through increased revenues and tight control of spending. Increases in money incomes must come down if Canada's competitive position and the jobs that depend on it are to be protected.

- Equity and fairness. The budget proposes a major overhaul of the personal tax system to sharply reduce existing tax shelters and lower tax rates. It also provides interest relief to homeowners, farmers and small businesses most in need, and introduces incentives to stimulate the construction of rental accommodation.

- Renewal, to lay the basis for sustained growth in future. Industrial development, resource development, transportation, export promotion and human resources are the five priority areas of the government's economic development policy.

Personal Income Tax

The tax system now contains a proliferation of tax preferences. Some of these serve important policy goals. But others no longer serve a useful purpose; they have perverse economic effects, or undermine the fairness of the system. In most cases their benefits go mainly to high-income groups. By reducing the total income subject to tax, they force tax rates to be higher than need be.

The budget proposes to end a number of special tax preferences, restrict others, and use some of the resulting additional revenues to reduce tax rates.

> *"Lower tax rates will improve the incentives to work, save and invest. These incentives will be direct, easy to understand and available to all."*

- Tax rates will be reduced for some 5.8 million taxpayers with taxable incomes over $11,120. The top combined federal-provincial rate will now average 50 per cent, down from about 64 per cent.
- The federal tax reduction is currently 9 per cent of tax with a minimum cut of $200 and a maximum of $500. Next year the reduction will be set at a flat $200 for *all* taxpayers, with married taxpayers allowed to claim an

additional $200 for their dependent spouses, thus doubling the tax credit for lower-income couples.

- Full indexing of income tax will apply for 1982. This will mean tax reductions totalling more than $3 billion in 1982 in federal and provincial tax.

Overall, the net result for 1982 of all changes in personal income tax — including cutbacks in tax preferences and indexing — will be reductions averaging $210 for almost 12 million taxpayers, while some 795,000 will see their federal tax increase.

Measures to Aid Borrowers

The problem of high interest rates is particularly acute for small businesses, farmers and householders having to renew mortgages. The budget's basic response has been the anti-inflation strategy of deficit reduction, but more specific relief is proposed for individuals in those groups who face financial difficulty. To finance these measures the government is allocating $50 million to subsidize farm loans and $350 million to assist homeowners unable to meet high mortgage costs and to stimulate rental construction.

The assistance measures:

- Special loans by the Farm Credit Corporation, for farmers in financial distress, will provide interest rebates of up to 5 percentage points off the normal FCC interest rate of 16 ¾ per cent. This program will be in effect until next March 31, and rebates will be provided for up to two years.

- Since most household budgets have experienced income growth since their last mortgage renewal, relatively few homeowners renewing mortgages face actual loss of their home. But the government is proposing help in those cases where gross debt service payments under the new mortgage will exceed 30 per cent of household income. In order to encourage lending institutions to make interest deferral available in such cases, the government is prepared to guarantee repayment, within limits, of deferred interest. For homeowners who choose to defer part of the increased mortgage interest costs, this will provide flexibility in adjusting to the situation. And for homeowners with insufficient equity in their home to support interest deferral, the government will pay up to 100 per cent of the interest deferred under the guarantee plan.

- To help overcome shortages of rental accommodation, a new incentive program will provide interest-free loans of up to $7,500 per rental unit for 15,000 units, allocated to tight market areas across the country.

- The small business bond plan for reduced-interest financing will be extended for one year to the end of 1982. Previously limited to corporations, the plan will be broadened to cover unincorporated small businesses, including farmers. Loans will be available only to firms in financial difficulty. The provision will reduce financing costs by six to eight percentage points.

Tax Preferences

The budget's cutback of tax preferences will remove inequities, reduce economic distortions and permit lower tax rates. Since the preferences most benefit high-income taxpayers, the progressivity of the tax will be increased. Some of the main changes:

- The deduction for income-averaging annuity contracts, and reserve provision for capital gains, both of which allow deferral of tax, will be discontinued. The general averaging provision will also be withdrawn. A new forward-averaging mechanism will provide relief to taxpayers with fluctuating incomes.
- The value of taxable benefit to an employee from use of a company car will be increased. The tax-free status of a number of other employee benefits ends in 1982, including employer contributions to private health service and dental plans, free travel passes, and subsidized board and lodging - although board and lodging benefits at remote worksites will be exempt for workers who maintain a residence elsewhere.
- Benefits of low-interest or interest-free employee loans to buy a house or to purchase company shares will become fully taxable. Corporations may no longer claim deductions for payments into deferred profit-sharing plans which benefit a principal shareholder.

- Deduction of interest on money borrowed to purchase registered retirement savings plans (RRSPs) and other income-deferral plans will be disallowed on all new borrowings.

- A limit will be placed on the amount of a retiring allowance that can be reinvested tax-free in an RRSP and all job-termination payments will be fully taxable.

- Extended tax deferrals on accrued investment income will be limited by requiring taxation of such accruals every third year, including income on life insurance savings. Deduction of interest expenses will be restricted to the amount of investment income in a given year.

- Personal service corporations, by which high-income individuals convert employment income into business income eligible for the low small business tax rate, will become subject to full corporate tax rates.

- Professionals will no longer be allowed to deduct the expenses incurred for unbilled work-in-progress at the end of the year.

- The tax exemption for capital gains on a taxpayer's principal residence will be limited to one residence for each family.

- Deductions for support payments to non-resident dependants will be limited to payments made to a taxpayer's spouse and children.

Corporate Measures

The corporate surtax will be extended for two years, for large corporations, at rates of 5 per cent in 1982 and 2½ per cent in 1983 of a corporation's income tax otherwise payable.

Only half of the annual capital cost allowance rate will be allowed in the first year in which assets are acquired.

Depreciation will no longer be allowed on objects of art or antiques acquired after the budget, except for the initial purchase of an art work of a living Canadian artist.

Further restrictions will be placed on corporations' use of term preferred shares for so-called "after-tax" financing.

Small Business Measures

Ceilings for the low corporate tax on small business will be increased from $150,000 to $200,000 income each year. To target this incentive to growing businesses, corporations will no longer be able to maintain their eligibility for this benefit by paying out dividends.

Small business corporations will be exempted from the corporate surtax.

The provision for small business bonds will be extended for another year, to the end of 1982, for businesses in financial difficulty.

A tax of 12.5 per cent will be levied on dividends distributed by small business corporations, to correct an existing over-compensation from the dividend tax credit system.

Federal Sales Tax

The federal sales tax will be moved from the manufacturing to the wholesale level, effective July 1, 1982, and the rate will be reduced so that revenues will not be affected. The new structure will remove a number of inequities and the present serious bias against Canadian-produced goods.

Other Tax and Tariff Measures

Legislation relating to taxation of oil and gas production will implement the recent agreements with producing provinces.

Improvements in the General Preferential Tariff for developing countries will extend its coverage and reduce rates on a range of products of interest to developing countries. Duty-free entry will be granted for imported products designed for disabled persons.

Unemployment Insurance

The employee and employer rates of contribution to the unemployment insurance program will be reduced in 1982, a result of lower-than-expected unemployment in 1981.

Federal-Provincial Fiscal Arrangements

The federal government will maintain its support to provinces for post-secondary education, medical care and hospital care. It proposes to end compensation for the 1972 revenue guarantee - a reduction in payments to provinces that will be offset over the next two years by higher provincial revenues resulting from budget tax changes. The government is also proposing a revised equalization system to replace the system that expires on March 31, 1982.

Government Spending

> *"...we are committed to restraining the growth of our spending over the next few years to less than the growth of the economy as a whole while still exercising our responsibilities for leadership and for caring."*

Government spending over the next few years will decline from 20.6 per cent of gross national product (GNP) in 1981-82 to 19.2 per cent in 1985-86.

Within the constrained total, $400 million will be set aside for the relief of those hardest hit by high interest rates, and the government's priorities for economic development, foreign aid and defence will be met.

In addition to the proposed saving in transfers to the provinces, there have been reductions or deferrals from original allocations to energy and the Western Development Fund. The postal deficit will be eliminated over time. Additional economies in government overhead costs will be achieved. With lower deficits and interest rates, growth in interest costs of government borrowing will fall dramatically.

The Fiscal Plan

With the tax measures and expenditure plan announced in the budget, the government's deficit will be cut sharply in 1982-83 and decline further in the following fiscal year. The financial requirements, which are expected to account for 3 per cent of gross national product in the current fiscal year, would drop to 1.7 per cent of GNP in 1982-83 and to 1.2 per cent of national output by 1985-86 at the end of the five-year fiscal plan.

Financial requirements for 1982-83 will be at their lowest level in six years. Thus one source of pressure on interest rates will be eased, and more room will be left for other borrowers.

The Fiscal Plan: Summary Transactions[1]

	1980-81	1981-82	1982-83	1983-84	1984-85	1985-86
			(millions of dollars)			
Budgetary transactions						
Revenues	45,398	54,310	64,960	74,525	82,655	91,745
Expenditures	−58,066	−67,650	−75,450	−84,075	−92,635	−101,950
Surplus or deficit (−)	−12,668	−13,340	−10,490	−9,550	−9,980	−10,205
Non-budgetary transactions						
Loans, investments and advances	−523	−650	−850	−1,075	−1,265	−1,350
Specified purpose accounts	2,781	3,720	3,550	3,910	4,705	5,420
Other transactions	293	495	1,205	1,170	560	−230
Net source or requirement (−)	2,551	3,565	3,905	4,005	4,000	3,840
Financial requirements (excluding foreign exchange transactions)	−10,117	−9,775	−6,585	−5,545	−5,980	−6,365
Total outlays[2]	58,589	68,300	76,300	85,150	93,900	103,300

(1) For comparability, accounts for 1980-81 and 1981-82 treat Canada Post as if it were a Crown corporation. Budgetary deficit and financial requirements are unaffected by the adjustments.

(2) Total outlays are composed of budgetary expenditures plus loans, investments and advances.

The 1980 budget's anti-inflationary strategy of steady deficit reduction is being intensified in the current fiscal plan. This requires strong growth in revenues from oil and gas production, some increases in general taxes, and strict spending restraint.

The new energy taxes will yield $900 million of additional revenue in 1982-83, and $1.5 billion more in 1983-84, than projected in the 1980 budget. Budget measures will increase federal tax collections by a further $1.4 billion next year and by $2.1 billion in 1983-84.

> *"I believe that the economic strategy contained in the budget is the surest, fairest response to the economic problems which confront us. It will not provide a quick fix; such magic is not available. It is only with care, determination and persistence that our economic and social goals can be realized. But we can now reasonably expect that the rate of inflation will gradually come down from the peak levels reached this summer."*

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