The Budget Plan 1998

Including Supplementary Information and Notices of Ways and Means Motions

Building Canada for the 21st Century

Strong Economy & Secure Society

Tabled in the House of Commons
by the Honourable Paul Martin, P.C., M.P.
Minister of Finance

February 24, 1998

Department of Finance Canada   Ministère des Finances Canada

Price: $26.75 including GST

Available from the
Finance Canada Distribution Centre
300 Laurier Avenue West, Ottawa K1A 0G5
Tel: (613) 943-8665
Fax: (613) 996-0901

and from participating bookstores.

Electronic versions are also available from
Finance Canada Distribution Centre.

Cette publication est également disponible en français.

Cat No.: F1-23/1998-1E
ISBN 0-660-17401-4

Table of Contents

Annexes

1

Building Canada for the 21st Century –

A Strong Economy and a Secure Society

Highlights

- The budget will be balanced in 1997-98 – the first balanced budget since 1969-70.
- The budget will also be balanced in 1998-99 and 1999-2000 – the first time in almost 50 years that the budget will be in balance for three consecutive years.
- Canada's debt burden will be put on a permanent downward track through sustained economic growth and a debt repayment plan.
- The Canadian economy strengthened in 1997, with 372,000 jobs created – all full time and in the private sector.
- Continued strong economic growth and job creation are expected for 1998 and 1999.
- The *Canadian Opportunities Strategy* will expand access for all Canadians to the knowledge, skills and learning needed for the job opportunities of the 21st century.
- The amount of income that low-income Canadians can receive on a tax-free basis will be increased by $500, taking 400,000 Canadians off the tax rolls.

- The 3-per-cent general surtax will be eliminated for almost 13 million taxpayers with incomes up to about $50,000, and reduced for an additional one million taxpayers.
- As part of the National Child Benefit System, a further increase in the Canada Child Tax Benefit will be phased in over two years.
- The child care expense deduction will be enriched and other targeted tax assistance will be provided to promote a strong economy and a secure society.
- Over the next three years, $7 billion of tax relief is being provided, primarily to low- and middle-income Canadians.
- Eighty per cent of the new spending initiatives reflect two of the highest priorities of Canadians – access to knowledge and skills, and increased funding for health and education through increased transfers to the provinces.
- Program spending will continue to decline relative to the size of the economy. It is projected to fall to 11.5 per cent of gross domestic product (GDP) in 1999-2000 – its lowest level in 50 years.

Introduction

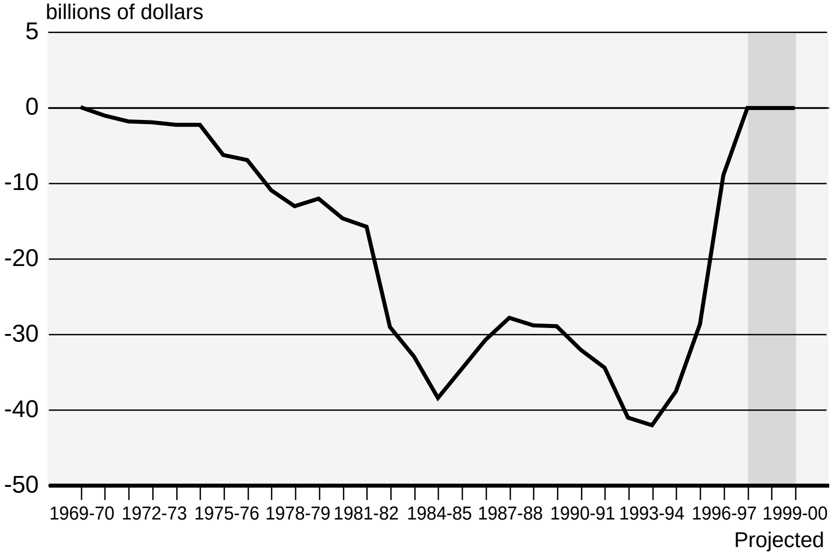
The government's key priority is to build a strong economy and a secure society for the 21st century. These two goals are mutually reinforcing.

- A strong economy creates employment opportunities and generates the resources needed to maintain and enhance programs that contribute to a secure society.
- A secure society provides Canadians with the means and sense of security necessary to adjust to the changes in a modern economy.

Restoring fiscal health and modernizing government programs have been prerequisites to achieving the government's economic and social objectives. Strong and durable economic growth could not have been achieved without first addressing Canada's fiscal problem.

Chart 1.1

Budgetary deficit (-)/surplus (+)
(public accounts basis)



But even while the fiscal problem was being addressed, the government made a number of strategic investments, through targeted programs and tax measures. These investments were in areas that promised a high economic return, such as knowledge and skills, or were a key priority for Canada's health and social objectives.

This strategy is paying off. The economy is now growing strongly and creating job opportunities for Canadians. The unemployment rate has fallen and consumer and business confidence are at their highest levels in many years. Private sector economists predict that economic growth will remain strong in 1998 and 1999. Canada's economic growth is expected to be the strongest of all Group of Seven (G-7) countries in 1998. Overall, the economic environment in Canada is more positive than it has been in 25 years.

This budget marks the start of a new fiscal era. The government is now planning on the basis of balanced budgets and a steady decline in the debt burden.

As a result of the structural changes introduced since 1993, a positive fiscal dynamic is now emerging. The government intends to use the increased financial resources that will become available to strengthen the economy and make Canada a more secure society.

Maintaining Sound Economic and Financial Management

The greatest contribution the government can make to enhancing opportunity and security is to maintain sound economic and financial management. Based on the financial results for the first nine months of 1997-98, expected developments over the balance of the fiscal year, and including the measures announced in this budget, the budget will be balanced this fiscal year. This will mark the first balanced budget since 1969-70.

The government will build on the fiscal progress achieved to date by pursuing policies that contribute to sustained, strong economic growth and by implementing a debt repayment plan that will reduce the absolute amount of the debt. *The Debt Repayment Plan* is based on three key elements:

- as before, two-year fiscal plans based on prudent economic planning assumptions; the current plan commits to balanced budgets in 1998-99 and 1999-2000;
- the inclusion in the fiscal plan of a Contingency Reserve of $3 billion in each year; and
- the use of the Contingency Reserve, when it is not needed, to pay down the public debt. (Chart 1.2)

This will ensure that the debt-to-GDP ratio is put on a permanent downward track.

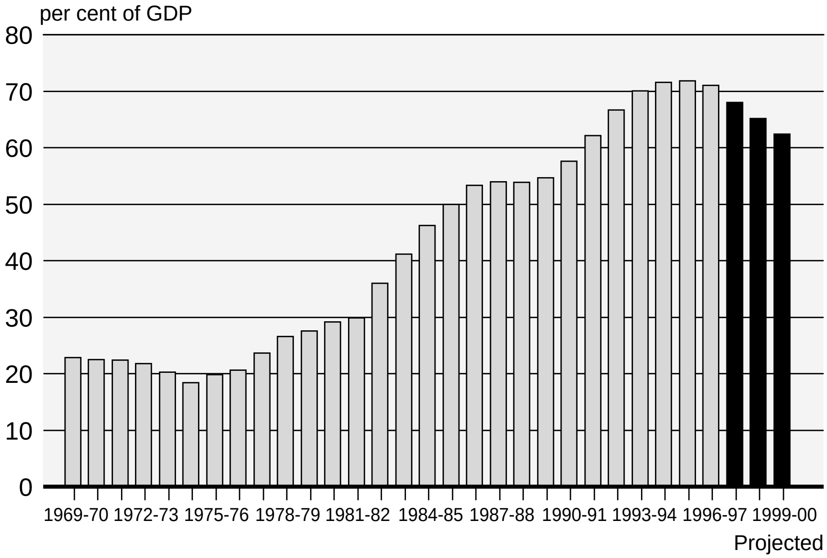
The commitment to balanced budgets in both 1998-99 and 1999-2000 also means that:

- there will be ongoing financial surpluses; and
- there will be a steady repayment of the federal government's market debt – the debt that it had to borrow on credit markets.

Other major industrialized countries report their budget balance on the basis of financial requirements/surplus – essentially the cash requirements or surplus resulting from government operations. On that basis, the federal government recorded a surplus of $1.3 billion in 1996-97 (Table 1.1). This was the best performance among the G-7 countries, including the United States. A financial surplus of about $12 billion is expected for 1997-98. Over the first nine months of 1997-98, the government had repaid $12.9 billion of market debt. Sizeable financial surpluses are expected to continue through 1999-2000.

Chart 1.2

Federal government net debt
(public accounts basis)



A successful debt reduction strategy requires that fiscal action be complemented by investments that are essential to long-term job creation and the economic health of the country. The government will therefore continue to make strategic investments to enhance the knowledge and skills of Canadians, to make Canadian society more secure, and to reduce taxes. This balanced approach – sustained economic growth and a reduction in the absolute level of the debt – is the best way of ensuring that the debt burden is reduced in a steady and sustained manner.

The fiscal outlook presented in Table 1.1 includes all spending and tax measures introduced since the 1997 budget – measures that will contribute to a stronger economy and a more secure society. Even taking this into account, total program spending as a percentage of the economy (GDP) is projected to decline over the next two years, to 11.5 per cent by 1999-2000. This is down from 16.6 per cent in 1993-94 and marks its lowest level in 50 years.

Table 1.1
Summary statement of transactions: fiscal outlook with budget measures

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
	(billions of dollars)						
Budgetary revenues	116.0	123.3	130.3	140.9	147.5	151.0	155.0
Program spending	120.0	118.7	112.0	104.8	106.0	104.5	107.0
Operating balance	-4.0	4.6	18.3	36.1	41.5	46.5	48.0
Public debt charges	38.0	42.0	46.9	45.0	41.5	43.5	45.0
Underlying balance	-42.0	-37.5	-28.6	-8.9	0.0	3.0	3.0
Contingency Reserve						3.0	3.0
Budgetary balance	-42.0	-37.5	-28.6	-8.9	0.0	0.0	0.0
Net public debt	508.2	545.7	574.3	583.2	583.2	583.2	583.2
Non-budgetary transactions	12.2	11.6	11.4	10.2	12.0	6.0	9.0
Financial requirements/ surplus (excluding foreign exchange transactions)	-29.8	-25.8	-17.2	1.3	12.0	6.0	9.0
Per cent of GDP							
Budgetary revenues	16.0	16.2	16.3	17.2	17.2	16.9	16.7
Program spending	16.6	15.6	14.0	12.8	12.4	11.7	11.5
Operating balance	-0.6	0.6	2.3	4.4	4.8	5.2	5.2
Public debt charges	5.2	5.5	5.9	5.5	4.8	4.9	4.9
Budgetary balance	-5.8	-4.9	-3.6	-1.1	0.0	0.0	0.0
Net public debt	70.2	71.6	71.9	71.1	68.1	65.4	62.9
Financial requirements/ surplus	-4.1	-3.4	-2.2	0.2	1.4	0.7	1.0

One of the cornerstones of sound economic and financial management is controlling the rate of inflation. The government and the Bank of Canada have agreed to extend the current inflation control targets, which keep inflation within a band of 1 per cent to 3 per cent, until the end of 2001. The extension of the inflation control targets will help to keep Canada’s inflation rate among the lowest in the world which, in turn, will help to maintain Canada’s low interest rates.

The Canadian Opportunities Strategy

Education, knowledge and skills are essential for Canadians to participate in, and benefit from, economic growth. This is especially crucial when that growth is increasingly dependent on the application of knowledge and skills. While the government cannot guarantee equality of outcomes, it can strive to ensure that Canadians have equality of opportunity.

This budget builds on actions taken in previous budgets to provide Canadians with enhanced access to knowledge and skills. It announces the *Canadian Opportunities Strategy* which will:

- provide more than 100,000 students with Canada Millennium Scholarships averaging $3,000 per year, and up to 25,000 students in financial need with children or other dependants with new Canada Study Grants;
- increase assistance for advanced research and for graduate students through increased funding for the three granting councils;
- help graduates manage their student debt loads by providing tax relief for interest payments on student loans, and improving the Canada Student Loans Program to help borrowers facing financial difficulties;
- help Canadians upgrade their skills throughout their working lives by allowing tax-free withdrawals from their registered retirement savings plans (RRSPs) for lifelong learning, and by extending the education tax credit and the child care expense deduction to part-time students;
- ensure that families can better afford higher education for their children by providing stronger incentives for saving through the new Canada Education Savings Grant, which will provide a grant of 20 per cent on the first $2,000 of annual contributions made to registered education savings plans (RESPs) for children up to age 18;
- support youth employment by more than doubling funding for youth at risk who lack basic education and job skills, and by providing employers an employment insurance premium holiday for additional young Canadians hired in 1999 and 2000; and
- increase funding for the SchoolNet, Community Access, and Canadian Network for the Advancement of Research, Industry and Education (CANARIE) programs to help bring the benefits of information technology into more classrooms and communities across Canada.

Taken together, and in combination with initiatives announced in previous budgets, these measures will give Canadians significantly greater and more affordable access to the knowledge and skills that will be necessary to succeed in the 21st century.

Building a Secure Society

Strong national programs are key to ensuring that Canadians have a sense of security and confidence in their future, and the means to pursue their economic objectives and a better quality of life.

Canadians need to know that their health care system will provide quality care for them when they need it. That is why the very first and most significant initiative the government took as a result of the better fiscal performance was to introduce legislation in December 1997 to raise the cash floor of the Canada Health and Social Transfer (CHST) from $11 billion to $12.5 billion. This means that, between 1997-98 and 2002-03, provinces will receive an additional $7 billion in transfer payments.

Canadians also need to know that the retirement income system will be there for them when they retire. Last year, the federal government, in partnership with provincial governments, agreed to reforms that preserve the Canada Pension Plan for the long term. The government will be introducing legislation to reform the second pillar of Canada's retirement income system – the Old Age Security (OAS) and the Guaranteed Income Supplement (GIS) programs – replacing them with a new Seniors Benefit. The Seniors Benefit will ensure that those who need public pensions in the future can count on them. Low-income seniors, most of whom are women, will see enhanced pensions.

This budget provides funding for initiatives set out in *Securing Our Future Together*, as well as other policy initiatives announced since the last budget. These policy initiatives include: renewing Canada's blood system in partnership with the provinces; implementing the international treaty on the prohibition and destruction of anti-personnel mines; and building a new partnership with Canada's aboriginal peoples.

In the February 1997 budget, the government announced increased federal funding to the Child Tax Benefit as a step towards a National Child Benefit System. The new system will have two parts: a federal platform for all eligible Canadian families – to be called the Canada Child Tax Benefit – and provincial supplements that will vary in amount and design. The federal government announced, in the February 1997 budget, an $850 million increase to the Canada Child Tax Benefit, which will take effect July 1998 and provide increased assistance to over one million children and their families.

The 1997 budget also committed to further enrich the Canada Child Tax Benefit. This budget honours that commitment by allocating $425 million as of July 1999 and an additional $425 million as of July 2000.

In addition, this budget announces:

- deductibility of health and dental plan premiums for self-employed Canadians; and
- increased support for families, notably through a new caregiver tax credit, increased limits for the child care expense deduction and increased support for persons with disabilities.

General Tax Relief for Canadians

This budget marks the beginning of general tax relief for Canadians, starting with those who need it most – low- and middle-income Canadians. This budget announces that:

- the amount of income that low-income Canadians can receive on a tax-free basis will be increased by $500, taking almost 400,000 Canadians off the tax rolls; and
- the 3-per-cent general surtax will be eliminated for almost 13 million taxpayers with incomes up to about $50,000 and reduced for an additional one million taxpayers.

Summary of Spending and Tax Actions

The net fiscal impact of actions (spending and tax) proposed since the 1997 budget is provided in Table 1.2. The fiscal cost of the spending and tax initiatives proposed in this budget amounts to $2.6 billion in 1997-98, $1.8 billion in 1998-99, $3.2 billion in 1999-2000 and $4.1 billion in 2000-01. The initiatives proposed in the *Canadian Opportunities Strategy* and in *Building a Secure Society* include some initiatives which were originally announced in

Securing Our Future Together, as well as a number of tax expenditure measures. The initiatives proposed in *General Tax Relief for Canadians* consist of the increase in the amount of income that low-income Canadians can receive on a tax-free basis and the elimination of the 3-per-cent general surtax for Canadians with incomes up to about $50,000.

Table 1.2
Spending and tax initiatives since the 1997 budget

	1997-98	1998-99	1999-00	2000-01
		(millions of dollars)		
Spending and tax measures announced in this budget				
Canadian Opportunities Strategy	2555	650	1085	1230
Building a secure society	90	264	714	1169
General tax relief for Canadians		880	1445	1680
Tax fairness measures		-5	-25	30
Total	2645	1789	3219	4109
Spending and tax measures announced before the budget				
Building a secure society				
Increase in CHST transfer payments	200	900	1500	1500
New partnerships with aboriginal peoples	350	126	126	126
Other	40	136	191	161
Total	590	1162	1817	1787
Tax relief for Canadians (EI premium rate reduction)	235	465		
Other *Securing Our Future Together*	3	85	85	83
Total	828	1712	1902	1870
Total	3473	3501	5121	5979

The budget also provides funding for the other initiatives announced since the 1997 budget. Most of these were announced in *Securing Our Future Together*. These include the increase in the cash floor under the Canada Health and Social Transfer to provinces and funding for other health care initiatives, culture and economic development initiatives, among others. In addition, funding is provided for *Gathering Strength* – a new partnership with Canada's aboriginal peoples – and for the reduction in the employment insurance premium rate from the February 1997 budget assumption of

$2.80 to $2.70 for 1998. In total, the cost of these actions amounts to $828 million in 1997-98, $1.7 billion in 1998-99, and $1.9 billion in both 1999-2000 and 2000-01.

Over the four years, 1997-98 to 2000-01, the net fiscal impact of the new investments and tax relief since the 1997 budget amounts to $18.1 billion. (See Annex 1 for details.) Of this amount, $10.9 billion represents spending initiatives. Most of this increased spending is for the *Canadian Opportunities Strategy* ($4.7 billion or 43 per cent) and for the increase in the Canada Health and Social Transfer ($4.1 billion or 38 per cent). As a result, 80 per cent of the spending initiatives reflect two of the highest priorities of Canadians – access to knowledge and skills, and increased funding for health and education transfers to provinces and territories.

Table 1.3
Spending and tax initiatives since the 1997 budget

	1997-98	1998-99	1999-00	2000-01	Cumu-lative total
	(millions of dollars)				
Spending Initiatives					
The Canadian Opportunites Strategy					
Canada Millennium Scholarships	2500				2500
Other initiatives	55	530	725	850	2160
Building a secure society					
Increased CHST cash transfers	200	900	1500	1500	4100
Other initiatives	480	466	491	461	1898
Other *Securing our Future Together*	3	85	85	83	256
Total	3238	1981	2801	2894	10914
Targeted and general tax relief					
The Canadian Opportunities Strategy		120	360	380	860
Building a secure society		130	610	1065	1805
General tax relief		880	1445	1680	4005
Tax fairness measures		-5	-25	30	0
Actions before budget	235	395	-70	-70	490
Total	235	1520	2320	3085	7160
Total spending and tax initiatives	3473	3501	5121	5979	18074
The Debt Repayment Plan: up to (assuming that Contingency Reserve not required)		3000	3000	3000	9000

The targeted and general tax relief actions total $7.2 billion over the four years. Of this amount, $7 billion is announced in this budget for the next three years.

Under *The Debt Repayment Plan*, the Contingency Reserve, if not required, will be used to pay down the public debt. Over this period, up to $9 billion could be used to pay down the public debt.

Outline of the Budget Plan

- Chapter 2 reviews recent economic developments and prospects for Canada. It establishes the economic planning assumptions that underlie the government's budget plan.
- Chapter 3 reviews the progress achieved to date in restoring fiscal health. It describes *The Debt Repayment Plan* and provides a detailed fiscal outlook through 1999-2000. It also announces the extension of the current inflation control targets to 2001.
- Chapter 4 announces the *Canadian Opportunities Strategy*, which will: provide financial assistance to students through the Canada Millennium Scholarships and Canada Study Grants; increase funding for the three granting councils; assist graduates in managing their student debt loads through tax relief for interest payments on student loans and improvements to the Canada Student Loans Program; help Canadians upgrade their skills through their working lives by allowing tax-free withdrawls from RRSPs and extending the education tax credit and the child care expense deduction to part-time students; provide incentive for parents to save for their children's education through a new Canada Education Savings Grant; support youth employment through increased funding for youth at risk and an employment insurance premium holiday for employers hiring additional youth in 1999 and 2000; and increase funding to bring the benefits of technology into more classrooms and communities across Canada.
- Chapter 5 describes the initiatives that were announced prior to the 1998 budget to build a more secure society. These include funding to further improve Canada's health care system, to support Canada's commitment to the Ottawa Process on Landmines, and to build a new partnership with Canada's aboriginal people. Chapter 5 also introduces a number of new initiatives to promote a secure society, including the proposed increase to the Canada Child Tax Benefit and the proposed increase in the child care expense deduction for working families.

- Chapter 6 announces two major initiatives to reduce personal income taxes. It proposes an increase in the amount of income that low-income Canadians can receive on a tax-free basis and the elimination of the 3-per-cent general surtax for Canadians earning up to about $50,000.

There are also a number of annexes.

- Annex 1 allocates the various initiatives since the February 1997 budget between spending initiatives and tax actions.
- Annex 2 describes three different measures of the federal fiscal position – the budgetary balance, the financial balance (requirements/surplus) and the national accounts budget balance (deficit/surplus) – and provides a discussion and reconciliation of these three measures.
- Annex 3 provides an update of the fiscal situation of the total government sector in Canada.
- Annex 4 compares Canada's fiscal situation with that in other major industrialized countries.
- Annex 5 describes the fiscal sensitivity of the federal fiscal situation to changes in economic growth and interest rates.
- Annex 6 outlines the government's response to the 1997 *Report of the Auditor General* and his observations on the Government of Canada's financial statements.
- Annex 7 provides supplementary information on the tax measures contained in this budget.

2

Building Canada for the 21st Century –

Economic Developments and Prospects: The Policy Payoff

Highlights

- Strong growth created 372,000 net new jobs in 1997. All are full-time, private sector positions. This brings the number of jobs created in the Canadian economy over the last four years to more than one million.
- All regions have benefited from the strengthening of growth and employment over the last 18 months.
- Strong household and business confidence have fuelled robust consumer and investment spending.
- Major international organizations expect that Canada will lead the G-7 in GDP growth in 1998, making 1997 and 1998 the best back-to-back years for GDP growth in a decade.
- Continued strong growth will pay off in continued strong job creation.

Introduction[1]

The sound economic policies that have been implemented in Canada for the past four years are generating demonstrable benefits. Starting in the third quarter of 1996, the economy has experienced six quarters of strong growth that has generated almost one-half million jobs. In 1997 alone, 372,000 new jobs were created – all of them full-time, private sector positions. And robust growth has restored household and business confidence, with the result that consumer spending and business investment have increased substantially over the past year.

Job creation through strong and steady growth has been a key objective of the government’s efforts to build a strong economy and a secure society. Creating good jobs for all those who want to work cannot be achieved without a strong economy, nor can economic growth endure without the household income that good jobs provide. But it is more than that: healthy job creation is a key condition for building a secure society.

This objective could not have been achieved without the difficult, but necessary, first step of restoring fiscal health. Indeed, the lower interest rates that have fuelled consumer spending and business investment would not have been possible without the determined efforts of federal and provincial governments to restore sound public finances. Canadians are now reaping the benefits of sound economic and fiscal policies working hand in hand.

The 1997 budget noted that lower interest rates would lead to a recovery in interest-sensitive expenditures sufficient to fuel a marked strengthening of growth. The outcome was even better than expected. And private sector economists expect that the improved economic environment will continue to fuel sustained healthy growth in 1998 and beyond.

Of course, the favourable outlook shared by most private sector economists is not without risk and budget planning must remain anchored to prudent economic assumptions. For instance, recent developments in Asia have focused attention on the uncertainties faced by Canada’s export sector as well as on the risks of increased global financial market volatility.

[1] All statistical references are as of Friday February 6, 1998.

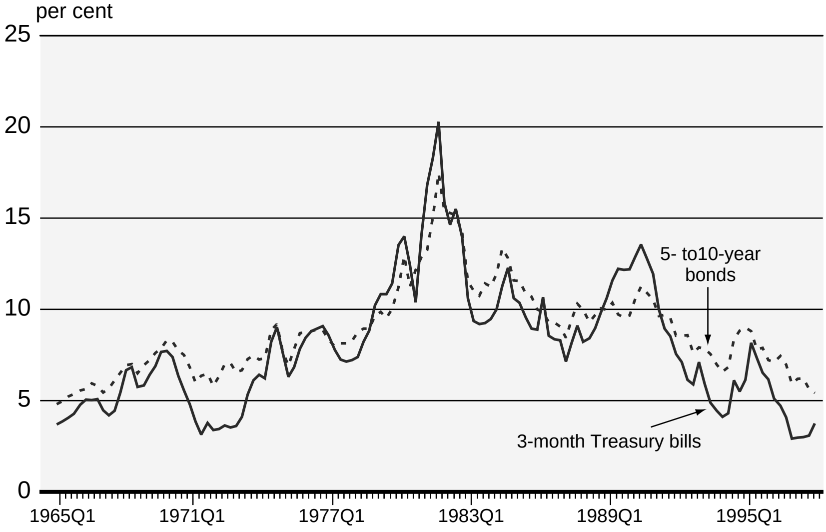
This chapter briefly reviews recent economic developments and discusses the factors underlying the robust growth in 1997 and the favourable near-term outlook. It outlines the results of the latest survey of private sector forecasters, discusses the major uncertainties in the outlook, and closes with a discussion of the prudence factors used in developing the economic assumptions used for budget planning.

Recent Economic Developments

The strengthening of growth over the past year-and-a-half and the optimistic outlook held by private sector forecasters demonstrate the payoffs from the government's economic policy framework.

The objective has always been to create the conditions conducive to private sector job creation and strong economic growth. Upon taking office in 1993, the government recognized that this goal would be impossible to achieve if public finances were allowed to continue to deteriorate and keep interest rates higher than they could be. By late 1996, the credibility of governments' commitments to eliminate their fiscal imbalances allowed monetary conditions to become highly supportive of growth, with short-term interest rates falling to their lowest levels in over 30 years (Chart 2.1).

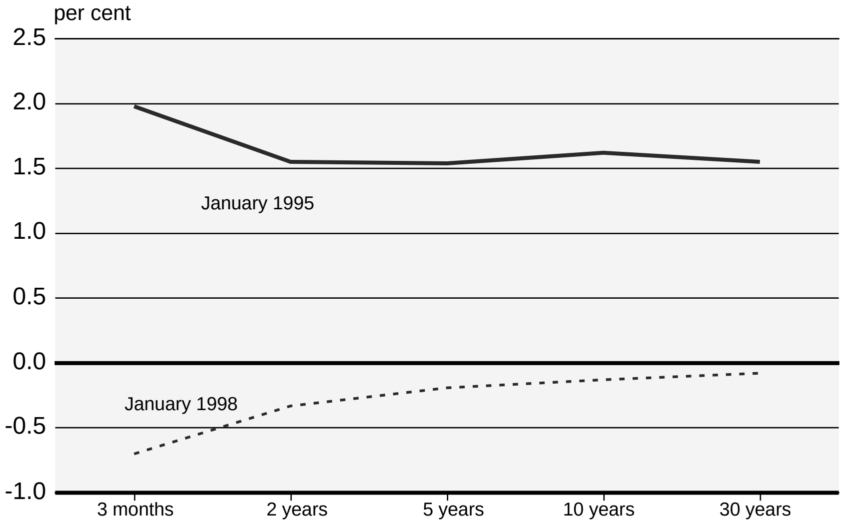
Chart 2.1
Canadian interest rates



Low interest rate risk premiums attached to Canadian debt instruments are evident in the negative spreads between comparable Canadian and U.S. interest rates (Chart 2.2). Canadian short-term interest rates have been below comparable U.S. rates for the past two years – the longest such period since the early 1970s. And longer-term Canadian interest rates have also remained below comparable U.S. rates. During the 1990s, Canadian 10-year bond rates have averaged about 120 basis points *above* those in the U.S. But for more than a year now, the 10-year bond rate has generally been *below* that in the U.S. The 30-year bond rate has remained at or slightly below that in the U.S. since the middle of last year. This is an historic achievement for Canada.

Chart 2.2

Canada-U.S. yield curve spreads



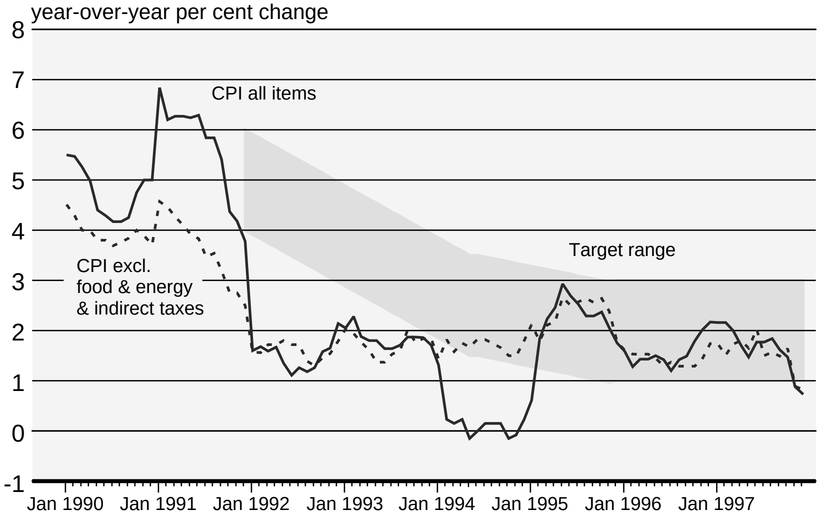
Canadian interest rate at given maturity minus comparable U.S. rate.

At the time of the last budget, interest rates were widely expected to begin moving higher through 1997 as the pace of economic activity accelerated. Private sector forecasters expected short-term interest rates to average 3.2 per cent for the year as a whole; 10-year government bond yields were expected to average just over 6½ per cent.

Despite strong growth, the actual outcome was better than expected. While short-term rates averaged just over 3 per cent, much as expected, 10-year rates averaged 6.1 per cent, well *below* the levels forecast one year ago.

Canada's commitment to low inflation – clearly demonstrated by the 1- to 3-per-cent target inflation range established jointly by the government and the Bank of Canada in 1993 – has also been important in supporting this improved economic and financial environment. The target range assures all investors that the government and the Bank of Canada are committed to containing cost and price pressures as the expansion continues. Indeed, consumer price inflation, excluding the effects of changes in food and energy prices, has remained at or below the mid-point of the range for the past 24 consecutive months (Chart 2.3).

Chart 2.3
CPI inflation

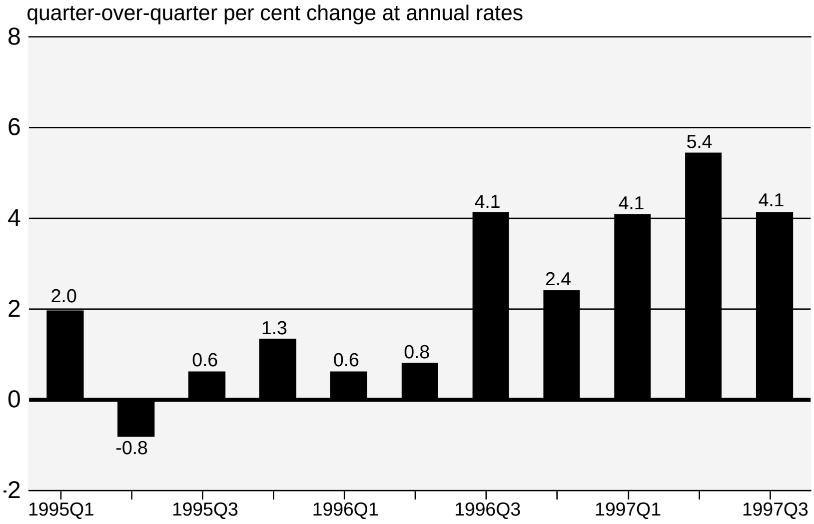


The Payoff in Growth and Jobs

At the time of the last budget, private sector economists expected growth to increase to 3.3 per cent in 1997, up from about 1½ per cent in 1996. The outcome appears to have been better than expected: final 1997 gross domestic product (GDP) data available in early March will likely show that growth averaged more than 3½ per cent. The robust growth of the past six quarters compares very favourably with the weak growth in 1995 and the first half of 1996 (Chart 2.4).

Chart 2.4

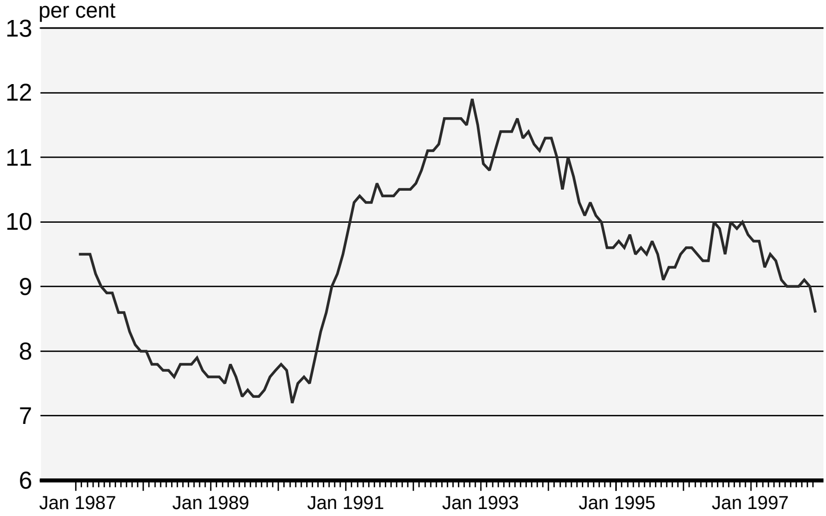
Real GDP growth



Most important, the growing economy is creating economic opportunities for Canadians across the country. Employment growth began to strengthen in the second half of 1996, when nearly 120,000 jobs were created. The pace of job creation quickened in 1997, with the addition of 372,000 new jobs, all of them full time and in the private sector. By December 1997, strong employment growth brought the unemployment rate down to 8.6 per cent, its lowest level since September 1990 (Chart 2.5). Although the severe ice storm that affected parts of eastern Ontario and Quebec disrupted production in January, and led to a temporary rise in the national unemployment rate, private sector forecasters expect that the trend toward strong job creation will continue in 1998.

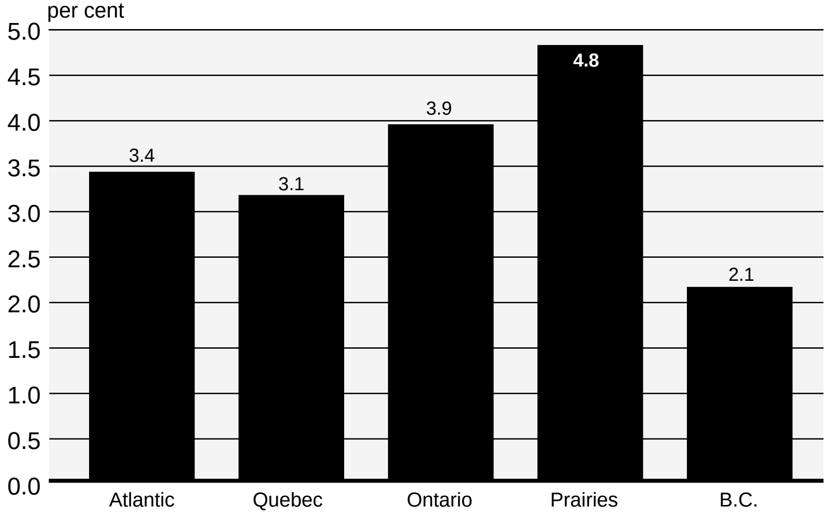
Especially encouraging is the evidence that the benefits of

Chart 2.5
Unemployment rate



stronger employment are being enjoyed across the country: employment has risen in all regions of the country over the past 18 months (Chart 2.6).

Chart 2.6
Cumulative employment growth by region
June 1996 to December 1997



Moreover, in 1997, the unemployment rate fell the most in those regions where the level of unemployment has been the highest. Clearly, however, the economy of British Columbia is being adversely affected to a greater degree than other provinces by the weakness of many Asian economies.

Strong employment growth over the past 18 months has now created a "virtuous circle" in which employment gains generate higher household incomes that lead to stronger consumer spending, increased investment, and the higher economic growth that in turn fuels continued job creation. Especially important are the recent strong gains in full-time employment – over 140,000 new jobs created in the three months since October 1997 alone. The potential impact of this effect cannot be dismissed: the wages and salaries of all Canadians who found employment over the past year represent a significant stimulus to the economy, totalling almost 1½ per cent of GDP.

Supporting the virtuous circle is the fact that the elimination of the deficit, low interest rates and strong employment growth have restored household and business confidence. Consumer confidence, as measured by the Conference Board of Canada, remains near its highest level in almost nine years and above its average level for the last 30 years, despite a modest decline in the fourth quarter of 1997. And business confidence, driven by high levels of capacity utilization, has set record highs.

It is not surprising, therefore, that the economy grew at an average annual rate of about 3¾ per cent over the six quarters to end-1997, nor that this growth reflects robust gains in two key interest-sensitive components of domestic demand – household consumption and business investment. Since mid-1996, sales of durable consumer goods such as cars and appliances have been strong, rising by 14 per cent. Capacity utilization rates have increased steadily with the recovery of domestic demand. And real business investment in machinery and equipment has soared, up by 32 per cent since the second quarter of 1996. Investment in non-residential construction has also increased, up by 15 per cent over the same period.

The recent strength of these components of domestic demand stands in marked contrast to the situation in 1995 and the first half of 1996 (Chart 2.7). This broadening of the sources of growth from the trade sector to domestic demand makes expansion much less dependent on external demand, which could not realistically have been expected to continue growing indefinitely at the very robust pace witnessed in 1995. This rebalancing of demand thus bodes well for the country's future economic prospects.

Chart 2.7a

Growth in consumer spending

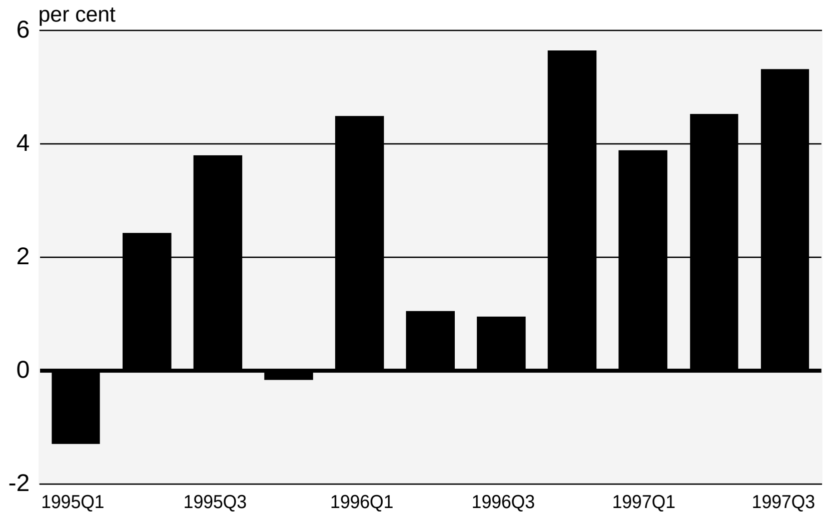
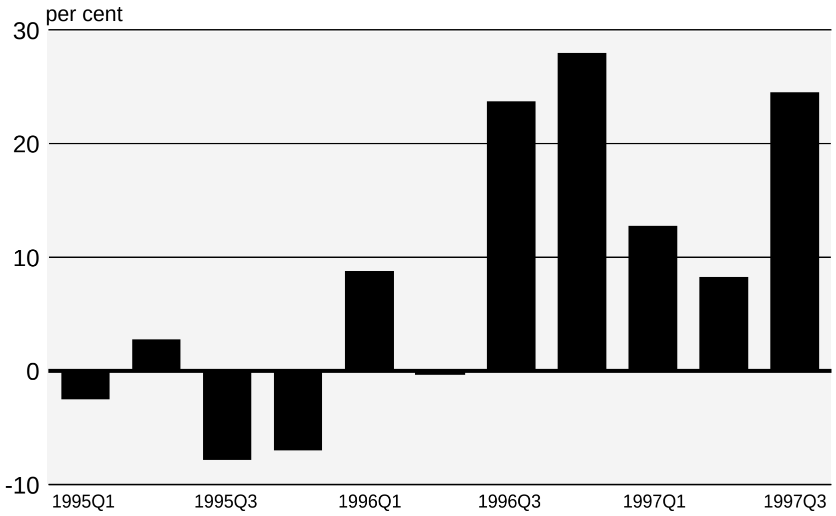


Chart 2.7b

Growth in business fixed investment

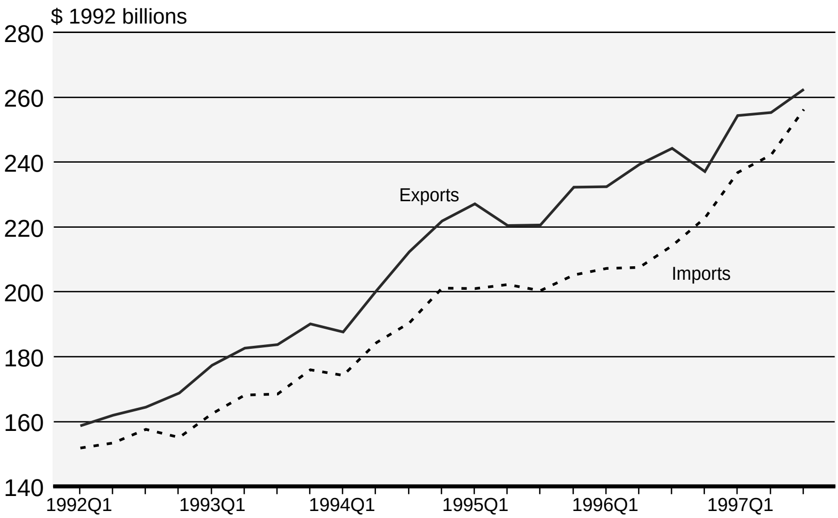


Exports remain a major source of growth and job creation in the Canadian economy. Canada's exports of goods and services have risen more than 50 per cent in the last four years. The share of exports in Canada's GDP now stands at about 40 per cent – the highest in the Group of Seven (G-7) and up from about 25 per cent at the beginning of the 1990s.

But the rebound in spending on durable goods and investment expenditures over the past 18 months has led to a decline in Canada's external balances. While export growth held up well through 1997, stronger domestic demand – especially higher spending on machinery and equipment investment (largely purchased abroad) – boosted imports (Chart 2.8) and cut into the trade surplus. And the current account, which in 1996 moved from a chronic deficit into a surplus position, returned to deficit in 1997 (Chart 2.9).

Chart 2.8

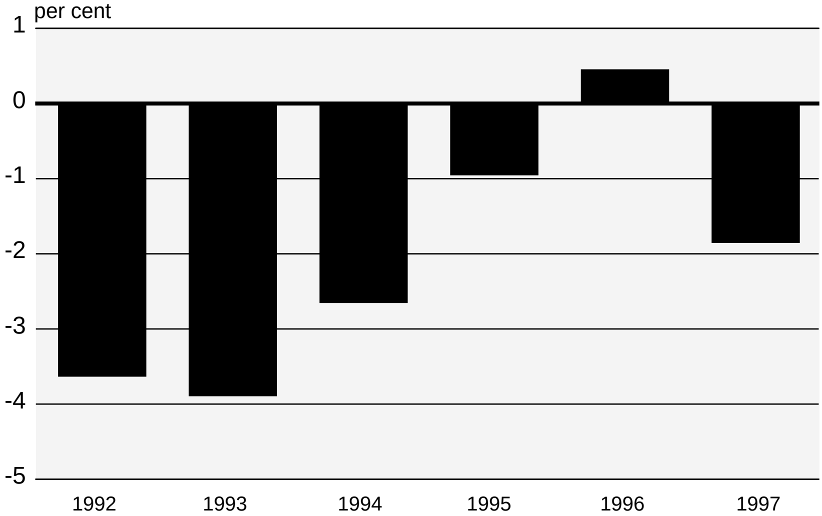
Real imports and exports



This decline in the current account balance should be put in perspective. It is especially noteworthy that, while the deficit in the current account increased significantly in the third quarter of 1997, it remains well below past levels. Although final data are not yet available, the 1997 current account deficit as a percentage of GDP was modest compared to the experience in the early 1990s.

Chart 2.9

Current account as a share of GDP



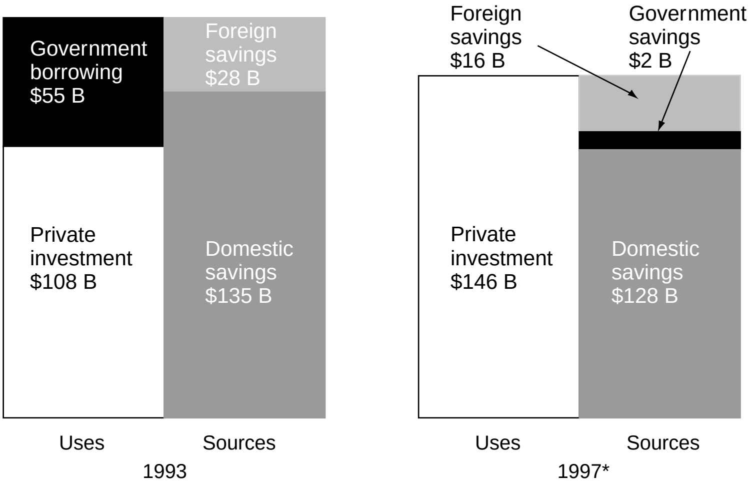
Note: 1997 assumes 4th quarter equals the 3rd quarter value.

The factors accounting for the re-emergence of a current account deficit also differ significantly from earlier experience. Most important, the steep increase in imports has been driven by a surge in investment spending, particularly investment in machinery and equipment. Indeed, imports of machinery and equipment rose 33 per cent between mid-1996 and the third quarter of 1997. Although this import boom helps explain the re-emergence of a current account deficit, it is also boosting the economy's long-run growth and export potential. This is in contrast to the external imbalances earlier in the decade, which largely reflected high government borrowing (Chart 2.10).

Moreover, the prospects for the current account are reasonably favourable. This is because current accounts ultimately reflect national savings and investment imbalances and domestic savings can be expected to rise over the medium term. Several factors are at work here. The decline in interest rates has induced consumers to greatly increase their spending on durable goods, spending that for many households had been delayed by prolonged economic uncertainty. This has lowered the personal saving rate. Improved employment prospects and enhanced consumer confidence has unleashed a 'catch-up' on consumption. But stronger disposable income growth, and a desire by households to restore savings to more normal levels, will likely lead to a gradual increase in household savings.

Chart 2.10

Sources and uses of savings



*Estimate

More fundamental, however, is the restoration of sound public finances through the actions of federal and provincial governments, which have shifted from being net users to being a net source of savings (Chart 2.10). The reform of the Canada and Quebec Pension Plans, which will lead to a greater degree of funding of these plans, will further increase public sector saving.

One potential risk to this generally encouraging outlook for the current account relates to the prospects for commodity prices and hence Canada's terms of trade (i.e. the prices that Canada earns on its exports compared to those it pays on its imports – a key determinant of the current account and national income). In late 1996 and early 1997, well before the situation in Asia began to negatively influence commodity markets, Canada's terms of trade had begun to weaken following several quarters of improvement. To the extent that the Asian crisis leads to a sustained downward revision to growth prospects for the region, it may exert a more prolonged negative impact on commodity prices and thus on Canada's terms of trade and current account.

Issues and Prospects for the Outlook

Sustaining growth through a virtuous circle

The broadening of growth to key components of domestic demand and the creation of a virtuous circle should sustain the expansion by making it less dependent on external sources. And while short-term interest rates moved higher late in 1997 and early in 1998 as the dollar weakened, most households will continue to benefit from interest rates that remain near historic lows. The reason is simple: thousands of Canadians have renewed their mortgages or refinanced their homes at significantly lower rates. For example, a homeowner who takes out a five-year term on a $100,000 mortgage will save more than $3,000 per year on mortgage payments compared to three years ago.

At the same time, the overall mix of macroeconomic policies remains conducive to sustained growth. With the difficult stage of deficit reduction largely completed across the country, and the direct impact of public sector job cuts now largely behind us, the underlying momentum of the private sector should become more evident. Moreover, although short-term interest rates have increased in recent months, the impact of higher interest rates on growth has been largely offset by the stimulative impact of a lower Canadian dollar. Indeed, overall monetary conditions, which measure the combined effect on growth of interest rates and the exchange rate are now roughly as expansionary as they were at the time of the last budget and the fall *Economic and Fiscal Update*. As a result, there are sound reasons to believe that growth in 1998 and beyond will remain strong. The private sector consensus outlook reflects this assessment.

Uncertainties in the outlook

As always, however, uncertainties remain. In particular, financial market volatility following developments in Asia underscores the importance of the external environment in an open global economy linked by large trade and capital flows. Indeed, the International Monetary Fund (IMF) has already marked down its forecast of global growth in 1998 by about three-quarters of 1 percentage point in view of these developments, while the OECD has indicated that global growth in 1998 could be a full percentage point lower than previously estimated. In both cases, however, the estimated impacts on Canada and the United States are far smaller.

Spillovers from the Asian crisis

Recent developments in Asia clearly increase the uncertainty attached to the economic outlook.

The overall impact of the Asian crisis will depend on the potential spillover effects through which the turmoil in Asia may be transmitted abroad and the scope that exists to mitigate these effects. There are a number of possible transmission channels.

- The direct trade effects are most certain. Exports to the region will decline as a result of slower growth there and a major depreciation of local currencies. But the small share of our exports absorbed by the region (about 8 per cent of total exports or about 3 per cent of GDP) limits the size of this effect, although there could also be an indirect impact on Canada if U.S. growth were to be affected.
- Commodity prices have already fallen and may remain weak, especially for such products as lumber, as a result of weaker demand in Asia. This represents a deterioration in Canada's terms of trade that may only be partly offset by lower import prices. But while weaker commodity prices will exert a dampening effect on the economy, this effect should not be overestimated. The share of commodities in Canada's merchandise exports has fallen from around 60 per cent in 1980 to around 40 per cent in 1996.
- Consumer confidence may be eroded as a result of increased uncertainty about future economic and financial prospects, and this may lead to a retrenchment in consumer spending. This is less likely, but nevertheless remains a possibility.

The IMF estimates the impact on growth in Canada and the U.S. to be limited – on the order of one-quarter of 1 percentage point of GDP.

These conclusions should be regarded as both *preliminary* and *tentative* given the evolving nature of the situation. The spread of financial turmoil to other countries in the region and beyond would represent a greater risk to the global economy. The IMF is acting in concert with the international community to stabilize and contain the situation in Asia. Recent developments in this regard are encouraging, although these economies still face substantial economic restructuring ahead.

The recent volatility in financial markets caused by the Asian crisis provides a clear reminder of how Canada can be affected by international economic events, even in regions of the world that seemingly have little to do with the domestic economy. Withstanding them requires the government to continue to be prepared for unforeseen and adverse economic developments.

Canada must therefore be prepared to act with other nations to ensure stable international financial markets. The government will soon be introducing legislative amendments to increase the International Monetary Fund's capacity to maintain a stable international financial system. The government will be giving itself additional means to participate in international co-operative financing arrangements in support of IMF programs. In addition, legislation will be introduced to amend the *International Development (Financial Institutions) Assistance Act* to formalize the process of consultation between the Finance Minister and the Foreign Affairs Minister with respect to multilateral development bank replenishments. This will improve budgetary control over the growth in contingent liabilities to these institutions. Fundamentally, however, the ability of Canada to withstand global economic shocks will depend on the underlying health of its economy and its finances, and its continued success as an exporter.

Indeed, with a relatively small domestic market and with exports accounting for about 40 per cent of GDP, Canada's future prosperity depends on sustaining success as an exporter. Accordingly, the government will continue to make a priority of assisting Canada's exporters, particularly small and medium-sized enterprises, to achieve international success through initiatives including Team Canada trade missions; promoting Canada as the location of choice for investment in North America; improving access to international markets through further global trade liberalization; and enhancing our international competitiveness through the fostering of research and development.

Continued financial market volatility

The Canadian dollar began to weaken late in 1997, with this weakness extending into early 1998. In the view of many private sector forecasters, the weakness of the dollar reflects a number of factors. First, there has been a general movement of international funds into U.S. dollar-denominated instruments, which is common in times of global financial market turbulence since these are regarded as particularly safe investments. One by-product of this has been downward pressure on other currencies, including the Canadian dollar. Second, in this environment of generally unsettled financial markets, the deterioration in the trade balance and the current account associated with strong investment spending, together with lower commodity prices resulting from the economic and financial crisis in Asia, has added to the downward pressure on the exchange rate.

But the factors that led private sector forecasters to expect an appreciation of the dollar over time – a return to sound public finances, a sound competitive position, and low inflation – remain in place. And while interest rates increased late in 1997 and early in 1998, Canadian short-term interest rates remain low and *below* comparable U.S. rates.

Here the contrast between the financial market response in late 1997 and that in the wake of the Mexican peso crisis in early 1995 is quite striking, and is clearly linked to Canada's much improved fiscal and economic situation. For example, in the month following the devaluation of the Mexican peso in December 1994, Canadian long-term interest rates rose nearly 50 basis points. In contrast, since August 1997, the period during which the Asian financial crisis became more acute, Canadian long-term rates have *fallen* by more than 60 basis points. The commitment to fiscal balance is also very important in terms of the long-term outlook for the current account. Indeed, the private sector consensus remains one of declining current account deficits over the medium term.

The external environment

Provided the Asian situation stabilizes, the overall economic environments in both the United States and most major overseas economies are expected to remain conducive to strong job creation and growth.

The United States

Over the past two years, economic developments in the U.S. have been very favourable to growth in Canada. U.S. interest rates have remained stable over this period, while strong growth has provided a growing market for Canadian exports. Developments in the U.S. economy demonstrate that strong and steady growth leads to strong and steady job creation and that low unemployment together with quiescent inflation can be achieved when they are based on sound macroeconomic policies.

On balance, the prevailing consensus on U.S. economic prospects seems to be that a modest slowing of U.S. growth attributable to the Asian crisis might dissipate incipient inflationary pressures. Consequently, most analysts expect short-term interest rates to remain stable for a longer period than was expected only a few months ago.

The consensus view of private sector economists is for the U.S. economy to grow at a moderate pace in 1998 (Table 2.1). Indeed, many economists expected a slowing of growth even before the full extent of the Asian crisis became apparent. This assessment reflected the steep appreciation of the U.S. dollar over the past year, which has led to a significant tightening of overall monetary conditions. Moreover, because interest rates have remained stable, the decline in inflation has resulted in a steady increase in real, or inflation-adjusted, interest rates that should further slow the pace of growth.

Table 2.1
U.S. economic outlook – private sector consensus

	1997	1998	1999
		(per cent)	
Real GDP	3.7	2.5	2.3
CPI	2.4	2.2	2.6
3-month Treasury bill rate	5.3	5.2	5.2
10-year government bond rate	6.4	5.9	6.0

Source: *Blue Chip Economic Indicators*, January 10, 1998. This is a survey of approximately 50 private sector forecasters of the U.S. economy. The 3-month T-bill rate has been adjusted from a discount basis to a true-yield basis by the Department of Finance.

Major overseas economies

Growth among the major overseas economies diverged somewhat in 1997. Available data suggest that Germany, the U.K. and Italy all grew at a faster pace than was expected at the time of the last budget. In contrast, growth prospects were marked down progressively through the year in Japan.

Growth is generally expected to strengthen modestly in 1998 – the exception being the United Kingdom. One of the most positive factors shaping the economic situation in these countries is the virtual absence of inflationary pressures. This provides monetary authorities considerable scope to maintain interest rates at their present accommodative levels, a stance that supports growth and deficit reduction.

Table 2.2
Outlook for overseas economic growth

	1997	1998	1999
		(per cent)	
Japan	0.5	1.7	2.1
Germany	2.4	3.0	2.9
France	2.3	2.9	2.8
United Kingdom	3.4	2.2	2.1
Italy	1.3	2.1	2.6

Source: *OECD Economic Outlook*, December 1997.

There are clear risks to this outlook. Most important, concerns remain that economic growth in Japan may be curtailed if domestic demand fails to strengthen. The risk of this outcome would be heightened by a further deterioration of economic prospects in Asia. In Europe, unemployment remains high and uncertainties about prospects for domestic demand and sustained growth remain, along with uncertainties about the effects of the transition to the European Monetary Union.

Private sector assessment of the economic outlook for Canada

Continued strong output growth through the third quarter suggests that real GDP grew by more than 3½ per cent in 1997, in line with the private sector consensus in September, as presented in *The Economic and Fiscal Update* in October. However, nominal GDP has grown at a slower rate than the 4.7-per-cent pace expected in September owing to lower-than-expected GDP inflation.

Against this background, Canadian private sector economists remain optimistic notwithstanding the effects of the Asian crisis. In September, these forecasters expected growth of 3.7 per cent in 1998 (Table 2.3). And with the favourable outcome last year, the consensus among private sector forecasters surveyed by the Department of Finance is little changed – for 1998, growth of 3.5 per cent is now expected, well above the 2.9 per cent expected at the time of the 1997 budget. The realization of this outcome would mark the best back-to-back economic performances in 10 years. The extended outlook is similarly encouraging with growth of almost 3 per cent expected in 1999.

This assessment is shared by major international economic organizations – the IMF and the Organization for Economic Co-operation and Development (OECD). Indeed, both expect Canada to lead the G-7 in output and job growth in 1998.

In contrast, GDP inflation in 1997 has to date been much lower than expected at the time of the last budget, or indeed at the time of *The Economic and Fiscal Update*. The dampening effect of this on nominal GDP growth is magnified in 1998. For example, private sector economists now expect nominal GDP growth of 4.7 per cent in 1998, about ½ percentage point below the rate of over 5 per cent expected in September.

Other aspects of the private sector consensus have changed little from the very positive outlook prevailing at the time of *The Economic and Fiscal Update*. Short-term interest rates are expected to remain very low by historical standards, although private sector forecasters now expect somewhat higher rates in 1998, reflecting developments since late 1997. The higher interest rates expected by private sector forecasters in 1998 also reflect their view that interest rates will gradually rise as the economy moves toward its productive potential. In contrast, long-term interest rates are now expected to be somewhat *lower* as compared to only a few months ago. This reflects the continued progress on fiscal consolidation and the absence of significant inflationary pressures in the economy. Private sector forecasters also expect strong growth will fuel job creation sufficient to further reduce the unemployment rate, to an average of about 8½ per cent in 1998 and just over 8 per cent in 1999.

Table 2.3
Evolution of private sector forecast survey results

	1997	1998	1999
Real GDP growth (%)			
February 1997	3.3	2.9	
September 1997	3.7	3.7	
February 1998	3.8	3.5	2.9
GDP inflation (%)			
February 1997	1.6	1.7	
September 1997	1.0	1.6	
February 1998	0.7	1.2	2.0
Nominal GDP growth (%)			
February 1997	4.9	4.7	
September 1997	4.7	5.2	
February 1998	4.5	4.7	4.9
CPI inflation (%)			
February 1997	1.6	1.8	
September 1997	1.8	2.0	
February 1998	1.6	1.5	1.7
Unemployment rate (%)			
February 1997	9.3	8.8	
September 1997	9.2	8.6	
February 1998	9.2	8.6	8.2
Employment growth (%)			
February 1997	2.0	2.0	
September 1997	2.0	2.4	
February 1998	1.9	2.3	2.1
3-month Treasury bill rate (%)			
February 1997	3.2	3.7	
September 1997	3.2	4.1	
February 1998	3.2	4.6	4.6
10-year govt. bond yield (%)			
February 1997	6.6	6.6	
September 1997	6.3	6.3	
February 1998	6.1	5.9	6.0

The February 1998 survey is based on 18 respondents for 1998 and 1999 who had updated their forecasts since the release of the Canadian Income and Expenditure Accounts for the third quarter of 1997. The February 1998 data for 1997 reflect actual outcomes, with the exception of GDP data, which are private sector estimates.

Prudent Assumptions for Fiscal Planning

The prudence factors applied to projections for budget planning purposes are to set short-term interest rates 80 basis points higher than the private sector average in 1998, and long-term rates 50 basis points higher. This is in line with the prudence used in the 1997 budget. However, given the unusual degree of uncertainty in the outlook resulting from recent developments in Asia and abroad, the prudence factors used for 1999 are both set 100 basis points higher than the private sector consensus.

For prudent budget planning, nominal GDP growth is also reduced relative to the private sector consensus by an amount that is consistent with the economic impact of the higher interest rates used for budget planning and an overall assessment of risk factors. Taking these into account, the rate of nominal GDP growth used for budget planning purposes is about ½ percentage point lower than the private sector consensus in 1998 and 1 percentage point lower in 1999.

Table 2.4
Prudent planning assumptions[1]

	1997	1998	1999
Real GDP growth (%)			
1997 budget	3.2	2.6	
1998 budget	3.8	3.0	2.5
Nominal GDP growth (%)			
1997 budget	4.7	4.1	
1998 budget	4.5	4.1	3.9
Nominal GDP ($ bn)			
1997 budget	835	870	
1998 budget[2]	857	892	927
3-month Treasury bill rate (%)			
1997 budget	4.0	4.5	
1998 budget	3.2	5.4	5.6
10-year govt. bond yield (%)			
1997 budget	7.1	7.1	
1998 budget	6.1	6.4	7.0

[1] The 1998 budget planning assumptions for real and nominal GDP in 1997 are estimates of the outcome. Assumptions for the 3-month Treasury bill rate and the 10-year government bond yield are actual outcomes.

[2] Canada's National Income and Expenditure Accounts, from which GDP data are obtained, were revised in December 1997. As a result, the historical level and growth rate of nominal GDP has changed. The planning assumptions for nominal GDP used in the 1997 budget are based on nominal GDP data before these revisions were made, while those used in the 1998 budget include the revisions.

3

Building Canada for the 21st Century –

Maintaining Sound Economic and Financial Management

Highlights

- The budget will be balanced in 1997-98 – the first balanced budget since 1969-70.
- The budget will also be balanced in 1998-99 and 1999-2000 – the first time in almost 50 years that the budget will be in balance for three consecutive years.
- Canada's debt burden will be put on a permanent downward track through sustained economic growth and a debt repayment plan.
- By international standards, Canada is the only Group of Seven (G-7) country to have balanced its budget.
- As a share of gross domestic product (GDP), program spending will fall to 11.5 per cent by 1999-2000 – its lowest level in 50 years.
- Current inflation control targets, which keep inflation within a range of 1 per cent to 3 per cent, will be extended to the end of 2001.

Introduction

In 1993-94, Canada was caught in a vicious fiscal circle – high deficits were pushing up interest rates and depressing economic activity which, in turn, worsened the fiscal situation. By that time, a national consensus had formed that Canada's deficit had to be eliminated and the burden of public debt reduced.

The government responded to that consensus. It set out a deliberate, measured and responsible plan to ultimately eliminate the deficit through program reforms that ensured permanent savings, while allowing Canadians and the economy time to adapt. Budget plans were based on two-year rolling deficit targets, using prudent economic planning assumptions and including a sizeable Contingency Reserve. Prudence in budget planning has meant that the Contingency Reserve has not been needed and deficit reduction targets have been consistently bettered in each and every year.

Today, Canada enjoys the benefits of a *virtuous* circle, where fiscal progress contributes to stronger economic and employment growth, which in turn is leading to an ever-improving fiscal climate.

This chapter reviews the progress achieved en route to a balanced budget. It introduces *The Debt Repayment Plan* – the budget planning strategy that will guide the government in reducing its debt burden. It announces, jointly with the Bank of Canada, a three-year extension of Canada's inflation control targets. Finally, it provides a detailed discussion of the outlook for revenues and expenditures.

Balancing the Books – The First Time Since 1969-70

In December 1997, the federal government recorded a budgetary surplus of $3.6 billion – the largest monthly surplus ever recorded. As a result, for the first nine months of 1997-98, the government recorded a surplus of $5 billion. Based on these results, and coupled with expected developments over the balance of the fiscal year (including the traditional end-of-year accounting adjustments) and incorporating the fiscal impact of the initiatives announced in this budget, the budget will be balanced in 1997-98.

Achieving a balanced budget in 1997-98 means that the deficit has declined by $42 billion since 1993-94. The elimination of the deficit was due to a decline in program spending, largely as a result of the restraint measures introduced in the 1994 and 1995 budgets, and higher budgetary revenues, primarily from a growing economy. Partially offsetting these positive developments were somewhat higher public debt charges.

The reduction in program spending largely reflected the net impact of restraint measures taken since 1993-94. Program spending declined from $120 billion in 1993-94 to an estimated $106 billion in 1997-98 – a reduction of $14 billion. This decline includes the impact of the initiatives funded in this budget, which increase program spending by $3.2 billion in 1997-98.

Reductions in program spending were the result of a fundamental review of all federal government programs. Beginning with the 1994 budget and followed up in the 1995 and 1996 budgets, all federal government programs were examined to ensure that limited resources would be directed to the highest priorities. This review was conducted in two parts. Most components of direct program spending – total program spending excluding the major transfers to persons and other levels of government – were subject to the Program Review exercises. As a result:

- the government reduced its role in numerous areas where it no longer has a discernible positive impact – notably direct subsidies to business;
- services that were best delivered by the private sector were privatized or commercialized; and
- programs that could be best delivered by provincial governments were transferred, reducing overlap and duplication between the different levels of government.

In addition, the major transfer programs to persons and other levels of government were also reviewed to ensure that they would be sustainable over the long term. These transfers could not be exempt from overall program reduction, given their substantial share of overall program spending. Structural changes were made to the Employment Insurance (EI) Program. The Canada Assistance Plan and Established Programs Financing arrangements were replaced by the Canada Health and Social Transfer (CHST). The Equalization Program was not subject to restraint.

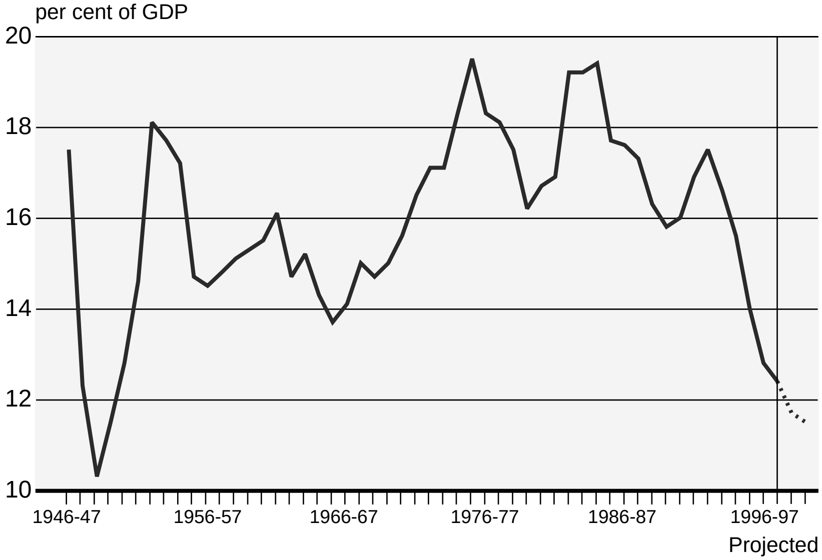
In 1993-94, total program spending as a percentage of the economy (GDP) stood at 16.6 per cent. By 1997-98, it is estimated to have declined to 12.4 per cent (Chart 3.1).

The federal government is not just smaller as a result of these reforms. It is also now more effective and efficient in delivering the programs and services that are central to its responsibilities and role in the Canadian federation. The government is announcing new spending in this budget, of which 80 per cent is being directed to two of the highest priorities of Canadians which will contribute to the building of a stronger economy and a more secure society.

Program spending will continue to be subject to ongoing review. The Expenditure Management System (EMS), first announced in the 1995 budget, will ensure that programs are permanently subject to strict cost control and evaluation. All necessary measures will be taken to ensure the effective management of human resources, with due regard for fiscal responsibility as well as for employees' needs. Under the EMS, departments must clearly set out their strategies through business plans, which are reviewed annually by Parliament. The EMS also provides ministers and departments with more flexibility to manage their resources efficiently, while subjecting them to increasing accountability. This structure will ensure that program spending remains strictly under control.

Chart 3.1

Program spending



Budgetary revenues are estimated to have increased by $31.5 billion between 1993-94 and 1997-98, with nearly $26 billion of this increase attributable to economic developments. Of this amount, about 85 per cent is due to the growth of the economy alone and about 15 per cent is due to the interaction between the tax system and rising incomes. Between 1993 and 1997, nominal income (the overall tax base for budgetary revenues) is estimated to have increased by $133 billion, with one million more Canadians employed. With a growing economy, more people are employed and paying taxes; increased consumer spending leads to higher sales tax revenues; while higher corporate profits result in increased corporate income tax collections.

One-time factors account for just over $3 billion of the total increase in budgetary revenues. Budgetary revenues were depressed in 1993-94 due to the transitional costs associated with the introduction of the Child Tax Benefit ($1.2 billion) and the faster processing of personal income tax returns in March 1994, resulting in higher personal income tax refunds ($1.2 billion). In contrast, budgetary revenues are somewhat inflated in 1997-98 by the inclusion of the Air Transport Tax ($0.7 billion) as part of budgetary revenues, whereas in previous years, it was netted against the cost of running the airports and, therefore, against program spending.

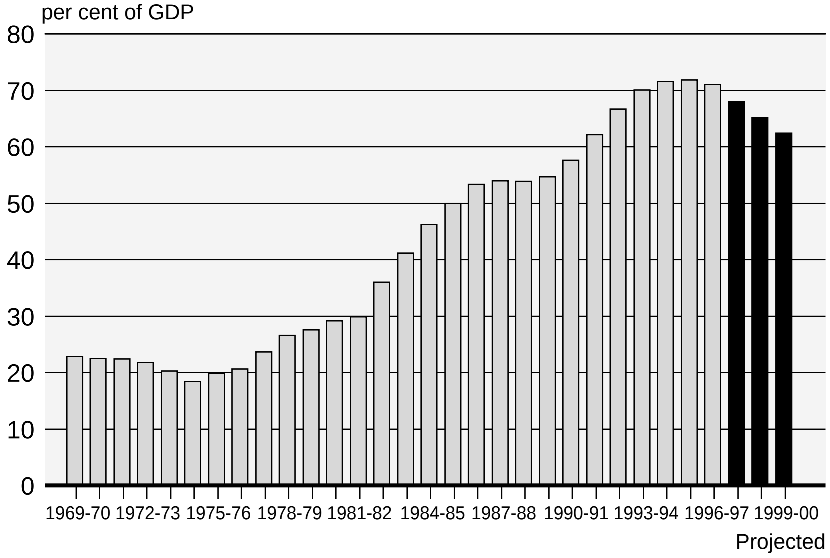
Only $2.6 billion of the estimated increase in budgetary revenues between 1993-94 and 1997-98 is attributable to the net impact of revenue-raising measures introduced since 1993. These measures were primarily designed to increase the fairness of the tax system and to remove or reduce a number of tax preferences. Since 1994, there have been no increases in personal income tax rates.

The Debt Repayment Plan

Canada’s remaining fiscal challenge is to significantly lower the government’s debt burden – measured as the ratio of net public debt to GDP. Although the debt-to-GDP ratio has begun to decline, it is still too high, both by historical Canadian and international standards. It is important to ensure that the debt-to-GDP ratio is put on a permanent downward track.

A high debt burden means that a large portion of the revenue the government collects from taxpayers must go towards debt servicing payments rather than to valued programs and services, to reduce taxes or to pay down the debt. In 1997-98, about 30 cents of each revenue dollar received will be used to pay interest on the public debt – double what was necessary in the mid-1970s.

Chart 3.2
Federal government net debt
(public accounts basis)



Reducing the high debt-to-GDP ratio will also lessen the exposure of Canada's fiscal situation to economic shocks, especially an increase in interest rates or prolonged slowdowns in economic activity.

Of even greater importance over time, reducing the debt-to-GDP ratio will ensure that future generations are left with a legacy of sound social and economic programs. To ensure that younger Canadians do not pay an unduly large portion of the debt, the debt-to-GDP ratio must be reduced while the generations that benefited most from its increase are still in the labour force.

The government intends to put the debt-to-GDP ratio on a permanent downward track by pursuing a two-pronged strategy of supporting long-term economic growth and achieving reductions in the absolute level of debt. First, as the fiscal situation permits, the government will undertake strategic initiatives to improve the growth potential of the Canadian economy. Second, the overall stock of public debt will be reduced through the government's *Debt Repayment Plan*.

The Debt Repayment Plan

The Debt Repayment Plan consists of three key elements:

- as before, two-year fiscal plans based on prudent economic planning assumptions; the current plan commits to balanced budgets in 1998-99 and 1999-2000;
- the inclusion in the fiscal plan of a Contingency Reserve of $3 billion in each year; and
- the use of the Contingency Reserve, when it is not needed, to pay down the public debt.

The Contingency Reserve is included in the budget projections primarily to cover risks arising from (i) unavoidable inaccuracies in the models used to translate economic assumptions into detailed budget forecasts, and (ii) unpredictable events. The Contingency Reserve also provides an extra measure of back-up against adverse errors in the economic forecast. **The Contingency Reserve is not a source of funding for new policy initiatives.**

The government will continue to use a two-year planning horizon for budget planning, which has proved extremely successful in eliminating the deficit. The short-term planning horizon ensures accountability and an immediate commitment to action to make sure that the targets are realized. However, the two-year budget planning horizon does not mean that the government cannot take action to address longer-term structural issues that could affect the Canadian economy and the fiscal situation. For example, the reforms to the Canada Pension Plan, agreed to by the federal and provincial governments, will ensure that it is secure for the future. The government has also proposed a new Seniors Benefit that will address the demographic pressures on the current Old Age Security and Guaranteed Income Supplement programs.

In addition to securing a durable reduction in the public debt burden, the government has also reduced its exposure to increases in interest rates by restructuring the composition of public debt. In 1992-93, one-half of the stock of debt was at fixed rates (one-year maturities and over). Today, 65 per cent of the debt is at fixed rates. This means that a 100-basis-point increase in interest rates would now raise public debt charges by $1 billion in the first year; in the mid-1990s, the first year impact of a 100-basis-point increase was estimated at about $1.8 billion.

Preserving the Gains from Low Inflation

The objective of Canadian monetary policy is to contribute to sustainable economic expansion, high levels of employment and rising standards of living. The best contribution monetary policy can make to these goals is through preserving confidence in the value of money by providing an environment of stable average prices.

Targets for reducing inflation were first adopted in February 1991. In December 1993, the government and the Bank of Canada agreed to extend the targets from the end of 1995 to the end of 1998 with the objective of holding inflation inside the range of 1 per cent to 3 per cent. It was also agreed that the targets would be re-examined by the end of 1998 and a new long-term target range consistent with price stability would be set at that time.

Since the initial adoption of these targets, considerable progress has been made in reducing inflation and maintaining it at a low level. Economic decisions are increasingly being made on expectations of a continuation of low inflation, and Canadians are beginning to experience the benefits from such an environment. For example, low inflation, together with the progress made by all levels of government in Canada to restore fiscal balance, has resulted in substantial declines in interest rates, with medium- and long-term interest rates near their lowest levels in decades. However, over the past several years, the Canadian economy has been through a difficult period of private and public sector restructuring, and the full benefits for economic performance of low inflation have yet to be realized.

It would be helpful to have a longer period of time in which the economy demonstrated more fully its ability to perform well under conditions of low inflation before determining the appropriate long-run target consistent with price stability. Consequently, the Government of Canada and the Bank of Canada have agreed to extend the existing inflation control targets, which are to hold inflation inside the range of 1 per cent to 3 per cent, to the end of 2001. The government and the Bank of Canada plan to determine the long-run target for monetary policy before the end of 2001. Providing Canadians with a long-term commitment will help to secure the benefits that a stable price environment can bring to the growth of incomes and employment in Canada.

The extension of the inflation targets will help to keep Canada's inflation rate among the lowest in the world. It will provide Canadians with a medium-term guide in making economic decisions. As well, it will solidify Canada's international reputation as a low inflation country, enhancing the credibility of Canadian economic policies.

Fiscal Outlook to 1999-2000

Overview

At no time in the past 25 years has Canada's fiscal situation been so positive (Table 3.1).

- The budget for 1997-98, including spending and tax relief initiatives announced in this budget, will be balanced. This will be the first time since 1969-70 that the federal government has achieved a balanced budget.
- The government is committed to balancing the budget for 1998-99 and 1999-2000. This will mark the first time in nearly 50 years that the federal government will have balanced its books for three years in a row.
- These targets are based on prudent planning assumptions and include a Contingency Reserve of $3 billion each year. If the Contingency Reserve is not needed, it will be used to pay down the debt.
- In 1996-97, the debt-to-GDP ratio fell – the first meaningful decline since 1974-75. With sustained economic growth and *The Debt Repayment Plan*, this ratio will continue to decline. By 1999-2000, it is projected to be at about 63 per cent of GDP, compared to almost 72 per cent in 1995-96.
- In 1996-97, a financial surplus of $1.3 billion was reported. This meant that the government took in more cash than was needed to pay for current operations and to pay interest on the public debt. With a commitment to balanced budgets in 1997-98 and in each of the next two fiscal years, the government will be in an ongoing net financial surplus position, or cash position. This will allow the government to steadily pay down its market debt. For the first nine months of 1997-98, the government paid down $12.9 billion of its market debt.

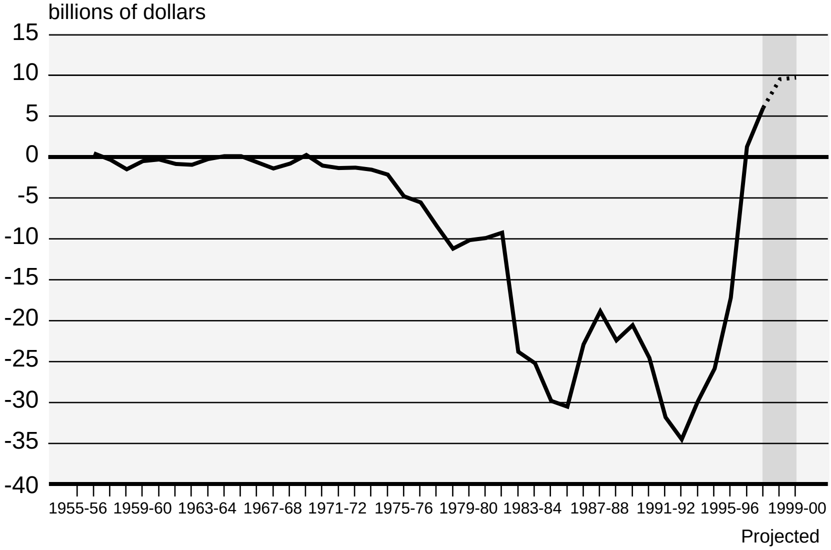
Table 3.1
Summary statement of transactions: fiscal outlook with budget measures

	1993-94	1994-95	1995-96	1996-97	1997-98	1998-99	1999-00
				(billions of dollars)			
Budgetary revenues	116.0	123.3	130.3	140.9	147.5	151.0	155.0
Program spending	120.0	118.7	112.0	104.8	106.0	104.5	107.0
Operating balance	-4.0	4.6	18.3	36.1	41.5	46.5	48.0
Public debt charges	38.0	42.0	46.9	45.0	41.5	43.5	45.0
Underlying balance	-42.0	-37.5	-28.6	-8.9	0.0	3.0	3.0
Contingency Reserve						3.0	3.0
Budgetary balance	-42.0	-37.5	-28.6	-8.9	0.0	0.0	0.0
Net public debt	508.2	545.7	574.3	583.2	583.2	583.2	583.2
Non-budgetary transactions	12.2	11.6	11.4	10.2	12.0	6.0	9.0
Financial requirements/surplus (excluding foreign exchange transactions)	-29.8	-25.8	-17.2	1.3	12.0	6.0	9.0
Per cent of GDP							
Budgetary revenues	16.0	16.2	16.3	17.2	17.2	16.9	16.7
Program spending	16.6	15.6	14.0	12.8	12.4	11.7	11.5
Operating balance	-0.6	0.6	2.3	4.4	4.8	5.2	5.2
Public debt charges	5.2	5.5	5.9	5.5	4.8	4.9	4.9
Budgetary balance	-5.8	-4.9	-3.6	-1.1	0.0	0.0	0.0
Net public debt	70.2	71.6	71.9	71.1	68.1	65.4	62.9
Financial requirements/ surplus	-4.1	-3.4	-2.2	0.2	1.4	0.7	1.0

■ Financial requirements/surplus are comparable to the measures of the budgetary balance used by other major industrialized countries, including the United States. Therefore, by internationally comparable measures, this means that the federal government had a surplus in 1996-97 and will continue to run surpluses – the best performance among all other G-7 countries (see Annex 4 for more details on international fiscal comparisons).

Chart 3.3

Financial requirements (-)/surplus (+)
(public accounts basis)



Changes since the 1997 budget forecast

The final deficit outcome for 1996-97 was $8.9 billion. This was $10.1 billion lower than the February 1997 budget estimate of $19 billion and $15.4 billion below the original deficit target of $24.3 billion. This better-than-expected performance reflected both lower program spending and higher revenues. This improvement has carried over into 1997-98.

Financial results for the first nine months of the 1997-98 fiscal year report a cumulative budgetary surplus of $5 billion (see *The Fiscal Monitor* for December 1997). Indeed, for the month of December 1997, the government recorded the largest monthly surplus ever. Over the remaining three months of the fiscal year and the end-of-year accounting period, it is expected that the federal government will run a small deficit. This is consistent with the flow of revenues and spending witnessed in previous fiscal years and takes into account adverse fiscal developments resulting from the January 1998 ice storm in eastern Canada. Incorporating the impact of the initiatives proposed in this budget, a balanced budget will be recorded in 1997-98. Final results will be published in the *Annual Financial Report*, which is released in the fall of each year.

Table 3.2
The fiscal outlook: changes since the 1997 budget

	1996-97	1997-98	1998-99
	(billions of dollars)		
Original deficit target	19.0	17.0	9.0
Impact of economic factors			
Revenues:			
Personal income tax		-1.9	-1.7
Corporate income tax	-1.2	-3.8	-3.4
Employment insurance premium revenue	-0.2	0.4	0.7
Sales and excise taxes/duties	-2.1	-3.6	-3.4
Other revenues	-1.9	-1.1	-0.7
Total	-5.4	-10.0	-8.5
Program spending			
Major transfers to persons	-0.7	-2.4	-1.5
Major transfers to other levels of government	0.2	0.3	-0.1
Direct program spending	-3.7	-0.9	0.6
Total	-4.2	-3.0	-1.0
Public debt charges	-0.5	-2.0	-0.5
Net impact of economic factors	-10.1	-15.0	-10.0
Adjustment to public debt charges		-2.5	-2.5
Net impact of policy changes		3.5	3.5
Contingency Reserve		-3.0	
Net changes since 1997 budget	-10.1	-17.0	-9.0
1998 budget deficit track	8.9	0.0	0.0

Note: (-) indicates a reduction in deficit
(+) indicates an increase in the deficit

Based on the financial results to date and expected developments over the balance of the fiscal year, budgetary revenues, excluding the impact of policy initiatives, are expected to be $10 billion higher in 1997-98 than estimated in the February 1997 budget. Most of the increased revenues reflect higher corporate income tax and goods and services tax (GST) collections. Both corporate profits and consumer expenditures subject to the GST are much higher than estimated at the time of the February 1997 budget. Personal income tax collections are also expected to be somewhat higher, reflecting the strong employment growth witnessed in 1997.

The higher overall collections estimated for 1997-98 are expected to continue into 1998-99, although at a somewhat reduced pace. As indicated in Chapter 2, nominal income growth is expected to slow somewhat from 1997.

Excluding the impact of policy initiatives, program spending is expected to be $3 billion lower in 1997-98 and $1 billion lower in 1998-99, from the levels estimated in the February 1997 budget. Most of the lower spending is attributable to lower-than-expected employment insurance benefit payments, because of the drop in the number of unemployed. Direct program spending is lower in 1997-98 but somewhat higher in 1998-99 as a result of some reprofiling of funds between fiscal years. The reprofiling of funds is subject to Treasury Board approval, and promotes more efficient cash management practices.

Public debt charges are expected to be $2.0 billion lower in 1997-98 and $0.5 billion lower in 1998-99. Both short- and long-term interest rates in 1997 turned out to be significantly lower than those assumed for prudent planning purposes in the 1997 budget. Although short-term interest rates are now assumed, for planning purposes, to be somewhat higher in 1998, long-term interest rates are somewhat lower.

As a result, economic factors accounted for $10.1 billion of the lower-than-expected deficit outcome for 1996-97. For 1997-98, economic factors are estimated to account for $15 billion, while in 1998-99, these factors are estimated to account for $10.0 billion.

The Auditor General disagrees with the way that the government is reporting interest costs related to public service pension plans (see Annex 6). For accounting purposes, the Auditor General and the Public Sector Accounting and Auditing Board (PSAAB) have recommended since 1996 that such interest costs be calculated on the basis of the actuarial obligation of the pension plans rather than on the financial obligation. At present, the actuarial obligation is significantly lower than the financial obligation. Beginning in 1997-98, the government will change its accounting policies to conform with the recommendations of the PSAAB and the Auditor General. This will have the effect of reducing net public debt charges by about $2.5 billion per year. In addition, the President of the Treasury Board will be undertaking consultations with plan members regarding fundamental reform of the management and financing of public service pensions.

New initiatives totalling $3.5 billion are planned for 1997-98. These include $2.5 billion for the Canada Millennium Scholarship Foundation and the $350 million fund for a Healing Strategy to address the legacy of abuse of aboriginal students in residential schools. The government believes that transparency and accountability to Parliament and Canadians are best served by recording such liabilities in the year in which they are incurred (see Annex 6). In addition, the commitment to raise the cash floor of the Canada Health and Social Transfer to $12.5 billion results in an additional transfer of $0.2 billion to provinces in 1997-98. Also included is the impact of the reduction in employment insurance premium rates for 1998 from an assumed rate of $2.80 in the 1997 budget (employee rate per $100 of insurable earnings) to $2.70.

The fiscal impact of spending and tax initiatives is estimated at $3.5 billion for 1998-99 as well. Of this amount: $0.9 billion relates to general tax relief for Canadians; $0.5 billion relates to the reduction in EI premium rates; $0.9 billion for the raising of the CHST cash floor; $0.7 billion for the *Canadian Opportunities Strategy*; $0.3 billion to Building a Secure Society; and the remainder allocated for other commitments in *Securing Our Future Together*.

Given the improvement in the fiscal outlook for 1997-98, the Contingency Reserve of $3 billion included in the original deficit target of $17 billion is no longer required. However, under *The Debt Repayment Plan*, the $3 billion Contingency Reserve is included in the balanced budget target for 1998-99 and 1999-2000.

Outlook for budgetary revenues

The revenue outlook to 1999-2000 is summarized in Table 3.3.

In the first nine months of 1997-98, budgetary revenues were up 6.7 per cent over the same period last year. Strong gains were reported for personal and corporate income tax collections and for the GST. This pace of revenue growth is expected to slow over the balance of the fiscal year. For the year as a whole, budgetary revenues are expected to increase by 4.7 per cent. An increase of only 2.4 per cent is expected for 1998-99, primarily reflecting the impact of the general and targeted tax relief measures proposed in this budget. For 1999-2000, budgetary revenues are expected to increase by 2.6 per cent. As a percentage of GDP, revenues are expected to fall from 17.2 per cent in 1997-98 to 16.7 per cent in 1999-2000.

Table 3.3
The revenue outlook

	1996-97	1997-98	1998-99	1999-00
	(billions of dollars)			
Income tax revenue				
Personal income tax	63.3	68.4	71.0	73.5
Corporate income tax	17.0	20.0	20.5	20.9
Other	2.8	2.4	2.3	2.4
Total	83.1	90.8	93.8	96.8
Employment insurance premium revenue	19.8	18.7	18.6	19.0
Sales and excise taxes/duties				
Goods and services tax	18.1	19.8	20.9	21.8
Customs import duties	2.7	2.7	2.5	2.5
Other	8.3	8.8	8.6	8.5
Total	29.1	31.3	32.0	32.7
Non-tax revenue	8.8	6.8	6.7	6.6
Total budgetary revenues	140.8	147.5	151.0	155.0
Per cent of GDP	17.2	17.2	16.9	16.7

Personal income tax revenues, the single largest source of federal revenues, are expected to increase by 3.8 per cent in 1998-99, following an expected advance of 8.1 per cent in 1997-98. The slower rate of growth in 1998-99 reflects the impact of the proposed increase in the amount of income that low-income Canadians can receive on a tax-free basis and the elimination of the 3-per-cent surtax for those Canadians with incomes up to about $50,000. These measures, coupled with the proposed increase in the Canada Child Tax Benefit, also affect personal income tax growth in 1999-2000.

Over the first nine months of 1997-98, corporate income tax collections are up 27.6 per cent. Collection growth is expected to slow considerably over the balance of the fiscal year and an increase of 17.6 per cent is expected for the year as a whole. For both 1998-99 and 1999-2000, collections are expected to increase only marginally, reflecting the assumed increase in corporate profits.

For 1998, the employment insurance premium rate has been lowered to $2.70 (employee rate) per $100 of insurable earnings, from $2.90 in 1997. The government is planning its budget on a premium rate of $2.70 for 1999 and $2.60 for 2000. This budget also proposes an employer employment insurance premium holiday for additional young Canadians hired in 1999 and 2000.

This is expected to lower employment insurance premium revenues by about $100 million in 1999-2000. These measures are largely expected to offset any increase in premium revenues resulting from advances in overall job creation.

Goods and services tax collections are up 13.1 per cent in the first nine months of 1997-98, reflecting the growth in consumer spending subject to the GST. For the year as a whole, GST collections are expected to be up 9.4 per cent. Other excise tax collections are expected to decline in 1998-99, largely due to the phase-out of the Air Transport Tax in 1998.

Non-tax revenues include return on investments, most notably Bank of Canada profits and exchange fund earnings, and other non-tax revenues such as user fees and charges. Revenues were exceptionally large in 1996-97 due to the inclusion of the proceeds from the sale of Transport Canada's air navigation assets.

Outlook for program spending

Table 3.4 provides the major elements of program spending through to 1999-2000. The profile of program spending reflects the impact of new initiatives announced since the 1997 budget.

For 1997-98, total program spending is expected to amount to $106 billion. This is only marginally higher than the February 1997 budget estimate of $105.8 billion, even though the current estimate includes the cost of the Canada Millennium Scholarship Foundation of $2.5 billion and the fiscal impact of other initiatives announced since the February 1997 budget. The elimination of the deficit has allowed the government to undertake additional strategic investments without materially affecting the level of program spending projected in the 1997 budget.

Program spending is estimated to fall to $104.5 billion in 1998-99. In the February 1997 budget, program spending was estimated at $103.5 billion. However, excluding the impact of the new initiatives ($2 billion) since the February 1997 budget, program spending would have been $1 billion lower than estimated in the 1997 budget.

By 1998-99, the Program Review restraint measures are fully reflected in the spending estimates. Although these measures are permanent, there are no incremental restraint measures beyond 1998-99. In 1999-2000, program spending increases to $107.0 billion, an increase of 2.4 per cent from 1998-99.

This increase reflects, in part, the impact of rising transfers to persons (elderly and employment insurance benefits) and the spending initiatives funded in this budget. As well, after five years of steady decline in government operating budgets, an increase in departmental spending in line with the rate of inflation (1.5 per cent) has been factored into the program spending estimates to address wage and price increases and workload pressures.

Program spending falls into three components: major transfers to persons, major transfers to other levels of government and direct program spending – referred to as departmental spending.

Major transfers to persons

Major transfers to persons consist of elderly benefits – Old Age Security (OAS), Guaranteed Income Supplement (GIS) and Spouse's Allowance (SPA) – and employment insurance benefits.

The increase in elderly benefits expected through 1999-2000 reflects a combination of rising maximum benefits (which are indexed to inflation) and growth in the senior population. The government intends to introduce legislation in the coming months to replace OAS and GIS with a new Seniors Benefit.

Employment insurance benefit payments are expected to continue to fall through 1997-98. EI benefits peaked in 1992-93 at $19.1 billion. The decline is due to improvements in the job market since 1993 and to structural reforms to the EI program. However, benefits payments are expected to rise modestly, starting in 1998-99. With an improving economy, the number of beneficiaries relative to the number of unemployed typically increases.

Major transfers to other levels of government

There are three major programs under which the federal government transfers funds to other levels of government. The largest of these is the Canada Health and Social Transfer (CHST), a block-funded transfer to provinces and territories to support health care, post-secondary education and other social programs.

Total CHST entitlements are determined through legislation. The CHST is delivered in the form of tax point transfers and cash transfers. Tax point transfers involved the transfer of federal "tax room" to the provinces, which allowed the provinces to increase their tax rates by an equivalent amount with no impact on taxpayers. The cash transfer is the difference between the total entitlement and the value of the tax point transfer.

Reflecting the commitment made in *Securing Our Future Together*, legislation was introduced in December 1997 to raise the cash floor to $12.5 billion beginning in 1997-98. The $12.5 billion cash floor means:

- in 1999-2000, provinces and territories are scheduled to receive an estimated $1.5 billion more in CHST cash transfers than they were to receive in the 1997 budget;
- over the period 1997-98 to 2002-03, there will be an additional $7 billion in CHST cash transfers; and
- CHST entitlements will start to grow in 1998-99. By 1999-2000, the estimated CHST entitlement will have increased more that 5 per cent over the 1997-98 level.

Equalization provides a further transfer in excess of $8.5 billion in cash to provinces with below-average per capita capacity to raise revenues. This enables these provinces to provide public services that are reasonably comparable to those available elsewhere in the country, without having to resort to above-average levels of taxation.

Between 1993-94 and 1996-97, Equalization payments increased significantly, reflecting the fact that this program was not subject to restraint. Over the fiscal planning horizon, provincial revenue growth, the strength of resource-based revenues in some of the Equalization-receiving provinces and shifts in population among provinces, will have an impact on Equalization payments. Statutory authority for Equalization expires March 31, 1999. For planning purposes, the estimates of Equalization transfers beyond 1998-99 assume a continuation of the current statutory formula.

The federal government also provides transfers to territorial governments, recognizing that these governments are in a unique situation due to the special challenges of providing public services in the north. These transfers are estimated at $1.1 billion in 1997-98 and 1998-99. In 1999, when Nunavut comes into existence, new arrangements will be required for the three northern territories. The federal government is consulting with northern parties to estimate reasonable incremental costs that will result from the division. For planning purposes, estimates of transfers to the territorial governments in 1999-2000 assume funding at current levels.

The economies of Canada's territories, like other regions, are undergoing significant change. Northern governments are pursuing the diversification of their economies in a variety of ways including the development of traditional economic activities, knowledge-based industries and a new diamond industry. The government is committed to working with territorial governments and other northern partners to develop a modern economic development strategy that recognizes the dynamics of the North and the need to establish more diversified economies.

The Alternative Payments for Standing Programs represent recoveries of federal tax point abatements under contracting-out arrangements. These arrangements allowed provinces to assume the administrative and financial authority for certain federal-provincial programs. In turn, the federal government provided provinces with tax points, the value of which are netted against total entitlements, and accordingly recovered from the cash transfers. Quebec was the only province to choose these arrangements when they were offered in the mid-1960s. The recoveries have no impact on net federal transfers or on Quebec's net receipts.

Direct program spending

Direct program spending consists of total program spending excluding the major transfers to persons and to other levels of government. It includes transfer programs administered by departments, expenditures related to Crown corporations and the operating, maintenance, and capital costs of departments, including defence.

Seven departments account for the majority of transfer payments.

- Transfers within the agriculture department largely consist of the agricultural safety net programs. The spending profile reflects the ongoing phase-out of the dairy subsidy and the reprofiling of funds within the agriculture safety-net envelope.
- Industry and regional development transfers support a wide range of programs, such as advanced research and technology adoption and diffusion and support for small businesses. Transfers will increase over the next two years reflecting the measures in this budget in support of advanced research and the information economy (i.e. funding for the granting councils and for the CANARIE, SchoolNet and Community Access programs) and the Technology Partnerships Canada Program introduced in the 1996 budget.

- A significant portion of the transfers administered by the Department of Foreign Affairs and International Trade consists of funding for international assistance. The international assistance envelope will be up slightly from the estimate at the time of the 1997 budget, reflecting the impact of one-time payments of $90 million in 1997-98 and $50 million in 1998-99.

- A significant portion of Health Canada's transfers is for First Nations and Inuit health services, as well as funding for the population health strategy and the Medical Research Council. Reflecting growth in the First Nations and Inuit populations and new initiatives since the 1997 budget, such as increased funding for HIV/AIDS and the Medical Research Council, health expenditures will increase over the forecast horizon.

- Growth in transfer programs adminstered by the Department of Indian and Northern Affairs was restrained in the 1995 and 1996 budgets. However, rapid growth of the on-reserve aboriginal population meant that this was one of the few program areas that did not experience an absolute decline in spending. Current spending levels incorporate a number of initiatives announced in *Gathering Strength*, which will raise the level of transfers to $4.1 billion in 1998-99 and 1999-2000.

The ongoing effects of restraint measures introduced since 1993 will continue to restrain Crown corporation expenditures over the next two years. Spending on Crown corporations will average $3.8 billion over the 1997-98 to 1999-2000 period compared with the $5 to 6 billion in the early 1990s. The government will continue to review its equity holdings in Crown corporations and other assets, divesting those that no longer serve a public policy objective.

Defence spending is also expected to decline through 1998-99 as past expenditure restraint decisions are fully implemented. The increase in defence spending in 1999-2000 largely reflects the effect of one-time savings of $150 million in 1998-99 that were put into effect in the 1996 budget as well as a carry-forward of capital expenditures from 1996-97 to 1999-2000.

All other spending includes departmental operating costs and centrally held funds to assist departments in managing unavoidable cost pressures during the fiscal year. The expenditure control measures implemented by the government since 1993-94 have significantly reduced operating budgets of departments. And the continued operation of the Expenditure Management System (introduced in the 1995 budget) will ensure that departments fulfill their mandates in the most efficient and cost-effective manner possible. This means that, to the greatest possible extent, new cost pressures will be funded by internal reallocation and increased efficiencies.

The public service of Canada is an essential institution with a long and proud record of outstanding contributions to national objectives and high quality service to citizens. In recent years, it has undergone difficult adjustments in response to severe fiscal pressures and the need for changing priorities. The ability to address future priorities will depend to a considerable degree on the continued strength of the public service. The government is committed to implementing measures that will ensure the revitalization of the public service and the capacity to work in partnership with other sectors in Canadian society to help build the Canada of the future.

The Year 2000 preparedness presents a global challenge – for individuals, for businesses and for governments. The recent report of the Task Force on Year 2000 set out a variety of actions that business will have to undertake to ensure that they meet the challenge of continuing operation of computer-supported systems in the next millennium. The initiatives taken by securities commissions and stock exchanges to ensure full disclosure by publicly traded companies of their state of readiness in this regard represent a further welcome step in preparing Canada to meet this challenge. The government is also clarifying the tax treatment of Year 2000 expenditures. Expenditures that are made to ensure functionality in the Year 2000 will be fully deductible in the year incurred.

For its part, the government will ensure that all of its critical computer-based systems will continue to function at the turn of the millennium. To this end, the government is reallocating resources within its own information technology budget to focus on solving the Year 2000 problem.

Table 3.4
The outlook for program spending

	1996-97	1997-98	1998-99	1999-00
	(billions of dollars)			
Major transfers to persons				
Elderly benefits	21.6	22.2	22.9	23.6
Employment insurance benefits	12.4	12.0	12.6	13.2
Total	34.0	34.2	35.5	36.8
Major transfers to other levels of government				
CHST				
Total entitlements	26.9	25.3	26.0	26.6
Tax point transfer	-12.1	-12.8	-13.5	-14.1
Cash payment	14.8	12.5	12.5	12.5
Equalization	8.7	8.8	8.5	8.7
Transfers to territories	1.1	1.1	1.1	1.1
Other fiscal transfers	-0.4	-0.4	-0.4	-0.5
Alternative Payments for Standing Programs	-2.0	-2.1	-2.2	-2.3
Total cash transfers	22.2	19.9	19.5	19.5
Reference:				
Total entitlements	36.0	34.2	34.7	35.4
Direct program spending				
Departmental transfers				
Agriculture	1.1	1.0	1.0	0.9
Industry and Regional Development	1.6	1.9	2.0	1.8
Foreign Affairs	2.1	2.2	1.9	1.9
Health	0.9	0.9	1.1	1.1
Human Resources Development	2.1	2.1	2.2	2.0
Indian and Northern Development	3.9	4.0	4.1	4.1
Other	6.1	7.6	4.7	5.1
Total	17.9	19.6	17.0	16.8
Crown corporations	3.6	3.9	3.8	3.8
Defence	8.5	8.4	7.9	8.2
Other	18.7	20.0	20.9	21.9
Total direct program spending	48.7	52.0	49.5	50.7
Total program spending	104.8	106.0	104.5	107.0
Per cent of GDP	12.8	12.4	11.7	11.5

Numbers may not add due to rounding.

Public debt charges

Public debt charges are expected to fall to $41.5 billion in 1997-98, reflecting the impact of the decline in interest rates and the change in accounting for pension interest. The higher interest rates, embedded in the prudent budget planning assumptions, result in an increase in public debt charges over the planning horizon.

Table 3.5
Public debt charges

	1996-97	1997-98	1998-99	1999-00
		(billions of dollars)		
Public debt charges	45.0	41.5	43.5	45.0

Financial surplus

The financial balance (requirements/surplus) provides a measure of net cash requirements to fund the government's programs and debt charges. In 1996-97, the financial balance was in surplus by $1.3 billion. The financial surplus is expected to be $12 billion in 1997-98, $6 billion in 1998-99 and $9 billion in 1999-2000.

The difference between the financial balance and the budgetary balance is due to a number of non-budgetary transactions that provide funds to the government. Non-budgetary transactions convert the cash-based financial requirements to the accrual-based spending and revenue concepts in the deficit. The largest of the non-budgetary transactions are the government employees' pension accounts. Other smaller sources of funds include loans, investments and advances, cash in transit and accounts payable.

Non-budgetary transactions are expected to be up significantly in 1997-98, down significantly in 1998-99 and then return to more normal levels in 1999-2000. This pattern reflects the impact of the Canada Millennium Scholarship Foundation. The Foundation will affect the budgetary balance in 1997-98, but it will affect the financial balance only in 1998-99 – the year the government actually advances the $2.5 billion to the Foundation.

Financial requirements (excluding foreign exchange transactions) are a proxy for the amount of net new debt that the government issues on financial markets. However, in any single month, changes in the government's cash balances and foreign exchange reserves will also have an impact on the level of market debt.

Reflecting the increased flows and volatility in foreign exchange markets, the government plans to continue to increase foreign exchange reserves. This will bring Canadian reserves more in line with other comparable countries.

Table 3.6
Budgetary balance, non-budgetary transactions and financial surplus

	1996-97	1997-98	1998-99	1999-00
	(billions of dollars)			
Budgetary balance	-8.9	0.0	0.0	0.0
Non-budgetary transactions				
Loans, investments & advances	0.3	1.0	1.3	0.4
Pension and other accounts	6.9	3.7	5.0	5.7
Other	3.0	7.3	-0.3	2.9
Total	10.2	12.0	6.0	9.0
Financial surplus (excluding foreign exchange transactions)	1.3	12.0	6.0	9.0

(-) implies a requirement for funds / (+) implies a source of funds.

4

Building Canada for the 21st Century –

The Canadian Opportunities Strategy

Highlights

The budget proposes a comprehensive *Canadian Opportunities Strategy* to expand access to the knowledge and skills needed for better job opportunities in the 21st century. The Strategy acts on seven fronts to:

- provide more than 100,000 students with Canada Millennium Scholarships averaging $3,000 per year and to 25,000 students who are in financial need and have children or other dependants with new Canada Study Grants;
- increase assistance for advanced research and for graduate students through increased funding for the three granting councils;
- help graduates manage their student debt loads by providing tax relief for interest payments on student loans, and improving the Canada Student Loans Program to help individuals facing financial difficulties;

Highlights *(cont'd)*

- help Canadians upgrade their skills throughout their working lives by allowing tax-free withdrawals of up to $10,000 per year from their registered retirement savings plan for lifelong learning, and by extending the education tax credit and the child care expense deduction to part-time students;
- ensure that families can better save for their children's future education by providing stronger incentives through the new Canada Education Savings Grant – a grant of 20 per cent on the first $2,000 of contributions made each year to registered education savings plans;
- support youth employment by more than doubling funding for youth at risk who lack basic education and job skills, and by providing to employers an employment insurance premium holiday for additional young Canadians hired in 1999 and 2000; and
- increase funding for SchoolNet, the Community Access Program, and the Canadian Network for the Advancement of Research, Industry and Education (CANARIE) to help bring the benefits of the information age into more classrooms and communities across Canada.

Introduction

The challenge

In the past, Canada's economic prosperity was due, in large part, to our rich natural resource endowment. Now, and in the future, our economic prospects will depend more and more on the skills and strengths of our human resources. Canadians must have the knowledge and skills to participate in the changing economy. A productive and innovative workforce can give Canada the vital edge in competing in the future.

The key to growth and jobs in the years ahead is knowledge and skills. If Canadians are to enjoy prosperity and a high quality of life in the next century, they must be prepared for the jobs of tomorrow. That is why there can be no wiser investment in the future than investments in knowledge and skills. Preparing Canadians for the 21st century is the goal.

For individual Canadians, knowledge and skills offer hope and opportunity: the prospect of better employment, higher earnings and greater job security. The acquisition of knowledge and skills is the greatest equalizer of all.

Many Canadians are concerned about the rising costs of post-secondary education in Canada. Although the lion's share of higher education is financed by governments, tuition fees have more than doubled over the past decade and other costs have risen as well. Incomes have not kept pace. Consequently, many students are now graduating with higher debt loads.

For families with limited income, the increased cost of education and the prospect of taking on large debts represent a barrier to pursuing the acquisition of knowledge and skills.

The aim of the *Canadian Opportunities Strategy* is to help ensure that all Canadians – especially those with low and middle incomes – have an equal opportunity to participate in the changing labour market. This means reducing the financial barriers and other obstacles to acquiring skills and knowledge. By increasing access and opportunity, the Government of Canada is building a stronger economy and a more secure society.

Acting on shared goals

In December 1997, Canada's First Ministers agreed on the importance of lessening students' financial burden. Furthermore, it was agreed that the federal Minister of Finance and Minister of Human Resources Development would accelerate work in concert with provincial and territorial education ministers so that the Minister of Finance could take account of this work in this budget. First Ministers also committed to a youth employment action plan, one objective of which is to maintain and improve access to education and skills for Canada's young people.

Education is a matter of provincial jurisdiction: provinces manage educational institutions, establish education policies and set curricula. They also regulate apprenticeships and set the standards for occupational skills. Nine of the 10 provinces have signed agreements with the federal government to promote labour market development under the Employment Insurance Program.

Both the federal government and provincial governments have long-established roles in enhancing equality of opportunity for Canadians by assisting those who face financial barriers to learning. The federal role goes back to the post-war years when assistance was provided to veterans so that they could go on to post-secondary education – as so many did – providing the foundation for much of Canada's economic success in the second half of this century.

Creating opportunities for Canadians

The changes that are taking place in the economy are altering the way Canadians work and the skills they need to find better jobs and ensure a higher standard of living.

In a rapidly changing labour market, the knowledge and skills that Canadians need for employment will evolve through their working lives. Whether through the disappearance of old jobs or through personal choice, many Canadians will want, or need, to learn new skills.

Over the past two decades, job growth has been faster for those with higher skills. For persons with less than high school education, the number of jobs is shrinking rapidly: as a result, their unemployment rate is now much higher than that of persons with a university degree. Moreover, given the relatively weak demand for low-skilled workers, their employment earnings are falling behind those of more educated and skilled workers. The rising importance of knowledge and skills is only partly due to the creation of new "high-skill" jobs in "high-tech" industries. There has also been a steady increase in skill requirements in all sectors of the economy and in most types of jobs – from machinists to warehouse workers, from farmers to loggers.

Some Canadians think of learning, especially post-secondary education, as something that takes place solely full time in a classroom and that is only for the young. In reality, it can take place almost anywhere and is important for Canadians of all ages.

Canadians learn at universities, but also at community colleges, CEGEPs, and vocational and technical institutions. They learn both full time and part time. Knowledge and skills are important for

Canadians, be they nurses, engineers, sheetmetal workers, or data analysts. And this process does not stop at the classroom door. Gaining experience and on-the-job skills are vital ways of learning. For many people, this is the most effective way to acquire practical skills.

A more educated and skilled workforce is better at developing, diffusing and adopting advances in knowledge that are the key to economic growth. Businesses, educational institutions and governments must accommodate a wide range of learners of all ages. And governments must recognize the different ways, and different points of their lives, in which people learn.

Canadians have long recognized the value of learning. Young Canadians are enrolling in higher education at a record rate. Almost a million students are enrolled full time in post-secondary education and a further 430,000 part time. Twenty-five years ago, only 19 per cent of young people were enrolled in public post-secondary educational institutions. Now this has risen to 33 per cent.

Canada ranks first among industrialized countries in enrolment of youth age 18-21. However, among older groups, Canada's ranking is not as high. For those age 22-25, Canada ranks third; for those age 26-29, it ranks sixth.

Forty-six per cent of working-age Canadians have at least some post-secondary education. Canada places third among industrialized countries, behind the United States and the Netherlands, in the proportion of university-educated individuals. This is a notable achievement.

Canada, unfortunately, also has a higher proportion of persons of working age with less than high school education than do the United States and several other major industrial countries. This is especially prevalent among older workers, but it is most worrisome among the young.

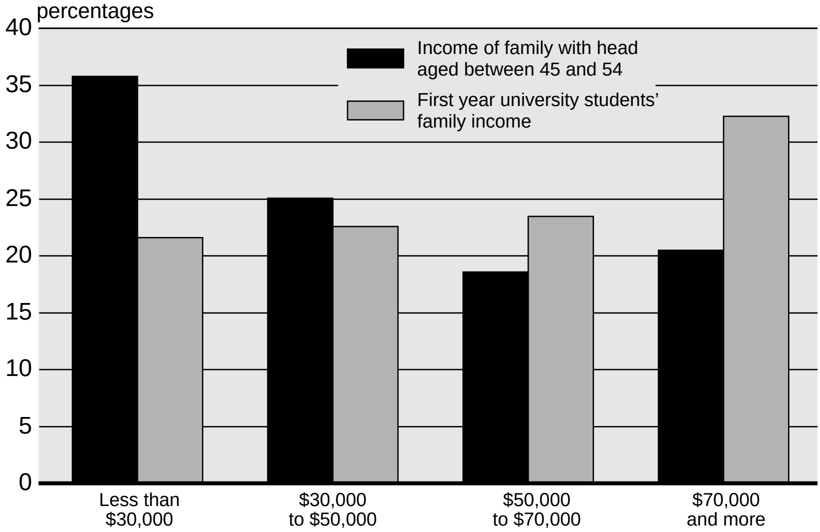
In 1995, more than 160,000 young people between the ages of 22 and 24 had not completed high school. These young Canadians face difficult employment prospects and lower lifetime earnings than more educated and skilled youth.

Canadians are coming to recognize that learning is a lifelong pursuit. The number of adults returning to school full time has tripled in the last 20 years, with most of them returning to school for job-related reasons.

Canada needs to do a better job of ensuring that all Canadians have access to learning opportunities. Children from low-income families remain under-represented in universities. According to a 1995 survey, only 22 per cent of first-year university students came from families reporting incomes of less than $30,000, while 36 per cent of the population reported family income of less than $30,000 (Chart 4.1).

Chart 4.1

Income levels of Canadian families with heads age 45-54 and families of first year university students, 1995



Source: Association of Universities and Colleges of Canada (AUCC) and Statistics Canada.

Lower-income students, not surprisingly, rely more heavily on government loans than do higher income students. At the same time, lower-income students appear more cautious about taking on large debt loads, as reported by the Maritime Provinces Higher Education Commission.

Student debt levels are increasing. Between 1990 and 1998, for those who borrow, the average debt at graduation after a four-year program will rise from $13,000 to an expected $25,000. For low- and middle-income families, rising costs threaten access to higher education for their children. This clearly calls for further action by governments: to help to ensure that low- and middle-income Canadians are given greater opportunity to prosper in the knowledge society.

The Canadian Opportunities Strategy

This budget responds to the concerns of Canadians – students now struggling to cope with rising costs, individuals facing growing student debt burdens and uncertain job prospects, adults looking to upgrade their job skills, children seeking to be brought in touch with the information age, youth at risk of being left behind by changing labour markets, and parents knowing the value of higher education and wanting to save for their children's future.

The budget reflects many important recommendations from the House of Commons Standing Committee on Finance, the Standing Committee on Human Resources Development and the Status of Persons with Disabilities, and the Report of the Special Senate Committee on Post-Secondary Education in Canada.

This budget builds on numerous measures taken in the 1996 and 1997 budgets to support Canadians in the acquisition of knowledge and skills (see summary below), especially through the creation of the Canada Foundation for Innovation. The government has invested $800 million in the Foundation to provide financial support to modernize research infrastructure at universities, colleges, research hospitals and other non-profit research institutions.

Actions Taken in the 1996 and 1997 Budgets

- Education tax credit amount increased from $80 to $200 a month.
- Tuition tax credit extended to include mandatory fees.
- Students allowed to carry forward the unused portions of the tuition and education tax credits.
- Interest relief extended for graduates experiencing hardship in repaying student loans.
- Registered education savings plans enriched and made more flexible.
- Funding for the National Literacy Secretariat increased.
- Canada Foundation for Innovation created.
- Networks of Centres of Excellence renewed.
- Funding for SchoolNet increased.
- Community Access Program expanded.
- Youth Employment Strategy strengthened.

The balance of this chapter describes the strategy proposed to expand access to opportunity as Canada enters the 21st century. The measures are outlined in Table 4.1.

Table 4.1
The Canadian Opportunities Strategy

	1997-98	1998-99	1999-00	2000-01
	(millions of dollars)			
Financial assistance to students				
Canada Millennium Scholarship Foundation	2500			
Canada Study Grants[1]		100	100	100
Total	2500	100	100	100
Support for advanced research and graduate students				
Granting councils		120	135	150
Helping students manage debt				
Tax relief for interest on student loans		80	130	145
Canada Student Loans Program improvements		50	145	150
Total		130	275	295
Helping Canadians upgrade their skills				
Tax-free RRSP withdrawals for lifelong learning		15	40	45
Tax relief for part-time students		25	90	90
Total		40	130	135
Encouraging families to save for education				
Canada Education Savings Grant		150	200	275
Supporting youth employment				
EI premium holiday for youth employment			100	100
Youth at risk		50	75	100
Total		50	175	200
Connecting Canadians to information and knowledge				
SchoolNet/Community Access Program/CANARIE[2]	55	60	70	75
Total measures announced in the budget	2555	650	1085	1230

[1] Initiatives contained in *Securing Our Future Together*.

[2] Includes Voluntary Sector Networks contained in *Securing Our Future Together*.

Financial assistance for students

Canada Millennium Scholarships

The Prime Minister stated in his September 24, 1997 speech to Parliament that there would be no better way to mark the new millennium than to help Canadians prepare for the knowledge society. To improve access to post-secondary education, he announced that a new arm's-length foundation would be created to provide Millennium Scholarships for thousands of Canadians.

This budget provides further details on the scholarships and the foundation.

The government will provide an initial endowment of $2.5 billion to the Canada Millennium Scholarship Foundation. This constitutes the single largest investment ever made by a federal government to support access to knowledge and skills for all Canadians. It will provide more than 100,000 scholarships annually to Canadians from low- and middle-income families to prepare them for the knowledge-based economy of the 21st century. Awards will be available in 2000.

- Scholarships will be awarded to individuals who need help in financing their studies and demonstrate merit.
- Scholarships will average $3,000 per year for full-time study; scholarships for part-time study will be provided as well.
- The scholarships will be available for up to four academic years of study (32 months) towards undergraduate degrees, diplomas or certificates. Individuals can receive up to $15,000 over the course of their studies. This could reduce the debt load many students would otherwise incur by over half.
- The Foundation will have the discretion to adjust the average and cumulative amounts of the scholarships over time.
- Awards will help recipients of scholarships to study away from home and particularly outside their province, and support limited terms of study outside Canada.
- The scholarships will support a wide range of learning and skills acquisition and will be available to persons of all ages, studying full time or part time, in publicly funded universities, community colleges, CEGEPs and technical institutions.

Legislation will be introduced shortly to create the Canada Millennium Scholarship Foundation as a private independent body to manage the endowment and to award scholarships.

The Foundation will be able to draw down this initial endowment over a 10-year period. This should provide about $325 million annually for scholarships. The Foundation will be required to invest the funds prudently. The Foundation will accept donations and bequests from third parties.

The Foundation will be managed by a board of directors made up of private citizens. A student will be among the private citizens on the board. The Council of Ministers of Education, Canada, representing provincial governments as well as the post-secondary education community, will have a role in identifying directors.

The Foundation will decide how best to design and deliver the new Canada Millennium Scholarships within the mandate given to it. In establishing its basic mandate, an advisory group, composed of individuals drawn from the academic community, was consulted, as were student groups.

The federal and provincial governments both play a role in enhancing equality of opportunity for those in financial need. Once established, the Foundation will consult closely with provincial governments and the post-secondary education community on the design and delivery of Canada Millennium Scholarships. The goal will be to award scholarships by the Foundation to individuals in a manner that avoids duplication in any province, to build on existing provincial needs assessment processes to complement existing provincial programs and, most importantly – to significantly increase access to post-secondary education everywhere in Canada for low- and middle-income students. The legislation creating the Foundation will provide it with the administrative flexibility required to meet these partnership objectives.

In particular, the Foundation will have the authority, subject to mutually agreed needs, merit and mobility criteria, to contract with appropriate provincial authorities for the selection of those recipients in a province to whom the Foundation will award Canada Millennium Scholarships.

In carrying out its mandate, the Foundation will be asked to minimize administrative costs and overhead. The Foundation should be in a position to assess applications and award scholarships beginning in the year 2000.

Canada Study Grants

There are some Canadians whose financial needs and special circumstances cannot be fully met through scholarships and student loans. These include students with dependants, students with disabilities, and those with very limited income.

This recognition has led to the development of grants which provide opportunities for those with special needs.

Currently, the federal government provides $45 million in grants delivered as part of the Canada Student Loans Program to part-time students in financial need, students with disabilities, and women pursuing doctoral studies.

To complement other measures in this budget that improve access and affordability, and in keeping with the government's commitment in *Securing Our Future Together*, the federal government will introduce grants for students with dependants, effective 1998-99. The new grants will provide up to $3,000 per year to 25,000 needy students with dependants. The cost of this measure will be $100 million annually. This amount includes alternative payments of about $30 million to Quebec and the Northwest Territories, which do not participate in the Canada Student Loans Program, but are entitled to a payment under legislation if they have a measure which has substantially the same effect.

Support for advanced research and graduate students

Nothing is more critical to determining economic success in the next century than a vigorous, broad-based research and development effort. All of the products, processes and services used today owe their origins to past innovation. Innovation is the cornerstone of job creation – the more research and development that is done in Canada, the more jobs that will be created for Canadians.

Discoveries from basic research are the wellspring for innovative products, processes and services that fuel the growth of a knowledge-based economy and enrich our quality of life. Highly skilled researchers and workers are needed to make these discoveries and bring them to market at home and abroad.

The government therefore provided $800 million in the 1997 budget to create the Canada Foundation for Innovation. The Foundation will strengthen research infrastructure at universities and colleges, in research hospitals, and not-for-profit research institutions in the areas of health, environment, science and engineering. Funding will begin to flow in 1998.

For the past two decades, the government's contributions to the granting councils – the Natural Sciences and Engineering Research Council of Canada, the Medical Research Council of Canada and the Social Sciences and Humanities Research Council of Canada – have funded basic research and supported Canada's youth as they develop the leading-edge skills needed to participate in an increasingly knowledge-based economy. In 1997-98, the combined $766 million budget of the granting councils provided research grants, scholarships and fellowships for graduate and post-graduate students. These councils also administer the Networks of Centres of Excellence, which link talented researchers in the academic, public and private sectors.

As the deficit was brought down, many difficult choices were made. One of those was a reduction in funding for the granting councils. The improved fiscal situation means that the government can make some key investments in areas of prime importance to the knowledge-based economy.

- Effective 1998-99, the budgets of the granting councils will be restored to their 1994-95 levels. These budgets will grow further in the next two years. Indeed, by the end of 2000-01, these budgets will be at their highest level ever.
- Accordingly, this budget will make available increased funding of more than $400 million over the next three years to the granting councils – $120 million in 1998-99, $135 million in 1999-2000 and $150 million in 2000-01.
- In addition to these increases, the total funding provided through the granting councils will increase further, over the next three years, as a result of the 1997 budget decision to renew the Networks of Centres of Excellence.

These new research and development resources will focus on two key areas:

- increased support to graduate students engaged in research, through scholarships, post-doctoral fellowships and project grants; and
- enhanced partnerships between universities and industry.

Table 4.2
Granting Council Funding

	1994-95	1997-98	1998-99	1999-00	2000-01
			(millions of dollars)		
Natural Sciences and Engineering Research Council (NSERC)					
Increase announced in 1998 budget			71	78	85
NSERC funding level	493	434	494	495	501
Medical Research Council (MRC)					
Increase announced in 1998 budget			40	44	50
MRC funding level	265	238	267	270	276
Social Sciences and Humanities Research Council (SSHRC)					
Increase announced in 1998 budget			9	13	15
SSHRC funding level	101	94	101	101	103
Total granting councils					
Increase announced in 1998 budget			120	135	150
Unallocated Networks of Centres of Excellence funding			11	21	23
Total funding level	859	766	873	887	903

This funding will create new opportunities for Canada’s youth to develop into highly skilled workers and to become the next generation of instructors. More researchers will be encouraged to develop their careers in Canada. It will also increase the commercialization of university research and assist more young Canadians to make the transition from the academic world to industry.

Helping manage student debt

The Canada Student Loans Program plays an important role in expanding access to post-secondary education. The program provides financial assistance to students to supplement their own and their families’ savings and earnings. Since its inception in 1964, the program has provided more than $15 billion in loans to needy students to pursue a post-secondary education.

In 1997-98, more than 380,000 students (or about 30 per cent of students enrolled in universities, community colleges, and vocational and technical institutes) are supported by the Canada Student Loans Program at a cost of $530 million, plus $120 million in alternative payments to Quebec and the Northwest Territories, which do not participate in the program.

As the costs of education have increased, so too have student debt loads.

A large majority of individuals – about 80 per cent – have repaid their student loans in full. Rising student debt loads are, however, becoming a serious problem for some individuals facing difficulty in finding employment or in financial difficulty for other reasons.

For a typical person following a four-year program, debt loads which were $13,000 at the start of the decade are expected to increase to more than $25,000 in 1998. On average, about $15,000 of this is Canada Student Loans, and the remaining $10,000 is provincial loans.

In 1990, fewer than 8 per cent of graduates had debts exceeding $15,000. Now, more than 40 per cent of graduates have student debt in excess of $15,000.

For most graduates, higher education leads to employment and higher earnings. But others are less fortunate.

In November 1997, the Minister of Human Resources Development held a meeting with provinces, lenders, student groups, post-secondary educational institutions, and other organizations with an interest in student financial assistance. Following this, the National Roundtable – a coalition of post-secondary education groups representing students, institutions of higher learning, and student financial aid administrators – submitted several proposals to augment student assistance.

This budget proposes measures which will help all in repaying their student loans, as well as special measures to assist individuals in serious financial difficulty.

Tax relief for interest on student loans

This budget proposes to allow individuals repaying student loans to claim a tax credit on the interest portion of the amount paid. The credit will further recognize for tax purposes the value of investment in higher education, and provide significant assistance to more than one million individuals.

The credit will apply to payments of interest on loans approved under federal or provincial student loan programs.

This measure will be effective for 1998, and is expected to cost about $130 million in 1999-2000.

Example

A graduate is repaying total student loan debt of $25,000. Total payments this year are $3,800, of which $2,125 is interest. The combined federal and provincial value of the tax credit would be about $530 in the first year of payment, and up to $3,200 over the 10 years during which the loan is paid off.

Canada Student Loans Program improvement

Under the Canada Student Loans Program (CSLP), the government pays interest on the loan while a student is in school and all payments are deferred until the completion of studies. For six months after graduation, interest accrues but the graduate is not required to make payments.

After this six-month grace period, the graduate is then responsible for paying off the loan, usually over the next 9½ years. For those facing financial hardship (determined on the basis of a schedule that compares loan payments to income), the federal government pays all interest costs for up to 30 months over the five years after the student has left school. This 30-month interest relief period was extended from 18 months in the 1997 budget.

The measures in this budget will further help individuals who are encountering difficulty in repaying their student loans. The purpose of the measures is twofold: to help individuals who are encountering temporary difficulties in the transition from school to work and, where the individual’s income continues to be low for some time, to bring student debt down to a level where it can be repaid. This assistance will be targeted to those in greatest need, based on their financial circumstances.

Five measures under the CSLP are proposed to help individuals in financial hardship. These measures extend interest relief to more individuals, lengthen the repayment period for those in financial hardship and, finally, reduce the principal on loans to affordable levels for those in severe financial hardship.

Interest relief

- First, effective April 1998, changes will be made so a person can earn more and still be eligible for interest relief. This will be done by raising the income threshold used for interest relief by 9 per cent (e.g., for an individual with no children and annual CSLP payments of $2,350, the threshold will increase from $20,460 to $22,300; for an individual with a family of two and annual CSLP loan payments of $2,100, the threshold will increase to $32,880 from $30,170).
- Second, beginning in 1999, systems will be put in place to extend interest relief further up the income scale for graduates facing financial hardship. Below the basic income threshold, the government will continue to cover 100 per cent of interest. Above the basic threshold, the government will pay partial interest relief (75 per cent, 50 per cent or 25 per cent of interest), depending on the individual's income, up to a limit where the borrower remains solely responsible for loan payments.
- These two interest relief measures will now be available throughout the life of the loan and will assist up to 100,000 additional people. (See interest relief illustration.)

Repayment period

- Third, for individuals who have exhausted 30 months of interest relief, lenders will be asked to extend the repayment period of the loan from 10 to 15 years, thereby lowering monthly payments by nearly 25 per cent at current interest rates. This will enable more graduates to repay their loans over an extended period.

Extension of interest relief

- Fourth, if after the extension of the repayment period to 15 years, an individual remains in financial hardship, interest relief will be extended from 30 months to up to 54 months during the five years after leaving school.

Example 1: Interest Relief

A graduate with no children has a total loan of $25,000. The federal portion of the loan is $15,000 with annual federal loan payments of $2,350.

Interest relief eligibility: income thresholds

	Current	Proposed
Full interest relief	less than $20,460	less than $22,300
Partial interest relief	none	$22,300 to $28,300

1. *Currently*, if annual income is $22,000, the individual is not entitled to interest relief because income is above the $20,460 threshold.

2. Starting April 1998, with *expanded interest relief*, the individual is entitled to full interest relief because income is below the **new** $22,300 threshold.

3. With *graduated interest relief* beginning in 1999-00, the individual will receive partial interest relief up to income of $28,300. For example:

- If income is $24,000, the government will pay 75 per cent of the interest on the loan.
- If income is $26,000, the government will pay 50 per cent of the interest on the loan.
- If income is $28,000, the government will pay 25 per cent of the interest on the loan.

(Note: Income thresholds for interest relief vary with the size of the loan and the number of dependants in the individual's family.)

Example 2: Debt Reduction

A graduate has exhausted interest relief and the repayment period has been extended to 15 years.

Five years have passed since graduation and the individual is in financial difficulty with gross annual income of $17,000. The principal on the Canada Student Loan will be reduced from $15,000 to $7,500.

If the income was $22,000, the principal would be reduced by $3,820 to $11,180.

If the individual's income was above $25,970, there would be no principal reduction.

(Note: This assistance will be available five years after graduation.)

Debt reduction

- Fifth, for the small minority of individuals who still remain in financial difficulty, the government will reduce the loan principal so that payments are more affordable. To qualify, five years must have passed since the completion of studies, and the individual must have exhausted interest relief. The principal will be reduced if annual payments, on average, exceed 15 per cent of the individual's income. The maximum amount of assistance will be the lesser of 50 per cent of the loan amount, or $10,000.

The extension of the repayment period, extension of interest relief, and debt reduction measures will be effective April 1998. (See debt reduction illustration.)

The total cost of these measures is estimated to be $50 million in 1998-99, rising to $150 million in 2000-01. This amount includes alternative payments of $30 million to be provided to Quebec and the Northwest Territories, which do not participate in the Canada Student Loans Program, but are entitled to a payment under the legislation if they have a measure which has substantially the same effect.

Performance and accountability

The federal government will also take a number of steps to improve the performance and accountability of the Canada Student Loans Program.

- Measures will be put in place to deal with the situation of students with a history of severe credit abuse.
- Changes to bankruptcy legislation will be proposed so that student loans survive bankruptcy for 10 years following the completion of studies. This reflects the new measures that are being put in place to help graduates in financial hardship.
- The criteria for eligibility of educational institutions will be strengthened, in consultation with the provinces.
- Steps will be taken to improve communications with student borrowers.

The provinces play an important role in the delivery of the Canada Student Loans Program. They assess students' financial need on behalf of the federal government and they supplement the federal program with their own student assistance programs. The Government of Canada is working with the provinces to achieve agreements on a greater degree of harmonization between the

Canada Student Loans Program and provincial student financial assistance programs. Greater harmonization will result in a single loan product for student borrowers in participating provinces.

The Minister of Human Resources Development will continue to consult with his provincial counterparts, students, educational institutions, lenders and other stakeholders on the implementation of these changes.

Helping Canadians upgrade their skills

Tax-free RRSP withdrawals for lifelong learning

Throughout their working lives, Canadians increasingly need to upgrade their skills to retain their jobs, or to obtain new ones. They often have limited access to adequate resources when the need or opportunity for skills upgrading occurs.

For many Canadians, the most readily available source of funds may be their registered retirement savings plan (RRSP). Given the importance of saving for retirement, the current tax treatment of RRSPs discourages premature withdrawals under most circumstances, in order to protect retirement income. However, few circumstances are more crucial to preserving people's retirement income than keeping their job, or finding a new one if they are laid off. Retraining or further education is often a key factor in preserving future employment income and hence retirement income.

To give Canadians greater access to funds for retraining, the budget proposes to allow individuals to make tax-free RRSP withdrawals for lifelong learning, subject to certain conditions. To ensure that the role of RRSPs in providing funds for retirement is not compromised, individuals will have to repay the amount they withdraw over a fixed period of time. In many ways, this program parallels the Home Buyers' Plan.

Under this initiative, individuals can withdraw up to $10,000 per year from an RRSP, provided they are enrolled in full-time training or higher education for at least three months during the year. Disabled students can qualify for this program whether or not they are studying on a full-time basis. More than one withdrawal can be made in any particular year as long as the annual limit is not exceeded. Further withdrawals are permitted for a period up to four years, provided that the total amount withdrawn does not exceed $20,000.

RRSP withdrawals will be repayable to the individual's RRSP in equal instalments over a 10-year period. The first repayment must be made in the year following the last year in which the student was enrolled on a full-time basis, or in the sixth year following the first withdrawal for retraining, whichever comes first. Any amounts not repaid on time will be included in the individual's income in that year for tax purposes. Individuals may choose to repay more than the scheduled amount in any year. If they decide not to proceed with their retraining, they must repay the full amount withdrawn during the same year. As under the Home Buyers' Plan, all repayments are without interest, and cannot be deducted from income.

Individuals may participate in this program on one or more occasions over their lifetime. However, when individuals are in the repayment portion of the program, they are not allowed to make further withdrawals, or begin another cycle, until all repayments under the previous cycle have been completed. Contributions made to an RRSP less than 90 days before a withdrawal are not eligible under the plan.

Example

An individual loses his job in 1999 and decides to take a one-year, full-time computer programming course. To finance his studies, he withdraws $5,000 from his RRSP, tax free. He obtains a new job in 2000. He must repay $500 into his RRSP for each of the 10 years starting in 2001, although he can repay more rapidly at any time.

To permit the necessary administrative arrangements to be made, this measure will be effective on January 1, 1999.

Education credit for part-time study

Tax assistance to help current students is primarily delivered through the tuition and education credits. The education tax credit assists students with regard to non-tuition costs such as books, living expenses, etc. Among other measures, the last two budgets broadened the coverage of the tuition credit to include most ancillary fees, and increased the amount on which the education credit is based from $80 per month to $200 per month. For the typical university student, the education amount is about $1,600 per year, for an annual tax saving of about $400. When the education credit is combined with the tuition credit, the average post-secondary education student will receive roughly $1,200 in combined federal and provincial tax assistance each year.

At present, the tuition credit is generally available to both full- and part-time students, whereas the education credit is restricted to full-time students. In the new economy, however, many students are upgrading their skills on a part-time basis. Therefore, this budget proposes to allow part-time students enrolled in eligible programs to have access to the education credit.

Beginning in 1998, part-time students will be allowed to claim an education amount of $60 for each month during which they were enrolled in a course lasting at least three weeks and involving a minimum of 12 hours of course work each month. An eligible student may claim either one part-time or one full-time credit in respect of a particular month, but not both.

Example

A part-time student enrolled in two eligible courses for eight months during a year could be eligible for an education amount of $480 (i.e. eight months at $60 per month). This would result in an average combined federal-provincial tax saving of about $120. If the student's tuition is $1,200, the tuition and education credits together would be worth about $420 in tax relief.

This measure will provide additional assistance to about 250,000 part-time students.

Child care expense deduction for part-time study

The 1996 budget broadened eligibility for the child care expense deduction (CCED) by allowing single parents in full-time attendance at school to claim the CCED against all types of income. This measure was also applied to two-parent families where both are full-time students. This budget proposes to provide further assistance to part-time students by allowing single parents to claim a deduction in respect of child care expenses for periods during which they are enrolled in part-time course work. In a two-parent family, the higher-income spouse will be allowed to claim expenses arising out of the part-time education of the other spouse.

For two-parent families, the deduction would be equal to the lesser of (1) actual expenses, (2) two-thirds of earned income for the year, and (3) for each month for which a part-time education credit is claimed, $175 per child under age 7, and $100 per child age 7 to 16.

As indicated in Chapter 5, the limits on the child care expense deduction in respect of earned income are also being increased.

Example

As in the previous example, a single parent with two children age 8 and 6, is a part-time student for eight months of the year. She claims an education amount of $480, for a tax saving of $120. In addition, she will now be eligible to also claim all her child care expenses up to $2,200, for an additional tax saving of $550. Together, these measures provide tax savings of $670.

If her tuition is $1,200, she currently gets a tax reduction of $300. Under the current system, that is the total tax relief she receives with respect to her education expenses. With this budget's two new measures for part-time students, the tax assistance for her education will triple to $970.

About 50,000 part-time students with children will benefit from this measure.

Encouraging families to save for education

Canada Education Savings Grant

The previous measures provide increased assistance to today's students. The government is also taking steps to ensure that tomorrow's students will have access to affordable higher education.

The best way of ensuring access to higher learning is to help parents and grandparents to save for children's education. This will mean that more resources will be available to students in the future.

At present, Canadians save for their children's education in a number of ways. One way in which the government assists Canadians in saving for higher education is by supporting registered education savings plans (RESPs). Contributions to RESPs grow tax free.

The two previous budgets included several measures to make registered education savings plans more effective. The annual contribution limits to RESPs were raised from $1,500 to $4,000, and the lifetime contribution limits from $31,500 to $42,000. These changes allow a greater accumulation of savings for higher education, and more flexibility in saving if a family is unable to save for a number of years.

Although the vast majority of RESP beneficiaries do pursue higher education, the 1997 budget addressed the concerns of parents who were unsure if their children would go on to post-secondary education. As a result of the budget, individuals winding up an RESP are now allowed to transfer all or part of their RESP income into their registered retirement savings plan (RRSP), if they have contribution room. Alternatively, individuals without RRSP room, or who do not wish to make RRSP contributions, may receive the investment income directly, subject to an appropriate tax.

This budget proposes significant additional assistance to parents who save for their children's education.

Beginning immediately, the government will provide a Canada Education Savings Grant of 20 per cent on the first $2,000 of annual contributions made to RESPs for beneficiaries up to age 18. This grant, and the investment income accumulating on the grant over time, will be paid to the student when they enrol in eligible full-time post-secondary education or training programs. If the beneficiary does not pursue education or training, the grant will be returned to the government.

Beginning January 1, 1998, each child under 18 will accumulate grant contribution room of $2,000 per year until they are 18. Contributions by parents and other individuals will attract a grant up to the amount of that cumulative room, or $4,000 per year, whichever is less. This will allow a family which has been unable to make contributions for one or more years to catch up in later years for missed contributions.

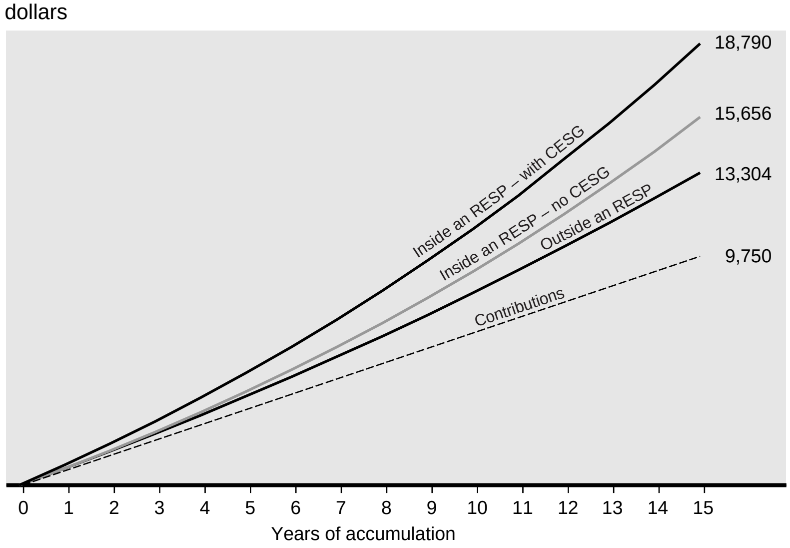
The government will provide the Canada Education Savings Grant directly to the plan trustee chosen by the parent or other contributor, to be invested in the same plan chosen by the contributor. The grant itself is not included in calculating the annual and lifetime RESP contribution limits.

Chart 4.2 highlights the benefits of contributing to RESPs for children. A family saving $25 every two weeks in an RESP over a 15-year period will accumulate an education fund worth $18,790, assuming a market rate return of 5 per cent. Without the grant, the fund would be worth about $3,100 less. Saving this amount outside an RESP, if income is taxable, could generate an education fund that is $5,400 smaller ($13,304). With the Canada Education Savings Grant, saving inside an RESP can yield an education fund worth 40 per cent more than saving outside an RESP.

The Canada Education Savings Grant will make RESPs among the most attractive savings vehicles available for a child's education. They could become as essential in saving for education as registered retirement savings plans are in saving for retirement.

Chart 4.2

Total RESP funds available to a student from $25 invested every two weeks



Example 1 : How the Canada Education Savings Grant (CESG) works

A family with a three-year-old child in 1998 saves $25 every two weeks (about $650 per year) in an RESP. As a result of the grant, the child could have an additional $783 available for each of four years of higher education (assuming a 5-per-cent rate of return on investment). If the family doubled the amount of contributions to the RESP, the value of the CESG would also double.

Total RESP contributions per year	$650
CESG rate	20 per cent
Number of years of contributions	15
Total contributions – principal	$9,750
Total CESG	$1,950
Total investment income	$7,090
Total value of RESP	$18,790
Total available to student for each of four years:	
From contributions	$3,914
From CESG	$783
Total each year	$4,697

Example 2: Illustration of carry-forward

Unused grant room is carried forward for use in future years.

CESG room "earned" each year by a child under 18	$2,000
Contributions for a child in 1998	$650
CESG for 1998	$130
Unused CESG room carried forward to 1999	$1,350
Cumulative CESG room available in 1999	$3,350
Value of potential CESG in 1999	$670

Example 3: Importance of saving early

While the carry-forward allows parents to receive the CESG as they catch up, the effects of compounding make it much more advantageous to begin saving early.

	Family A	Family B
Ages of child when contributions made	3 to 17	10 to 17
Number of years of contributions	15	7½
Annual contributions to an RESP	$650	$1,300
Total contributions	$9,750	$9,750
Total CESG	$1,950	$1,950
Total investment income	$7,090	$3,540
Total value of RESP	$18,790	$15,240

To discourage activities that do nothing to increase the stock of savings for education, only net new contributions for a beneficiary will receive a grant. Therefore, where contributions to RESPs made before the budget are subsequently withdrawn, contributions for the remainder of the year and for the two subsequent years will not receive the grant. The beneficiary will also lose the grant contribution room that would ordinarily accrue during those years. Contributions for children age 16 and 17 will receive a grant only if there have been RESP contributions for those children for at least four years in the past, or if total previous contributions for the children have reached $4,000.

The grant will apply to eligible contributions to RESPs made after January 1, 1998. The Department of Human Resources Development will administer the grant. The government and the RESP industry will put in place the necessary administrative systems as soon as possible. In the interim, eligible contributions received by RESP trustees will be tracked and when administrative arrangements are complete, grants will be turned over to the plans themselves. Thereafter, the government will transfer grant funds to the plans on a regular and ongoing basis.

The Canada Education Savings Grant, as well as several other measures which form part of the *Canada Opportunities Strategy*, will increase pressure on the definition of education and training programs eligible for assistance. To ensure the integrity of the system, additional resources will be provided to the Department of Human Resources Development to administer the grant and in particular to improve the process of determining the eligibility of institutions. Revenue Canada will be provided with additional resources to ensure that credits are claimed in respect of bona fide courses of study.

Supporting youth employment

Although the majority of Canada's youth are well equipped to participate in the economy, unemployment among young people remains significantly higher than for other Canadians.

Some young people have difficulty breaking into the job market because they have not acquired the skills required or because they lack work experience.

Of the approximately 400,000 youth who are unemployed today, many will obtain jobs from continued strong economic growth. For others, however, the problem is different. Of particular concern are those who dropped out of high school. They are at risk of being left behind in today's economy.

Governments have a responsibility to help youth acquire the tools to integrate into the labour market.

In February 1997, the government announced details of its Youth Employment Strategy. The strategy helps young Canadians find the critical first job that bridges the gap between school and work.

For 1998-99, the federal government has committed $380 million for youth employment programming, up from $353 million in 1997-98. About 100,000 young Canadians will be assisted in 1998-99.

- Youth Service Canada helps more than 5,000 unemployed youth through community-based projects that provide work experience in the local community. This has been successful in improving the employment prospects of unemployed youth lacking job skills.
- Youth Internship Canada helps approximately 15,000 young Canadians get a foot in the door with employers in growing industries. An additional 10,000 internships have been created through three new internship streams with government and private employers – for science and technology; for international business; and for aboriginals on reserves and Inuit in their communities.
- Summer career placements have been doubled allowing about 65,000 more students to gain experience and help to finance their education.

The government will also bring forward measures to strengthen networks among Canadians and to increase knowledge and understanding of Canada among Canadians; these measures will include enhanced exchange programs for young Canadians.

Encouraging employers to hire young Canadians

Many private sector employers are ready to help respond to the challenge of youth unemployment and to give young people a chance. The private sector Career Edge initiative, placing young people with a first employer after their education, is one very positive response. Another successful approach which has been taken by the private sector is Careers: The Next Generation, providing on-the-job experience to students at all levels of education. More is needed.

To encourage employers to hire young Canadians, this budget proposes to give employers an employment insurance (EI) premium holiday for additional young Canadians, between the ages of 18 and 24, hired in 1999 and 2000. As with the New Hires Program, in operation in 1997 and 1998, employers will be allowed to stop paying premiums when they reach the 1998 level of payroll, or they can claim a rebate when filing their tax forms. Unlike New Hires, however, there will be no minimum threshold and all firms will be eligible without limitation on size. This measure will start in 1999 when the New Hires Program ends.

This will reduce payroll costs for employers by about $100 million a year in 1999 and 2000.

Youth at risk

For too many young Canadians, traditional classroom education has not worked well. For these youth at risk, alternative approaches, such as programs based on on-the-job learning, offer another chance.

Youth Service Canada (YSC) currently supports youth at risk. Follow-up surveys show that one year after completing their YSC work experience, about 85 per cent of participants either found employment – mostly in permanent full-time jobs – or returned to school.

First Ministers have tasked their ministers of labour market development to develop a youth employment action plan. In support of this effort, the Government of Canada intends to build upon the success of Youth Service Canada.

By investing a further $50 million in 1998-99, $75 million in 1999-00, and $100 million a year thereafter, the government will more than double funding for youth at risk. The principal focus will be on assisting youth who have not completed high school.

The expanded programming will help young people prepare for today’s labour market. Wage subsidies of up to $10,000 will be provided to give youth work experience in the private and voluntary sectors that will prepare them for long-term employment and self-support.

Along with on-the-job training, youth will be given career counselling, mentoring and, when required, literacy upgrading through partnership with employers' organizations and non-profit groups.

Connecting Canadians to information and knowledge

The emergence of the information society is changing the way people work and learn, resulting in both opportunities and challenges for Canadians. Access to networks, such as the Internet, provides new opportunities for Canadians to acquire knowledge and to participate in lifelong learning.

Computer skills are becoming one of the basics of learning – joining reading and writing and arithmetic. Having access to a computer puts the world literally at the fingertips of our students – and it provides them with a skill that is essential in many jobs.

SchoolNet and the Community Access Program

Over the past five years the government has taken steps to encourage Canadian schools, libraries and rural communities to join the information society through Industry Canada's SchoolNet and the Community Access Program.

SchoolNet brings the Internet to students and into the classroom as a vital learning tool by developing on-line resources and applications. The Computers for Schools component of SchoolNet refurbishes surplus computers donated by governments and businesses and makes these computers available to schools. The Community Access Program is bringing rural Canada on-line by establishing 5,000 Internet access sites in Canada's rural and remote communities to provide access to these learning opportunities.

■ This budget will make available an additional $205 million over three years, beginning in 1998-99, for SchoolNet and the Community Access Program. These funds will expand and extend the SchoolNet program to enable children to continue to benefit from the learning opportunities made possible by today's information technology. SchoolNet will continue to support Computers for Schools, link First Nations classrooms and communities to the Internet, and support the development of multimedia learning-ware.

- These funds will also be used to expand the Community Access Program to a total of 10,000 access sites across Canada by creating an additional 5,000 access sites in urban neighbourhoods. These sites give Canadians the tools to make best use of the learning opportunities that information technology provides.

Through SchoolNet and the Community Access Program, the federal government will continue to work with provinces and the private sector to bring the benefits of the information highway into classrooms, neighbourhoods and communities to help prepare Canadians for the information society of the future.

Canadian Network for the Advancement of Research, Industry and Education (CANARIE)

While the private sector is building Canada's information infrastructure, the federal government has been playing a role through support to the Canadian Network for the Advancement of Research, Industry and Education (CANARIE). A non-profit corporation funded by the private sector, CANARIE has helped to propel Canadian technology to the forefront by supporting research and development into a broad range of new technologies and applications for the information highway. Federal support of $20 million annually for Phase 2 of CANARIE's activities is due to end in March 1999.

- In order for CANARIE to begin Phase 3 of its activities and create the next generation of high speed network backbone across Canada, the federal government will provide a one-time contribution of $55 million in this fiscal year. This contribution, together with significant support from CANARIE's private sector partners, will create the test bed required for future research into information technologies and applications. The work that CANARIE has done over the past several years has demonstrated that world-class efforts can attract widespread support from the private sector. CANARIE is expected to move toward a more self-supporting basis through the development of a cost-recovery plan.

Conclusion

The measures announced in this budget will enhance access and opportunity for Canadians throughout their lives:

- For **children**, it means bringing them in touch with the information age through SchoolNet.
- For **post-secondary students**, particularly those from low- and middle-income families, it means access and opportunity through scholarships, study grants and tax relief.
- For **graduate students and researchers**, it means increased support through the granting councils.
- For **individuals coping with student loan debt**, it means tax relief for interest payments on student loans and additional loan relief for those in financial hardship.
- For **youth facing difficulty in finding a job**, it means work experience, supported by wage subsidies and services, as well as an EI premium holiday to employers to hire more young Canadians.
- For **adults** seeking to renew their labour market skills – whether through university, community colleges or technical institutes – it means the opportunity to draw on their RRSPs through tax-free withdrawals, and to benefit from tax relief for part-time study.
- For **parents and grandparents**, it means a Canada Education Savings Grant that will make RESPs the best way to save for a child's future education.
- For **communities and schools across Canada**, it means connecting them to the knowledge society by expanding access to the Internet.

By fostering a culture of innovation, creativity and lifelong learning, we can build a Canada of equal opportunity. Through the *Canadian Opportunities Strategy*, the government is helping Canadians increase their opportunities and standard of living as they make their way in the 21st century.

5

Building Canada for the 21st Century –

Building a Secure Society

Highlights

The budget provides funding for initiatives announced over the past year, including increased health and social transfers to provinces, establishment of a new blood system in co-operation with the provinces and territories, a new partnership with aboriginal peoples, implementation of the international landmines treaty and increased support for Canadian culture.

The 1998 budget provides:

- support for families with children through a further increase in the Canada Child Tax Benefit;
- additional help for families with child care expenses;
- support for individuals caring for infirm or elderly family members;
- assistance for self-employed individuals who pay health and dental insurance premiums;
- assistance for persons with disabilities;
- support for communities and the voluntary sector;
- measures to address environmental challenges; and
- resources to further international co-operation.

Introduction

A strong economy is the bedrock of Canada’s national programs. A strong economy creates jobs and generates the resources needed to sustain the programs that contribute to a secure society.

Strong national programs enable Canadians to confront the economic changes now underway and to approach the future with confidence and security.

Canadians believe that they can prosper in the economy of the 21st century. But they are concerned about how economic change will affect them, their families and those less able to take advantage of the opportunities that change will bring. They are also concerned about the future of the health, education and social programs that serve us all.

Canadians want their governments to respond to economic change by providing national programs that are affordable, sustainable, and reflect Canadians’ priorities and needs. Canadians expect their governments to consult and harmonize their efforts in pursuit of shared goals, working in partnership and collaboration with stakeholders and voluntary groups.

The improving fiscal situation has allowed the federal government to increase funding for health, education and other social programs. Over the past year, the government has taken action to:

- improve health care services by increasing transfers to provinces for medicare and social programs;
- address key health priorities by providing additional funding for the transition to a new blood system, renewing HIV/AIDS funding and raising tobacco taxes;
- secure a sustainable public pension system;
- improve the well-being of children by increasing child benefits for low-income families;
- increase support for persons with disabilities;
- increase support for the voluntary sector by providing stronger incentives for charitable donations;
- build a new partnership with aboriginal peoples by responding to the *Report of the Royal Commission on Aboriginal Peoples*; and
- provide increased funding for Canadian cultural initiatives.

Table 5.1
Building a secure society – measures announced before the budget

	1997-98	1998-99	1999-00	2000-01
		(millions of dollars)		
Improving Canada's health care system				
Increase CHST cash floor[1]	200	900	1500	1500
National HIV/AIDS Strategy[1,4]		41	41	41
Establishing a new blood system		30	30	
Total	200	971	1571	1541
Assistance for persons with disabilities				
Increased funding for EAPD (net)[2]		15	20	20
New partnership with aboriginal peoples				
Aboriginal Health Institute[1]		5	5	5
Aboriginal Head Start[1]		25	25	25
Urban Aboriginal Youth Centres[1]		25	25	25
Preserving & teaching aboriginal languages[1]		5	5	5
Healing Strategy	350			
RCAP: expanded & new initiatives[3]		66	66	66
Total	350	126	126	126
Promoting Canadian culture and sports				
Canada TV and Cable Production Fund		50	100	100
Funding for Canada Council[1]	25	25	25	25
Publishing industry[1]	15	15	15	15
Amateur sport[1]		10	10	10
Total	40	100	150	150
Furthering international co-operation				
Landmine treaty		20	20	20
Total	590	1232	1887	1857
Less:				
Increase excise tax on tobacco products		-70	-70	-70
Total	590	1162	1817	1787

[1] Initiatives contained in *Securing Our Future Together*.

[2] EAPD is Employability Assistance for Persons with Disabilities Program, which replaced the Vocational Rehabilitation of Disabled Persons (VRDP). This amount represents incremental funding net of a $10 million contribution in 1998-99 and $5 million per year thereafter to be provided by the Department of Human Resources Development.

[3] This amount represents incremental funding net of $60 million per year from reallocations within the Department of Indian and Northern Affairs.

[4] In addition to these funds, a further $1.5 million per year will be provided by Health Canada.

Building on actions already taken, this budget:

- provides assistance for unincorporated self-employed individuals who pay health and dental insurance premiums;
- ensures that the alternative minimum tax does not reduce the benefit of using RRSPs to set money aside for retirement;
- increases support for families with children through a further investment in the Canada Child Tax Benefit;
- provides additional help for families with child care expenses;
- enhances support for individuals caring for infirm or elderly family members;
- increases assistance for persons with disabilities;
- provides additional support for communities and the voluntary sector;
- increased support to address environmental challenges; and
- furthers international co-operation efforts.

Table 5.2

Building a secure society – measures in this budget

	1997-98	1998-99	1999-00	2000-01
		(millions of dollars)		
Improving Canada's health care system				
Deductibility of health/dental insurance premiums			90	110
Sustainable retirement income system				
Alternative minimum tax and RRSPs		70	20	20
Support for families				
Canada Child Tax Benefit[1]			320	750
Child care expense deduction		20	45	45
Caregiver credit[2]		30	120	125
Total		50	485	920
Assistance for persons with disabilities				
Disability tax assistance measures		5	5	5
Strengthening communities and the voluntary sector				
Emergency services volunteers		5	10	10
FedNor			20	20
Total		5	30	30
Addressing environmental challenges				
Industrial Research Assistance Program[2]		34	34	34
Climate change		50	50	50
Total		84	84	84
Furthering international co-operation				
CIDA funding	90	50		
Total	90	264	714	1169

[1] Costs for the Canada Child Tax Benefit increase in fiscal year 1999-2000 correspond to three quarters of the $425 million increase in annual benefits starting in July 1999. Costs in fiscal year 2000-2001 correspond to the full increase of July 1999 and three quarters of the further increase starting in July 2000. Annual ongoing year costs will be $850 million thereafter.

[2] Initiatives contained in *Securing Our Future Together*.

Improving Canada's Health Care System

Canada's public health care system is an expression of Canadian values. Medicare is a fundamental pact between Canadians, their governments and health care providers. Medicare ensures that access to medically necessary health care services is based on need, not ability to pay.

As part of this contract, all Canadians, wherever they reside, expect high quality health care services. The federal government has identified health care as a national priority and has taken steps to put medicare on a more stable and secure financial footing, and to address the health concerns of Canadians.

As a result of the federal government's improved fiscal performance, the government introduced legislation to increase the Canada Health and Social Transfer (CHST) cash floor from $11 billion to $12.5 billion, as recommended by the National Forum on Health. The legislation will provide provinces with nearly $7 billion more in cash over the 1997-98 to 2002-03 period, which they can invest in their most pressing health and social priorities.

The latest estimates indicate that total CHST contributions to provinces, including both cash and tax transfers, will grow from $25.3 billion in 1997-98 to $26 billion in 1998-99.

In addition, the federal government will provide an estimated $8.8 billion cash in unconditional Equalization transfers to provinces this year. These cash transfers also support provincial public services, including health care. Equalization is particularly important to Atlantic Canada where it represents about 25 per cent of provincial revenues.

The federal government also supports national health priorities, research and the adoption of best practices.

■ The 1996 budget allocated $65 million over five years for the Health Services Research Fund.

■ The 1997 budget provided $300 million over three years for the following initiatives:

- $150 million was allocated to a Health Transition Fund to help provinces experiment with innovative forms of health service delivery and share results with other jurisdictions;

- $50 million was provided for health information systems; and
- $100 million was allocated to expand the Community Action Program for Children and the Canada Prenatal Nutrition Program.

■ In September 1997, the Minister of Health indicated that the federal government would increase its contribution towards the establishment of a new blood agency by $60 million over two years, starting in 1998-99.

■ In December 1997, the Minister of Health announced a five-year, $211 million renewal of the National HIV/AIDS Strategy, as promised in *Securing Our Future Together* and the Speech from the Throne.

To promote advanced research and graduate study, this budget provides $134 million in increased funding for the Medical Research Council over the next three years. As well, the increased funding of $37 million over three years for the Social Sciences and Humanities Research Council will strengthen its capacity to support health policy research.

Tobacco tax increase

The federal government announced increases in its excise taxes on cigarettes and tobacco sticks as part of a co-ordinated federal-provincial process to restore tobacco taxes in a gradual and sustainable manner so as not to encourage contraband activity.

Federal taxes were increased by 60 cents per carton on cigarettes for sale in Ontario, Quebec, Nova Scotia and Prince Edward Island, and by 40 cents per carton in New Brunswick. Equivalent increases in taxes on cigarettes were implemented concurrently by these provincial governments.

Increases were also announced in the excise tax rates on tobacco sticks for sale in all provinces. These increases, which vary by province, ranging from 80 cents to $1.52 per carton of 200, were announced to realign the rates between different cigarette products.

These measures will raise additional revenues of about $70 million a year and contribute to the government's continuing efforts to discourage smoking.

Helping the self-employed with health and dental insurance costs

Many Canadians receive supplementary coverage for prescription drugs, and dental and vision care through private insurance plans.

The number of self-employed Canadians is growing; many operate unincorporated businesses. Currently, self-employed individuals owning an unincorporated business cannot deduct premiums paid for their own supplementary coverage, while owner-operators of incorporated businesses may receive tax-exempt coverage through their business. This is unfair.

This budget seeks to redress this imbalance to better reflect the increasing role of self-employment in job creation. Starting in 1998, unincorporated owner-operators will be allowed to deduct premiums for supplementary health care coverage against their business income, to a maximum amount. More details on this measure are provided in the supplementary information on tax measures.

A Sustainable Retirement Income System

One of the defining features of a secure society is its capacity to provide a secure retirement income for its senior citizens. Canada's population is ageing. The number of persons over age 65 will almost double by 2030, as Canadians live longer and the baby boom generation moves into its retirement years. The number of workers for each retired person will drop from five to three. Action is therefore being taken to ensure that the public pension system can be sustained in the face of changing demographics.

The Canada Pension Plan

The federal government and the provinces are joint stewards of the Canada Pension Plan (CPP). In 1996, they held extensive consultations about the future of the CPP with Canadians in every province and territory. The message from Canadians was clear – they told their governments that they wanted to preserve the CPP, and they wanted the necessary action taken quickly.

The federal and eight provincial governments agreed on changes that ensure that the CPP can be sustained. The changes mean that the CPP Fund will not run out of money, and CPP contribution rates will never have to increase to anywhere near 14.2 per cent, as would have been the case if action had not been taken.

Legislation has been passed that provides for increases in contributions, a new investment policy and some modest changes to benefits.

- The combined employer-employee CPP contribution rate will rise to 9.9 per cent between now and 2003 and stay at that level thereafter, rather than increasing to 14.2 per cent by 2030.
- CPP funds will be prudently invested in a diversified portfolio of securities in the best interests of plan members. The Fund will be managed professionally at arm's length from governments by an independent investment board.
- A number of changes to the way benefits are administered and calculated will moderate escalating costs. There are no changes to benefits currently being paid, and benefits will remain fully indexed to inflation. The age of retirement also remains unchanged.

The CPP ensures that all working Canadians have a basic income on which to build for retirement. Canadians of all ages can now be confident that the CPP is secure.

The Seniors Benefit

Over recent months, the government has consulted interested groups on the 1996 budget proposal to replace the Old Age Security (OAS) and Guaranteed Income Supplement (GIS) programs by the Seniors Benefit. The government is currently reviewing the details of the proposal in light of the valuable suggestions received during these consultations and is committed to proceeding with the best possible policy to ensure that public pensions will be preserved for Canadians who will need them in the future. The fundamental objective remains to slow the growth in costs, while protecting and enhancing pensions for low- and modest-income seniors, most of whom are women. The government intends to introduce legislation on the Seniors Benefit for consideration by Parliament in the coming months.

The Guaranteed Income Supplement

The 1997 budget indicated that the Seniors Benefit legislation would include some administrative changes to the Guaranteed Income Supplement and Spouse's Allowance programs.

These changes involve:

- Shifting the annual GIS renewal date from April to July to allow benefits to be calculated from income tax returns. This will avoid processing delays and unnecessary duplication.
- Adapting the GIS formula to modern computerized calculations and harmonizing income definitions more closely with income tax definitions; providing consistent treatment to supplement recipients who change marital status; and ensuring that persons applying for Widowed Spouse's Allowances under international social security agreements are subject to the same restrictions applied to all other GIS and Spouse's Allowance recipients.

These changes will improve the way in which the GIS operates, provide better service to Canadian seniors, and eliminate short-term hardship for the most vulnerable. Legislation will be introduced very shortly, in advance of the Seniors Benefit legislation, so that these administrative changes to the GIS program can be implemented in 1999.

Alternative minimum tax and RRSPs

The alternative minimum tax (AMT) was introduced in 1986 to address the problem of high-income individuals paying little or no income tax by using various deductions and tax credits. Despite the limited number of individuals paying AMT (an average of about 20,000 per year), it still plays a significant role in ensuring fairness in the tax system. Individuals who might otherwise use tax shelters aggressively to avoid tax may not do so because they would be caught by the AMT.

In recent years, however, an increasing number of individuals have become subject to AMT as a result of roll-overs of severance pay to registered retirement savings plans (RRSPs) following lay-off. The current treatment of roll-overs also threatens to undo some of the benefit of the 1997 budget measure on pension adjustment reversal (PAR). PAR will allow individuals who receive low termination benefits when they leave an employer pension plan to recuperate RRSP contribution room. It would be inappropriate to subsequently levy AMT on individuals who make large RRSP contributions to compensate for the loss of employer-provided pension benefits. In fact, the existence of separate limits for RRSPs and the introduction in 1996 of indefinite carry-forward of RRSP contribution room suggest that all RRSP and registered pension plan (RPP) contributions should be excluded from the AMT base.

Although many taxpayers are able to recoup AMT payments through the seven-year carry-forward mechanism, some may not have sufficient income and tax payable before retirement to fully recover their AMT payments. This may be the case, for example, for an individual laid off at age 55, who has insufficient income to recover his AMT before retirement, and would thus lose a portion of the retirement benefits of his severance because of AMT on his RRSP contributions.

Accordingly, the budget proposes to remove RRSP and RPP contributions from the AMT base. Given the fact that the number of affected taxpayers has increased significantly in recent years, the budget proposes to make this measure retroactive to 1994.

This measure is expected to cost about $70 million in 1998-99 and about $20 million annually thereafter.

Support for Families

The government is committed to helping Canadian families meet the challenges of child rearing and caring for infirm or elderly family members.

Building a National Child Benefit System

Equality of opportunity means a good start in life. When children are deprived of the opportunity to reach their full potential, the country is deprived of reaching its full potential.

The federal government and provincial governments are working together to create a National Child Benefit (NCB) System to provide better support for low-income families with children. This co-ordinated effort of both levels of government is an important initiative designed to combat child poverty and to make it easier for low-income parents to enter and stay in the labour force to support their families. Over time, this initiative will build a more secure base of benefits and services for Canada's neediest children, providing them with a better start in life and laying the foundation for their future participation in Canadian society.

As an initial contribution to building the NCB System, the federal government announced in the 1997 budget the allocation of $850 million to create an enriched and simplified Canada Child Tax Benefit (CCTB).

The federal government will introduce legislation to implement the Canada Child Tax Benefit in July 1998. The CCTB will provide benefits of $1,625 for the first child and $1,425 for each additional child for families with income up to $20,921. Benefit levels will be gradually reduced for families above that income level. Benefits of $1,625 will be also provided, under the *Children's Special Allowances Act*, to provincial agencies for children in care (e.g., foster homes and group homes).

The Canada Child Tax Benefit will provide a national benefit to all eligible families with children. As part of the NCB System, social assistance payments made by provinces and territories will be adjusted in accordance with the increase in the CCTB. The provinces and territories will then reinvest the savings from social assistance to improve benefits and services to all low-income families with children whether they are on social assistance or working. Provinces are currently finalizing their reinvestment plans and are considering a variety of reinvestments, including provincial income benefits, earned income supplements, extension of medical and dental benefits to low-income working families, and increased support for child care. To ensure that aboriginal children on reserves benefit like other children from this initiative, the Minister of Indian Affairs and Northern Development is working with First Nations leaders and provinces to develop appropriate reinvestment strategies.

The National Child Benefit System is an important initiative to increase assistance to low-income families and reduce barriers to work, building on the respective strengths of the federal and provincial governments in achieving shared goals.

As part of the National Child Benefit System, the federal government has also made a commitment to further enrich the Canada Child Tax Benefit during the course of this mandate by $850 million annually. This budget allocates $425 million as of July 1999 and a further $425 million as of July 2000 to fulfil this commitment. After discussions with provincial and territorial partners and Canadians, the federal government will announce details of the enrichments to the Canada Child Tax Benefit in the 1999 budget.

Helping families with child care expenses

Many Canadian families with children incur significant child care expenses. To better reflect the costs these families incur, this budget increases the limits on the child care expense deduction from $5,000 to $7,000 for children under age 7 and from $3,000 to $4,000 for children age 7 to 16.

With these increases, the child care expense deduction will better recognize the costs of child care faced by parents paying for full-time, full-fee care. This measure will provide additional tax relief to about 65,000 working families with children.

Example

A parent earning $45,000 and paying fees of $14,000 for the care of two pre-school children can currently claim only $10,000 under the child care expense deduction. The increase in the deduction limits will allow this parent to claim the full costs. This will provide this parent with about $1,600 in additional federal-provincial tax relief.

Helping individuals caring for family members

Many Canadians provide care for family members – very often an elderly parent – at home. The support caregivers provide is very important. The tax system already recognizes this through measures such as the disability tax credit, the medical expense tax credit and the infirm dependant credit.

In 1996, the government enriched the infirm dependant credit by increasing the maximum credit amount from $270 to $400 and increasing the threshold at which the phase-out of the credit begins from $2,690 to $4,103 of the dependant's net income. This change provides more tax assistance to individuals supporting infirm relatives with less than $6,456 in net income. Still, most taxpayers who provide care to an elderly relative living with them cannot claim the credit because payments under the Old Age Security and the Guaranteed Income Supplement programs are well in excess of this income threshold.

To provide additional tax assistance to individuals providing in-home care for relatives, the budget proposes to introduce a new tax credit for caregivers.

The caregiver tax credit will reduce federal tax by up to $400 for individuals residing with and providing in-home care for a parent or grandparent over 65 years of age, or for an infirm dependent relative. The credit amount will be reduced by the dependant's net income in excess of $11,500.

The caregiver tax credit will provide $120 million annually in new federal tax assistance to about 450,000 caregivers. This credit will be especially beneficial to caregivers of elderly relatives.

Example

An individual caring at home for a senior relative receiving only OAS and GIS in income (about $10,750 in 1998) will receive about $600 in federal-provincial tax assistance from the caregiver credit.

The caregiver credit will also provide for increased tax assistance to parents providing care in their home to a relative with a disability. Families may not currently claim the infirm dependant tax credit as soon as the disabled family member receiving $6,500 or more in income. Many such families will be eligible to claim the caregiver credit and to receive up to $600 in federal-provincial assistance.

Assistance for Persons with Disabilities

The government is committed to helping Canadians with disabilities. As previously announced by the Minister of Human Resources Development, funding for the new Employability Assistance for Persons with Disabilities (EAPD) Program, which replaces the Vocational Rehabilitation of Disabled Persons (VRDP) Program, will be increased by $25 million to $193 million per year starting in 1998-99.

In addition, as part of the $250 million, five-year extension of the Residential Rehabilitation Assistance Program (RRAP) announced by the Minister Responsible for the Canada Mortgage and Housing Corporation in January, assistance for the disabled will be doubled from $4.1 million to $8 million per year.

The Government also provides $14 million annually for grants for students with disabilities to better enable them to pursue their studies.

A number of tax measures were also introduced in the 1997 budget to better recognize the impacts of disability-related costs on ability to pay.

This budget proposes to further improve tax assistance for persons with disabilities by:

- allowing existing homeowners to use the Home Buyers' Plan to purchase a more accessible home or a home for a disabled dependent relative;
- allowing supporting individuals to claim the medical expense tax credit for expenses for training courses related to the care of disabled dependent relatives;
- allowing occupational therapists and psychologists to certify eligibility for the disability tax credit; and
- exempting students with disabilities using RRSPs for lifelong learning from the requirement that their studies be on a full-time basis.

In addition to enhancing income tax support for persons with disabilities and their families, the government will exempt from the goods and services tax (GST) and harmonized sales tax (HST) the service of providing temporary care to a person who, by reason of infirmity or disability, has limited means of self-supervision or self-care. The proposed extension complements GST/HST relief that is already generally available for nursing home and home care services. Additional information regarding this measure is contained in the supplementary information section under sales tax measures.

Strengthening Communities and the Voluntary Sector

The government is committed to strengthening partnerships with non-profit and voluntary organizations that provide services which enhance the quality of life for Canadians.

Social needs are not met by governments alone. They are also met through services delivered in the social economy by people such as caregivers, social workers and volunteers. In the process, jobs and opportunities for skills development are generated. Government can play its part by supporting these important activities.

The 1997 budget further recognized the vital role of the voluntary sector. Among other initiatives, tax assistance for donations of certain appreciated publicly traded securities was enhanced and the annual income limit on the use of charitable donations tax credits was increased to 75 per cent for most charities. These measures have been well received. The voluntary sector has indicated that various organizations serving communities across Canada have already benefited from major new donations.

Emergency service volunteers

Many Canadians provide emergency services such as fire-fighting and first aid on a volunteer basis to small and rural communities. These volunteers give freely of their time and expertise, often at considerable risk to themselves, in the service of their community. The government recognizes that smaller communities are often unable to maintain full-time emergency staffs, and depend on the vital services of these volunteers. To further support volunteer emergency service providers, beginning January 1, 1998, the tax-free allowance for volunteer firefighters will be increased from $500 to $1,000, and extended to other emergency service volunteers.

Voluntary Sector Network Support

The federal government has been working to assist the voluntary sector in expanding its technological capacity, through Industry Canada's Community Access Program.

This budget provides funding for Voluntary Sector Network Support as part of the $205 million for SchoolNet and the Community Access Program which are discussed in Chapter 4.

As announced in *Securing Our Future Together*, this initiative will enhance the voluntary sector's capacity to engage Canadians by linking 2,500 voluntary organizations per year to the Internet and to each other. Emphasis will be placed on improving access to computer equipment, network support and training. Many services will be delivered by young people, providing them with employment opportunities and skills valued in today's economy.

Rural Canada

Nearly one-quarter of all Canadians live in rural Canada. They, like other Canadians, are experiencing the challenge of economic adjustment and need to be able to take advantage of new opportunities. In the 1997 budget, the government took steps to promote opportunities for growth and diversification in rural Canada by providing $50 million in additional capital to the Farm Credit Corporation. It also expanded the Community Access Program, that is creating 5,000 Internet access sites in rural Canada.

This budget confirms $20 million over the next four years to a multidepartmental Canadian Rural Partnership initiative announced in *Securing Our Future Together*. Led by the Minister of Agriculture and Agri-Food, this will build on a broad range of programs and services already in place in support of rural Canadians. It will involve a number of pilot projects that engage rural communities. It will also examine new ways to deliver information and programs so that rural Canadians are full participants in Canada's future prosperity.

Continuing support for Northern Ontario communities

Through the Federal Economic Development Initiative for Northern Ontario (FedNor), the federal government plays an active role in Northern Ontario communities by strengthening and diversifying their economies. FedNor funds community economic development initiatives, as well as programs that improve the availability of capital for small businesses in partnership with lending institutions.

The government previously announced $60 million over three years for FedNor. Recognizing the challenges faced by Northern Ontario communities, the government is confirming that the financial commitment currently being provided to FedNor will be maintained at $20 million per year after 1998-99. This puts FedNor funding on an ongoing basis, similar to regional development funding in other parts of the country.

New Partnership with Aboriginal Peoples

Gathering Strength, the federal response to the Royal Commission on Aboriginal Peoples, was released on January 7, 1998 by the Minister of Indian Affairs and Northern Development, and the federal Interlocutor for Métis and Non-Status Indians.

Gathering Strength contains a number of initiatives to be developed in partnership with aboriginal organizations to benefit Canada's aboriginal population. A $350 million fund has been set aside for a Healing Strategy to help address the legacy of abuse in residential schools. Another $126 million (combining $66 million in new funds with $60 million reallocated within the Department of Indian Affairs and Northern Development) has been allocated to new and expanded aboriginal programs. These funds will be spent on basic services including housing, water and sewer systems, and on supporting structural changes in the areas of education, social and economic development.

Gathering Strength reaffirmed the government's commitment to a number of aboriginal initiatives outlined in *Securing Our Future Together.* This budget provides funding for an extension of the Head Start program to on-reserve aboriginals, Urban Aboriginal Youth Centres, an Aboriginal Health Institute and an Aboriginal Languages program. Canada's aboriginal families will also benefit from the significant funding under the Canada Child Tax Benefit.

The Canada Millennium Scholarships and other initiatives in the Canadian Opportunities Strategy described in Chapter 4 will enable more aboriginal persons to pursue higher education and to upgrade their skills, so that they can more fully participate in the Canadian economy.

Addressing Environmental Challenges

Canadians attach a high value to the environment. They want Canada's rich endowment of natural resources to be managed wisely. They are conscious of growing problems associated with urban congestion and smog, and want to know that their health and that of their communities will be protected. They also recognize that much greater efficiency in the use of energy and an expanded role for renewable and alternative forms of energy will be needed in the years ahead.

Working in this direction makes not only good environmental sense, but also good economic sense. It means important opportunities in the form of new and more environmentally friendly and efficient technologies, new businesses and new markets, both in Canada and abroad. It can also contribute to lower costs. In other words, it is possible to protect the environment while at the same time strengthening the Canadian economy and creating jobs. Industry, from automobile makers to fossil fuel producers, is beginning to move in this direction.

That is why, in the 1997 budget, the government increased its direct financial support for energy efficiency and renewable energy by $60 million over three years beginning in 1998-99. In recent budgets, the government has also put in place tax changes to move toward a more level playing field between renewable and non-renewable energy so that, for example, renewable energy projects can now access tax-assisted financing using flow-through shares. The government will continue to examine cost-effective ways of encouraging energy efficiency and renewable energy through the tax system.

The negotiations which took place in Kyoto last December highlighted the importance of intensifying efforts to protect the global environment against the risk of climate change. Canada undertook to achieve substantial reductions in its emissions of greenhouse gases, as part of a global climate change initiative.

The government is committed to act in a genuine spirit of collaboration and partnership with the provinces and territories, the private sector, non-governmental organizations, local communities and consumers, as well as the National Round Table on the Environment and the Economy. Moving steadily forward, step by step, Canada is seeking solutions to lower emissions in such a way that no region or sector is asked to bear an unreasonable burden.

Prior to the 1997 budget, the government was investing over $100 million in direct spending each year to combat climate change. The additional $20 million per year over the next three years provided in the last budget reinforces these efforts. This budget provides a further $50 million annually over the next three years, to be invested by the government to build momentum toward concrete action and results.

Through partnerships and leveraging, these funds will help lay a strong foundation for early action, such as accelerated technology development and diffusion across many sectors; greater energy efficiency in government operations, industrial processes, vehicles, homes and small business; green infrastructure; community-based and citizen-based initiatives; broader public engagement within Canada; and the transfer of Canadian technology and expertise to the developing world.

Emissions trading offers the scope to achieve emissions reductions at lower cost and in a more market-oriented way than conventional regulation. Canada needs to be able to play a leading role in shaping an international approach to emissions trading that reflects Canada's circumstances. This includes how best to recognize early action by industry to reduce emissions. The government will be consulting widely with provinces, industry and non-governmental organizations, as well as international organizations including the World Bank, on the complex issues associated with developing an emissions trading system and how it could be designed for greenhouse gases.

The Minister of Natural Resources and the Minister of the Environment will be providing further details in the weeks and months ahead.

As reflected in *Securing Our Future Together*, funding for the National Research Council's Industrial Research Assistance Program (IRAP) will be increased by $34 million annually beginning in 1998-99. This funding, which will involve both grants and repayable contributions, will help small and medium-sized businesses to foster strategic innovation and to implement state-of-the-art technologies and approaches for using energy, water and natural resources more efficiently and for preventing pollution.

Promoting Canadian Culture and Sports

Canada's culture is rooted in shared experiences, national values, landscape and geography. Our cultural diversity and creativity unite us as citizens and distinguish us in the world. The government has already fulfilled several commitments made in *Securing Our Future Together* to support the creativity of Canadians and the excellence of our athletes. Earlier this year, the Minister of Canadian Heritage announced the following initiatives:

- an additional $25 million a year to the Canada Council starting in 1997-98 to support Canada's artists and arts organizations;
- an increase of $15 million a year in support to the Canadian book publishing industry, starting in 1997-98, to promote a viable and competitive book publishing industry; and
- an additional $50 million over the next five years to support athletes and coaches, and provide more opportunities to train and compete.

To make it possible to more easily mount major exhibitions of fine art and heritage objects in Canada, the government is exploring how to reduce the costs associated with insuring travelling exhibitions through an indemnification program.

Tax assistance to the Canadian film industry

The Canadian film production industry receives significant support from the federal government through the tax system. It benefits from two federal refundable tax credit programs. High Canadian content films certified by Canadian Heritage are eligible for a credit that can be up to 12 per cent of the total cost of the film. Other films are eligible for a lower-rate credit encouraging film producers to hire Canadians and produce films in Canada.

Canada Television and Cable Production Fund

Since 1996, the federal government has also provided significant direct support to Canadian television programs in both English and French through the Canada Television and Cable Production Fund.

In the 1996 budget, the federal government provided funding of $100 million in 1996-97 and 1997-98, and $50 million in 1998-99, to supplement the $100 million annually provided by the cable industry's production fund and Telefilm Canada.

The Fund has been an unqualified success. In the first full year of operation, the Fund generated some 2,200 hours of Canadian programming. This supported 19,600 full- and part-time jobs in all regions of the country, and leveraged a total of $625 million in television and production activity.

As announced recently by the Minister of Canadian Heritage, funding for the Canada Television and Cable Production Fund will be increased by $50 million in 1998-99, and $100 million in 1999-2000 and 2000-01. The Fund will therefore be maintained at $200 million annually until 2000-01. This will ensure that the Fund is able to:

- increase Canadian television programming during prime time;
- improve distinct Canadian drama, including feature length films, and variety, documentary, children's and arts programs; and
- promote the growth of skilled employment across the country.

Furthering International Co-operation

Canada has a long tradition of applying the shared values that define this country to furthering international co-operation and peace. Canada is recognized as the world leader in peacekeeping practices. Recently, the Canadian government has taken a lead role in successfully pursuing a global landmine treaty.

On December 3, 1997, Canada was the first country to sign the Convention on the Prohibition of the Use, Stockpiling, Production and Transfer of Anti-Personnel Mines and their Destruction. This treaty will enter into force once it has been ratified by 40 countries, expected within two years.

Canada will contribute $100 million over the next five years to help meet the goals of the treaty banning anti-personnel landmines. Canada's financial contribution will go towards implementing Ottawa Process II, an agenda for action. A key goal of this process is greatly expanded humanitarian assistance for landmine victims, to help with their medical care and to help rebuild their lives. Other goals include working towards universal adherence, early entry into force of the treaty, and assistance to countries which lack the means to fully implement their commitments under the treaty to clear mines and eliminate stockpiles.

The government will also devote an additional $90 million to the International Assistance Envelope in 1997-98. These funds will be used to pay calendar year 1998 commitments to international organizations, thus freeing up resources to be devoted to development initiatives in 1998-99 in the areas of environment, health, youth, and governance. A $50 million increase in the International Assistance Envelope for 1998-99 relative to the level previously projected for that year will also free up resources for such initiatives. This additional support is a signal that, as its fiscal situation allows, and consistent with its other priorities, the government will, as stated in the 1996 budget, make progress towards the official development assistance target of 0.7 per cent of gross domestic product (GDP).

6

Building Canada for the 21st Century –

General Tax Relief for Canadians

Highlights

- The amount of income that low-income Canadians can receive on a tax-free basis will be increased by $500, taking 400,000 Canadians off the tax rolls.
- The 3-per-cent general surtax will be eliminated for almost 13 million taxpayers with incomes up to about $50,000, and reduced for an additional one million taxpayers.

Introduction

The tax system plays a fundamental role in the social and economic fabric of a nation. Taxes provide the revenue needed to finance the services that government provides to Canadians.

With the federal government's books in balance, one of the government's goals is to reduce Canadians' taxes. This reduction in taxes is part of an overall strategy to achieve the nation's social and economic objectives.

The government's tax policy is an essential element of its overall social and economic policies, described in previous chapters, which have the following components:

- debt reduction, with the objective of lowering the stock of debt in absolute terms and in relation to the gross domestic product;
- strategic investments for job creation, economic growth and a secure society; and
- tax relief.

The government is determined to maintain balance in these three components of its strategy to simultaneously achieve a stronger economy and a secure society. To this end, tax relief has been, and will continue to be, provided on the following basis.

First, certain critical economic and social priorities cannot wait, as postponing action on them would impose net costs on Canadians. In such cases, targeted tax reductions generate a pay-off to the country that far exceeds any revenue loss.

Second, general tax relief will be provided only when fiscal resources permit. The size of such tax relief, and who gets it, will depend critically on the size of the fiscal dividend.

Third, the tax system must be fair. This implies that Canadians should pay taxes consistent with their ability to pay and that all taxes owed are indeed paid.

Consistent with this framework, all four of the government's previous budgets undertook targeted tax reductions to achieve social and economic objectives by providing assistance to education, children, charities and the disabled. These budgets also improved tax fairness. This budget builds on this approach. A number of strategic initiatives to provide enhanced opportunities and a secure society are described in Chapters 4 and 5. A comprehensive list of all the associated tax measures put forward in this and previous budgets can be found in Annex 7.

This budget also proposes some general personal income tax relief. The efforts of all Canadians in the past four years has now ensured that the task of balancing the budget is at hand. This has created room for some tax relief. In keeping with the nation's priorities, this implies first reducing taxes on those who can least afford to pay them, that is low- and middle-income Canadians.

Personal Income Tax Relief: the First Steps

The 1998 budget begins a process of general tax relief. Relief in personal income taxes is directed at Canadians with low and modest incomes. The budget proposes two measures to deliver this relief:

- increasing by $500 the amount of income that low-income Canadians can receive on a tax-free basis; and
- eliminating the general federal surtax for Canadians earning up to about $50,000, and reducing it for Canadians earning between $50,000 and $65,000.

Increase in tax-free income for low-income Canadians

Effective July 1, 1998, the amount of income that low-income Canadians can receive on a tax-free basis will be raised by $500 through a supplement to the basic personal and spousal amounts. The $500 supplement to the personal amounts will be phased out at a rate of 4 per cent of income over $6,956 in order to focus tax relief initially on individuals with incomes up to $20,000.

By 1999, this measure will eliminate federal tax payable for almost 400,000 very low-income Canadians, and reduce federal taxes for an additional 4.6 million Canadians.

This measure will cost $170 million in 1998-99 and $270 million in 1999-2000.

General surtax eliminated for most taxpayers

The general surtax, first introduced in 1986 as a temporary measure to reduce the deficit, is currently set at a rate of 3 per cent of basic federal tax. Effective July 1, 1998, the budget proposes to eliminate the 3-per-cent general surtax for filers earning up to about $50,000.

Surtax relief will reach a maximum of $250 per individual when fully in place in 1999. In order to focus surtax relief at low- to middle-income taxpayers, the surtax reduction will be phased out at a rate of 6 per cent of basic federal tax over $8,333. This measure will cost $710 million in 1998-99 and $1,175 million in 1999-2000.

When fully mature in the 1999 tax year, almost 13 million taxpayers (83 per cent of all taxable individuals) will no longer pay any federal surtax, and another one million taxpayers will see a significant reduction in their surtax liability.

Table 1 shows the number of taxpayers receiving tax reductions under these measures, while Table 2 shows the cost impact on federal revenues, which grow from $880 million in 1998-1999, to $1,445 million in 1999-2000, and to $1,680 million in 2000-2001.

Tables 3 and 4 show that the surtax reduction, combined with the $500 supplement to the basic personal and spousal amounts for low-income taxfilers, result in a progressive distribution of tax relief, with the degree of tax relief declining with income. For example, a one-earner family making $30,000 will receive $145 in tax relief corresponding to a 31-per-cent reduction of its current federal income tax burden. Relief for a one-earner family earning $50,000 will reach $238 or 3.3 per cent of its current federal income tax burden. Typical single individuals at $30,000 will receive $112 in tax relief, equivalent to 3 per cent of their current federal tax, while individuals at $50,000 will see a tax reduction of $219, or 2.4 per cent of their current federal tax.

Reductions in Employment Insurance Premiums

These income tax reductions are in addition to the decrease in the employment insurance (EI) premium rate from $2.90 to $2.70 per $100 of insurable earnings that took effect in January 1998. The 1998 premium rate reduction is the second largest drop in EI premiums since the 1970s. It will reduce premiums paid by employers and employees by an estimated $1.4 billion. For workers, it means paying up to $78 less in premiums in 1998 than in 1997. For employers, it means paying up to $109 less per employee. The reduction in EI premiums also provides a progressive relief in the burden of contributors, as workers at the lower-income end receive a proportionately larger cut than those at the higher-income end. This budget also announces a new initiative to direct further EI premium relief at youth employment (described in Chapter 4).

Tax Fairness: Tackling the Underground Economy

Tax evasion through participation in the underground economy penalizes honest taxpayers. The federal government has a comprehensive strategy for addressing this problem. This budget announces additional measures to reduce the underreporting of income.

Federal departments and agencies will begin issuing information slips for contract payments made from January 1, 1998 as will federal Crown corporations effective January 1, 1999.

The various associations involved in the construction industry have been concerned with competition from the underground economy for some time. In response to their concerns, the 1995 budget implemented a voluntary reporting system for the construction industry.

More recently, key industry associations, including the Building and Construction Trade Department of the AFL-CIO and the Interior Systems Contractor's Association of Ontario, have indicated that the reporting system to be effective needs to be made mandatory.

Effective January 1, 1999, reporting of construction contract payments to Revenue Canada will become mandatory. The federal government will consult with industry to ensure that any industry compliance costs are minimized and the system is effective.

Table 6.1
Impact on taxpayers – 1999

	Number of taxpayers
General tax relief	
Increase in tax-free income for low-income Canadians	
Number with tax reductions	5,000,000
Number removed from tax rolls	400,000
General surtax	
Number with surtax reductions	14,000,000
Number with surtax eliminated	12,600,000

Table 6.2
Impact on federal revenues

	1998-99	1999-2000	2000-2001
		($ millions)	
General tax relief			
Increase in tax-free income for low-income Canadians	-170	-270	-315
General surtax	-710	-1,175	-1,365
Total	-880	-1,445	-1,680

Table 6.3
Typical one-earner family of four – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax:

		Tax relief measures			
Total income	Current federal Tax[1]	Low-income supplement	Surtax reduction	Total tax relief	As a % of federal tax[2]
$	$	$	$	$	
13,500	-3,705	-169	-5	-174	n.a.[3]
15,000	-3,458	-168	-7	-175	n.a.[3]
20,000	-2,637	-132	-33	-165	n.a.[3]
25,000	-992	-97	-57	-154	n.a.[3]
30,000	461	-62	-83	-145	-31.4
35,000	2,246	-27	-122	-149	-6.6
40,000	3,953	0	-160	-160	-4.0
45,000	5,542	0	-199	-199	-3.6
50,000	7,131	0	-238	-238	-3.3
55,000	8,720	0	-195	-195	-2.3
60,000	10,335	0	-116	-116	-1.1
65,000	12,078	0	-29	-29	-0.3
75,000	15,485	0	0	0	0.0
100,000	23,315	0	0	0	0.0

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical families at and below $25,000 or so receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table 6.4
Typical single – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax:

		Tax relief measures			
Total income	Current federal Tax[1]	Low-income supplement	Surtax reduction	Total tax relief	As a % of federal tax[2]
$	$	$	$	$	
7,500	-97	-84	-1	-85	n.a[3]
10,000	264	-66	-14	-80	-30.2
15,000	1,051	-31	-39	-70	-6.6
20,000	1,872	0	-63	-63	-3.4
25,000	2,693	0	-87	-87	-3.2
30,000	3,756	0	-112	-112	-3.0
35,000	5,141	0	-150	-150	-2.9
40,000	6,445	0	-188	-188	-2.9
45,000	7,784	0	-227	-227	-2.9
50,000	9,123	0	-219	-219	-2.4
55,000	10,462	0	-141	-141	-1.4
60,000	11,826	0	-61	-61	-0.5
65,000	13,341	0	0	0	0.0
75,000	16,473	0	0	0	0.0
100,000	24,303	0	0	0	0.0

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical individuals at and below this income receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Annex 1

Spending and Tax Initiatives since the 1997 Budget

Annex 1 – Table
Spending and tax initiatives since the 1997 budget

	1997-98	1998-99	1999-00	2000-01	Cumu-lative Total
	(millions of dollars)				
Spending initiatives					
The Canadian Opportunities Strategy					
Canada Millennium Scholarships	2500				2500
Canada Study Grants		100	100	100	300
Granting councils		120	135	150	405
Improvements to Canada Student Loans Program		50	145	150	345
Canada Education Savings Grant		150	200	275	625
Youth at risk		50	75	100	225
Connecting Canadians to information and knowledge	55	60	70	75	260
Subtotal	2555	530	725	850	4660
Building a Secure Society					
Increase CHST cash floor	200	900	1500	1500	4100
National HIV/AIDs Strategy		41	41	41	123
Establishing a new blood system		30	30		60
Increased funding for EAPD[1]		15	20	20	55
New partnership with aboriginal peoples	350	126	126	126	728
Promoting Canadian culture and sports	40	100	150	150	440
Strengthening communities and the voluntary sector			20	20	40
Addressing environmental challenges		84	84	84	252
Furthering international co-operation	90	70	20	20	200
Subtotal	680	1366	1991	1961	5998
Other					
Other Securing *Our Future Together*	3	85	85	83	256
Total spending initiatives	3238	1981	2801	2894	10914

[1] Employability Assistance for Persons with Disabilities Program.

Annex 1 – Table (Cont'd)
Spending and tax initiatives since the 1997 budget

	1997-98	1998-99	1999-00	2000-01	Cumu-lative Total
	(millions of dollars)				
Targeted and general tax actions					
The Canadian Opportunities Strategy					
Tax relief for interest on student loans		80	130	145	355
Tax-free RRSP withdrawals for lifelong learning		15	40	45	100
Tax relief for part-time students		25	90	90	205
EI premium holiday for youth employment			100	100	200
Subtotal		120	360	380	860
Building a secure society					
Deductibility of health/ dental insurance premiums			90	110	200
Alternative minimum tax and RRSPs		70	20	20	110
Canada Child Tax Benefit			320	750	1070
Child care expense deduction		20	45	45	110
Caregiver credit		30	120	125	275
Disability tax assistance measures		5	5	5	15
Emergency service volunteers		5	10	10	25
Subtotal		130	610	1065	1805
General tax relief for Canadians					
Increase in tax-free income for low-income Canadians		170	270	315	755
General surtax relief		710	1175	1365	3250
Subtotal		880	1445	1680	4005
Tax fairness measures		-5	-25	30	0

Annex 1 – Table (Cont'd)
Spending and tax initiatives since the 1997 budget

	1997-98	1998-99	1999-00	2000-01	Cumulative Total
	(millions of dollars)				
Measures announced before the budget					
Increase excise tax on tobacco products		-70	-70	-70	-210
Reduction in EI premiums	235	465			700
Subtotal	235	395	-70	-70	490
Net targeted and general tax actions	235	1520	2320	3085	7160
Summary					
Spending initiatives					
The Canadian Opportunities Strategy					
Canada Millennium Scholarships	2500				2500
Other initiatives	55	530	725	850	2160
Building a secure society					
Increased CHST cash transfers	200	900	1500	1500	4100
Other initiatives	480	466	491	461	1898
Other *Securing our Future Together*	3	85	85	83	256
Total	3238	1981	2801	2894	10914
Targeted and general tax relief					
The Canadian Opportunities Strategy		120	360	380	860
Building a secure society		130	610	1065	1805
General tax relief		880	1445	1680	4005
Tax fairness measures		-5	-25	30	0
Actions before budget	235	395	-70	-70	490
Total	235	1520	2320	3085	7160
Total spending and tax initiatives	3473	3501	5121	5979	18074
The Debt Repayment Plan: up to (assuming that Contingency Reserve not required)		3000	3000	3000	9000

Annex 2

The Budgetary Balance, Financial Balance and National Accounts Budget Balance

There are three basic measures of the federal government's fiscal position in Canada – two measures based on the public accounts (budgetary balance and financial balance) and one based on the System of National Accounts, as prepared by Statistics Canada. Corresponding to each measure are indicators of the net debt position of the federal government.[1]

Differences in the measures arise because the accounting frameworks are designed for different purposes.

The fundamental purpose of the public accounts measures (budgetary balance and financial balance) is to provide information to Parliament on the government's financial activities as required under the *Financial Administration Act*. The purpose of the public accounts is to permit parliamentary control of public funds into and out of the Consolidated Revenue Fund. The results are based on generally accepted accounting principles for the public sector and are audited by the Auditor General of Canada.

The financial balance (requirements/surplus) measures the amount by which cash going out from the government exceeds cash coming in. Over time, it is roughly equivalent to the amount of money that the government has to borrow in credit markets or the amount of market debt that the government is repaying.

---

[1] National accounts data reported in this annex reflect the 1997 historical revisions to the Canadian System of National Accounts. Revised data for federal government debt on a national accounts basis are not yet available.

However, in any one year, changes in the government's cash balance and foreign reserve position can also have a temporary effect on the level of market debt.

- The main difference between the budgetary balance and the financial balance relates to the treatment of federal government employee pension accounts. The budgetary balance includes the total annual pension-related obligations (the government's contribution as an employer for current service costs plus interest on its borrowings from the pension accounts) while the financial balance includes only the benefits paid out in that year less employee premiums paid.
- In addition, the budgetary balance includes all the federal government's obligations incurred during the course of the year while the financial balance only includes the actual cash outlay related to these obligations.

Most industrialized countries present their budgets on a basis that is more comparable to the financial balance approach than to the public accounts measure of the budgetary balance. The financial balance corresponds closely to the Unified Budget Balance in the United States.

The primary objective of the national accounts is to measure economic production and income. The government sector in the national accounts is treated on the same basis as other sectors of the economy. The current national accounts treatment of the transactions of federal government employee pension accounts is similar to that in the public accounts measure of the financial balance.

- National accounts balances are used for international fiscal comparisons by the Organization for Economic Co-operation and Development (OECD) and the International Monetary Fund (IMF).
- The national accounts also provide a consistent framework for aggregation and comparison of the fiscal positions of the various levels of government in Canada.

The budgetary balance (deficit or surplus) is the most comprehensive of the three measures. It includes all transactions with outside parties that enter into the calculation of the deficit or surplus of the government. It also includes liabilities incurred during the year for which no cash payment has been made and only those revenues and program spending over which Parliament has given it control.

Chart A2.1

Alternative measures of the federal budget balance

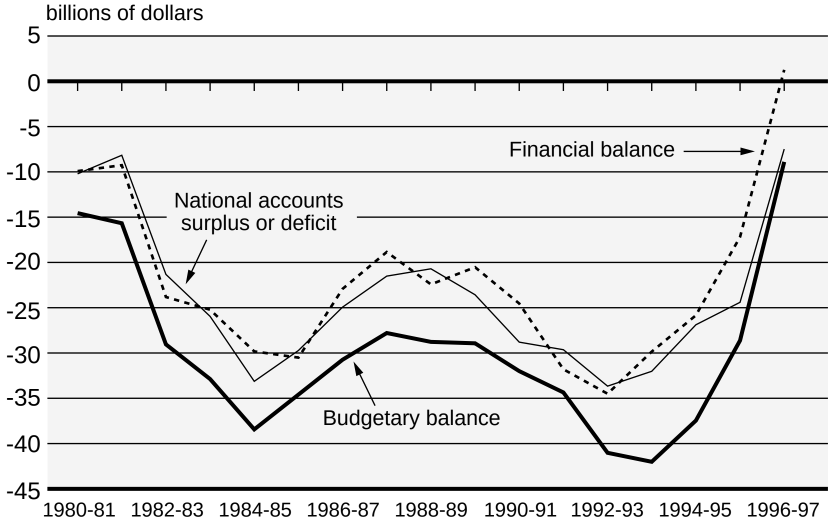


Table A2.1

Alternative measures of the federal balance[1]
1980-81 to 1996-97 (fiscal years)

Year	Budgetary balance		Financial balance (excluding foreign exchange transactions)		National accounts balance	
	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP
1980-81	-14,556	-4.6	-9,917	-3.1	-10,219	-3.2
1981-82	-15,674	-4.3	-9,264	-2.6	-8,168	-2.3
1982-83	-29,049	-7.6	-23,819	-6.3	-21,323	-5.6
1983-84	-32,877	-8.0	-25,219	-6.1	-25,957	-6.3
1984-85	-38,437	-8.6	-29,824	-6.6	-33,128	-7.4
1985-86	-34,595	-7.1	-30,510	-6.3	-29,725	-6.1
1986-87	-30,742	-6.0	-22,918	-4.5	-24,934	-4.9
1987-88	-27,794	-5.0	-18,849	-3.4	-21,511	-3.9
1988-89	-28,773	-4.7	-22,424	-3.7	-20,704	-3.4
1989-90	-28,930	-4.4	-20,530	-3.1	-23,571	-3.6
1990-91	-32,000	-4.7	-24,538	-3.6	-28,801	-4.2
1991-92	-34,357	-5.0	-31,800	-4.7	-29,638	-4.3
1992-93	-41,021	-5.9	-34,497	-4.9	-33,659	-4.8
1993-94	-42,012	-5.8	-29,850	-4.1	-32,021	-4.4
1994-95	-37,462	-4.9	-25,842	-3.4	-26,884	-3.5
1995-96	-28,617	-3.6	-17,183	-2.2	-24,401	-3.1
1996-97	-8,897	-1.1	1,265	0.2	-7,482	-0.9

[1] A positive number denotes a surplus, a negative number denotes a deficit.

Each of the three measures provides important complementary perspectives on the government's fiscal position. Although the measures differ in levels, their trends are broadly similar (Chart A2.1 and Table A2.1).

As the deficits or surpluses derived from these three measures are different, so are the measures of debt (Table A2.2). The accumulation of annual budgetary balances (deficits and surpluses) since Confederation is the net public debt. For financial requirements/surplus, the relevant measure is the stock of market debt that the government has outstanding (Table A2.2). Another important debt measure in the public accounts is *interest-bearing debt*. This measure includes all interest-bearing liabilities of the Government of Canada. As such, this is the measure that is most appropriate for calculating the average effective interest rate. Interest-bearing debt is larger than market debt because it includes liabilities which have not been issued on markets – notably the government's liabilities to its employee pension accounts.

The national accounts debt represents the government's total liabilities minus its financial assets (federal net debt consistent with recent revisions to the national accounts measure of the budget balance is not currently available).

Table A2.2
Alternative public accounts measures of the federal debt[1]
1980-81 to 1996-97 (fiscal years)

	Net debt		Interest-bearing debt		Market debt		National account debt[2]	
Actual	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP	Millions of dollars	Per cent of GDP
1980-81	91,948	29.2	112,418	35.7	83,138	26.4	49,609	15.7
1981-82	107,622	29.9	126,684	35.1	93,167	25.8	57,817	16.0
1982-83	136,671	36.0	154,221	40.6	116,562	30.7	79,547	20.9
1983-84	169,549	41.2	184,849	45.0	142,901	34.8	105,765	25.7
1984-85	207,986	46.3	219,458	48.8	172,719	38.4	136,620	30.4
1985-86	242,581	50.0	253,381	52.2	201,229	41.5	169,619	35.0
1986-87	273,323	53.4	286,034	55.9	228,611	44.7	195,919	38.3
1987-88	301,117	54.0	313,948	56.3	250,809	44.9	215,613	38.6
1988-89	329,890	53.9	345,057	56.4	276,301	45.2	236,708	38.7
1989-90	358,820	54.7	370,104	56.4	294,562	44.9	262,021	39.9
1990-91	390,820	57.6	406,475	59.9	323,903	47.8	287,618	42.4
1991-92	425,177	62.2	440,181	64.4	351,885	51.5	309,189	45.3
1992-93	466,198	66.7	477,034	68.3	382,741	54.8	340,699	48.8
1993-94	508,210	70.2	514,510	71.1	413,975	57.2	366,494	50.6
1994-95	545,672	71.6	550,192	72.2	440,998	57.9	395,313	51.9
1995-96	574,289	71.9	586,387	73.4	469,547	58.8	425,893	53.3
1996-97	583,186	71.1	600,557	73.2	476,852	58.1	439,279	53.5

[1] National accounts balance sheet data not available on the basis of revised Canadian System of National Accounts.

[2] National accounts debt figures represent net financial assets on a calendar year basis.

Annex 3

Improved Fiscal Outlook for the Canadian Government Sector

Introduction and Overview

This annex provides an overview of the fiscal performance of the federal and provincial-territorial governments.

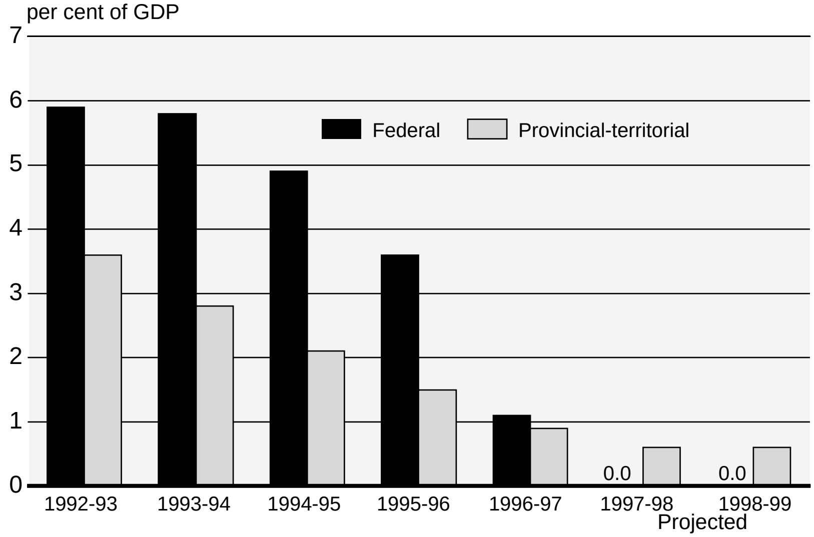
The financial situation of the Canadian government sector (federal and provincial-territorial), on a public accounts basis, has improved substantially in recent years. This progress can be assessed by the evolution of budget balances, debt-to-GDP ratios, debt servicing costs, program spending and operating balances. Based on current budget plans, further progress is expected in the coming years.

Deficit Elimination in Sight

In recent years, governments across Canada have made great progress towards the restoration of their fiscal health. The implementation of restraint measures has led to a sizeable reduction of deficits at the federal and provincial-territorial levels. In 1996-97, the federal deficit stood at 1.1 per cent of gross domestic product (GDP), down from 5.9 per cent in 1992-93. Over the same period, the total provincial-territorial deficit fell from 3.6 per cent of GDP to 0.9 per cent (Chart A3.1).

Chart A3.1

Federal and provincial-territorial budgetary deficits
(public accounts basis)

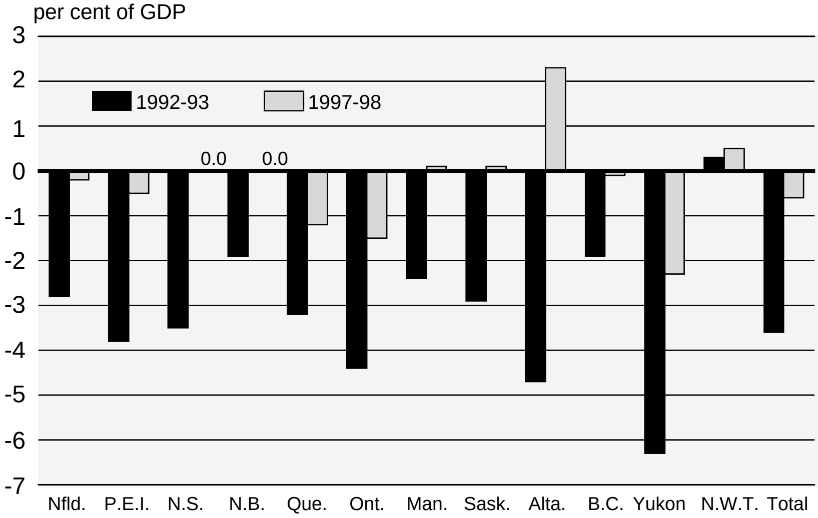


Source: Department of Finance, Canada.

In 1997-98, the federal government will post its first balanced budget since 1969-70. Six other jurisdictions (Nova Scotia, New Brunswick, Manitoba, Saskatchewan, Alberta and the Northwest Territories) are expected to record balanced budgets or surpluses in 1997-98 (Chart A3.2). The total government deficit will then be reduced to 0.6 per cent of GDP from 9.4 per cent in 1992-93.

The federal government is committed to balanced budget targets for 1998-99 and 1999-2000, the first time since 1951-52 that the budget will be in balance for three consecutive years. By the turn of the century, all jurisdictions in Canada should have balanced their books. Moreover, several jurisdictions have announced or legislated schedules for the repayment of public debt or have implemented personal income tax reductions.

Chart A3.2
Provincial-territorial surpluses (+)/deficits (-)
(public accounts basis)

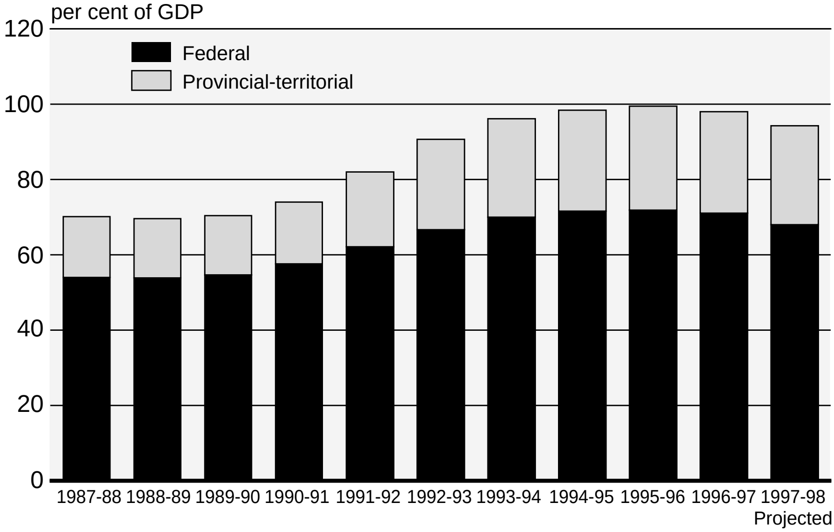


Source: Department of Finance, Canada.

Net Debt Burden on a Downward Track

As a result of the reduction in the deficit, the pace of debt accumulation has slowed over the last few years. This has led to a notable reduction in debt-to-GDP ratios for all levels of government. In 1996-97, the federal net debt fell to 71.1 per cent of GDP, down from 71.9 per cent in 1995-96 (Chart A3.3). This constitutes the first significant decline in 25 years. With sustained economic growth and *The Debt Repayment Plan*, which will reduce the absolute amount of the debt, the federal net debt-to-GDP ratio will be put on a permanent downward track.

Chart A3.3
Federal and provincial-territorial net debt
(public accounts basis)



Source: Department of Finance, Canada.

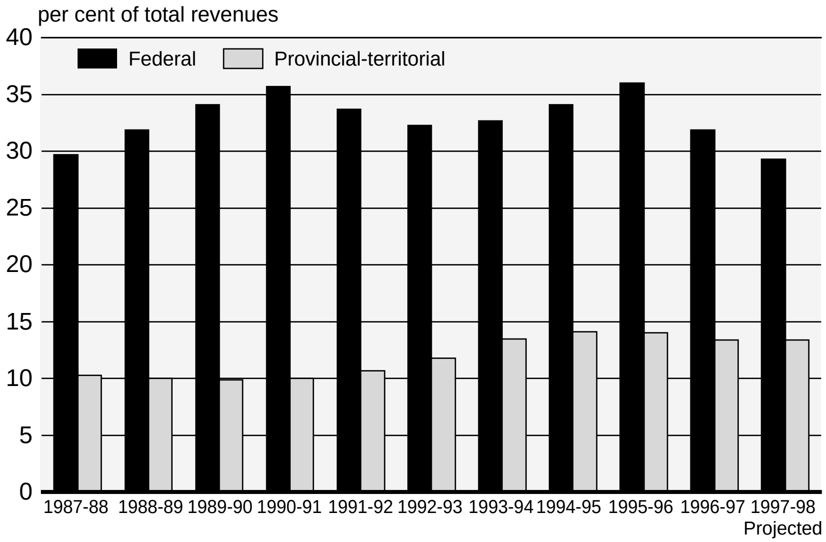
The provincial-territorial debt burden is also falling. The total net debt of the provinces and territories fell to 26.9 per cent of GDP in 1996-97, down 0.7 percentage points from the previous year. By 1999-2000, provincial-territorial net debt should represent some 25 per cent of GDP. Consequently, the total government net debt-to-GDP ratio is expected to decline substantially between 1996-97 and 1999-2000.

Interest Charges Declining as a Share of Revenues

As a result of the slowing in the pace of debt accumulation and the reduction in interest rates in recent years, debt charges are absorbing a smaller portion of government revenues. Federal debt charges totalled 31.9 per cent of federal revenues in 1996-97, down from their peak of 36 per cent the year before. Provincial-territorial debt servicing costs fell to 13.4 per cent of revenues in 1996-97, down from 14 per cent in 1994-95 (Chart A3.4). In 1997-98, the ratio of federal debt charges to total revenues will decline further to 28.1 per cent. At the provincial-territorial level, the burden of servicing the debt is expected to remain stable.

Chart A3.4

Federal and provinicial-territorial debt charges
(public accounts basis)



Source: Department of Finance, Canada.

Program Spending will Continue to Decline Relative to the Size of the Economy

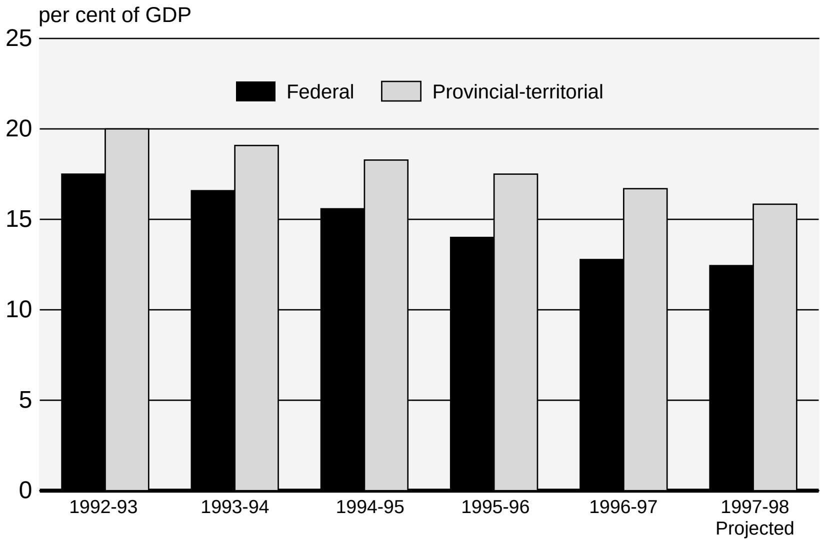
The turnaround in Canada's fiscal health was mainly the result of the decline in program spending. Between 1992-93 and 1996-97, federal program spending fell from 17.5 per cent to 12.8 per cent of GDP. Over the same period, provincial-territorial program spending dropped from 20.0 per cent to 16.7 per cent of GDP.

In 1997-98, federal program spending as a percentage of GDP will decline further to 12.4 per cent. Provincial-territorial program spending will also fall in 1997-98, to 16 per cent of GDP (Chart A3.5). By 1999-2000, federal program spending will have declined to 11.6 per cent of GDP, its lowest level in 50 years.

Chart A3.5

Federal and provincial-territorial program spending

(public accounts basis)



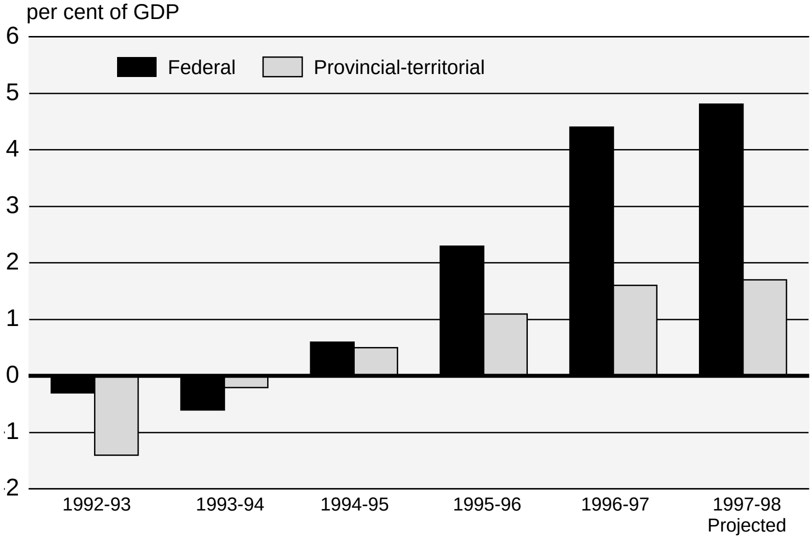
Source: Department of Finance, Canada.

Operating Balances in Large Surplus Position

The reduction of program spending in recent years, combined with revenue growth, pushed operating balances, defined as the difference between total budgetary revenues and program spending, into a significant surplus position. From 1992-93 to 1996-97, the federal operating balance as a percentage of GDP moved from a deficit of 0.3 per cent to a surplus of 4.4 per cent. At the same time, the provincial-territorial operating balance improved from a deficit of 1.4 per cent to a surplus of 1.6 per cent. In 1997-98, operating surpluses are expected to grow further at both levels of government (Chart A3.6).

Chart A3.6

Federal and provincial-territorial operating balances
(public accounts basis)



Source: Department of Finance, Canada.

Annex 4

Canada's Fiscal Progress in an International Context

Introduction and Overview

This annex compares Canada's fiscal situation to that of the other Group of Seven (G-7) countries.

Two factors tend to complicate international fiscal comparisons. First, accounting practices vary from one country to another, reducing comparability between countries. Second, fiscal responsibilities in each country are shared differently among the various levels of government. For these reasons, international comparisons are made using national accounts data for the total government sector. The Organization for Economic Co-operation and Development (OECD) presents a comprehensive set of national accounts estimates[1]. The figures presented in this annex relate to the OECD's December 1997 forecast and, as such, do not include any new policy initiatives.

Overall, Canada's fiscal performance compares very favourably with that of other G-7 countries.

[1] It is important to note that the OECD has not yet adjusted its national accounts data to incorporate recent revisions in the Canadian System of National Accounts.

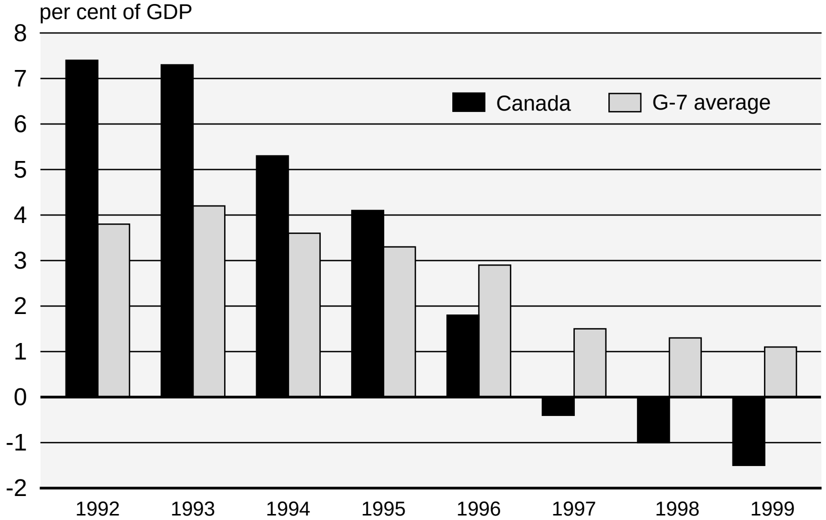
Growing Budgetary Surpluses in Canada

On a national accounts basis, the total Canadian deficit stood at 7.4 per cent of gross domestic product (GDP) in 1992 – nearly twice the G-7 average of 3.8 per cent.

However, as a result of deficit reduction efforts by all levels of government, the total government sector in Canada has closed the gap with respect to other G-7 countries. In 1996, Canada's total government deficit fell below the G-7 average. According to OECD projections, Canada's overall government sector will show a budgetary surplus in 1997, compared to an average deficit of 1.5 per cent of GDP in the G-7 countries. Furthermore, Canada's surpluses are expected to grow through 1999 (Chart A4.1).

Chart A4.1

Total government deficit (+)/surplus (-)
(national accounts basis)

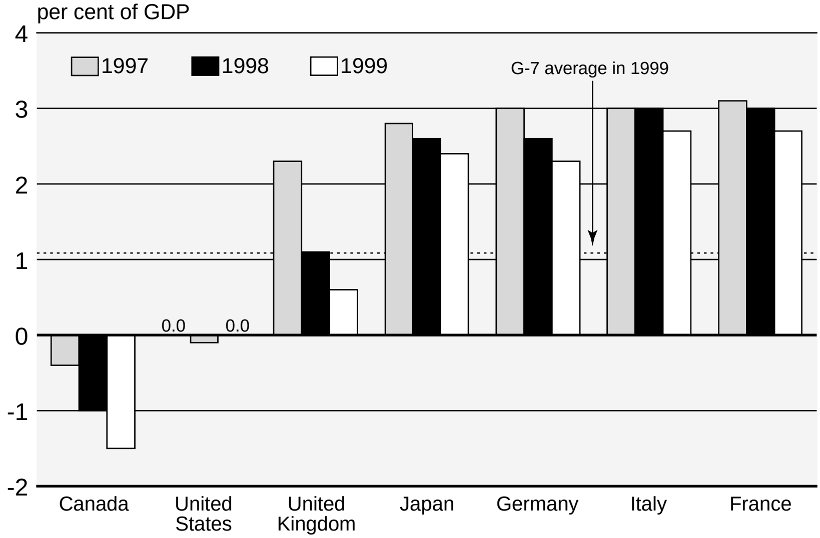


Source: *OECD Economic Outlook*, December 1997.

According to OECD estimates, Canada was the only G-7 country to post a surplus in 1997. In 1998 and 1999, Canada is expected to further consolidate its leading position. For those two years, the OECD expects the Canadian total government sector to post surpluses of 1.0 per cent and 1.5 per cent of GDP, respectively, again the best performance of the G-7 countries (Chart A4.2).

Chart A4.2

Total government deficit (+)/surplus (-) in G-7 countries
(national accounts basis)



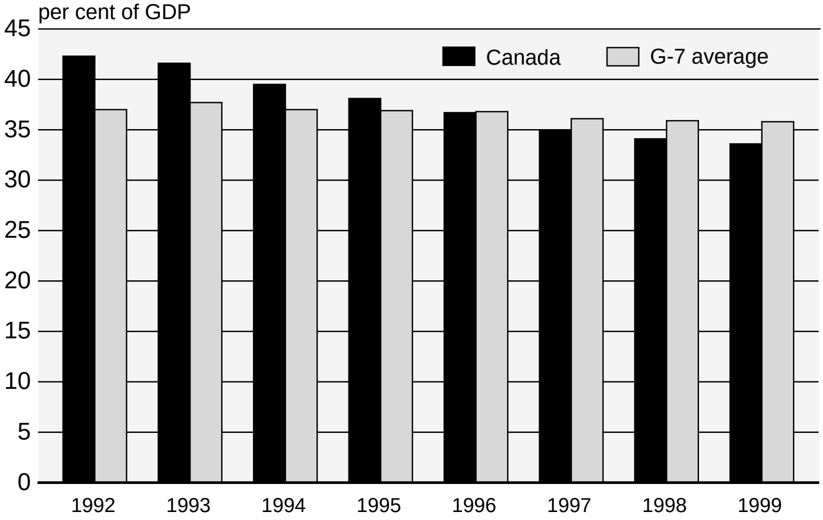
Source: *OECD Economic Outlook*, December 1997.

Program Spending is Declining Faster

This rapid turnaround in Canada's public finances can be traced back to a sharp reduction in program spending. Since 1992, program spending has fallen much faster in Canada than in other G-7 countries. Between 1992 and 1997, Canada's total government program spending has been reduced from 42.3 per cent to 34.9 per cent of GDP – a 7.4 percentage point decline – while, over the same period, program spending in the G-7 countries declined by only 0.9 per cent of GDP. Canada's program spending as a percentage of GDP is lower than the G-7 average and is projected to remain lower (Chart A4.3).

Chart A4.3

Total government program spending
(national accounts basis)

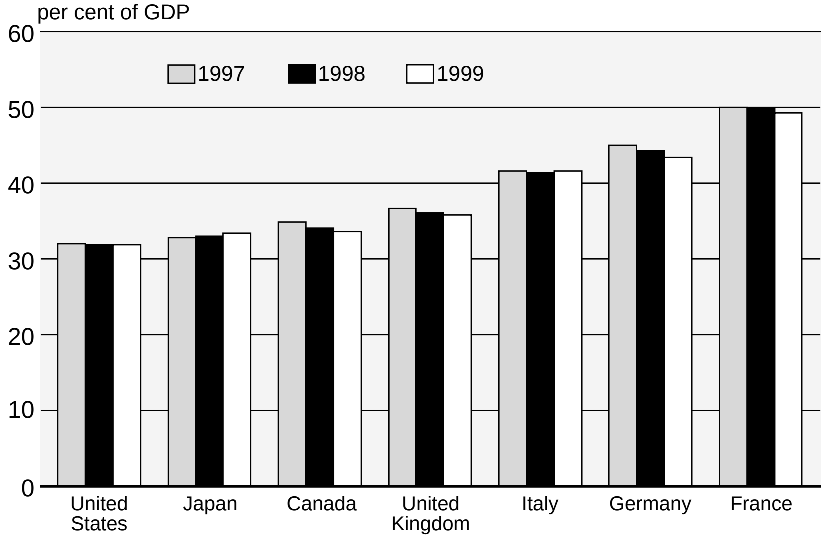


Source: *OECD Economic Outlook*, December 1997.

In 1998 and 1999, Canada's program spending as a percentage of GDP is projected to be the third lowest among the G-7 countries, behind the United States and Japan (Chart A4.4).

Chart A4.4

Total government program spending in G-7 countries
(national accounts basis)



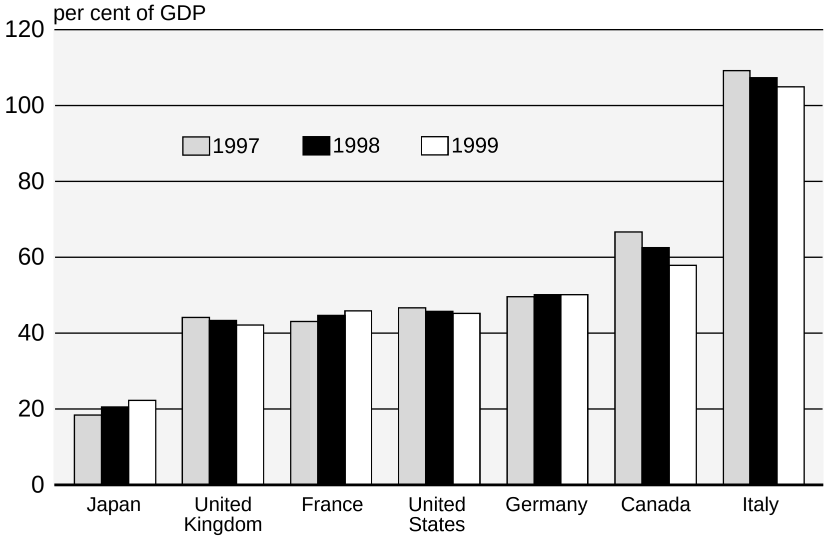
Source: *OECD Economic Outlook,* December 1997.

Canadian Net Debt-to-GDP Ratio Declining More Rapidly

Between 1997 and 1999, the Canadian net debt-to-GDP ratio is expected to decline by almost 9 percentage points, the largest decline among the G-7 countries. While declining, Canada's debt burden will remain high by international standards (Chart A4.5).

Chart A4.5

Total government net debt in G-7 countries
(national accounts basis)



Source: *OECD Economic Outlook*, December 1997.

Annex 5

Fiscal Outlook: Sensitivity to Economic Assumptions

Sensitivity to Changes in Economic Assumptions

Estimates of the main fiscal aggregates are sensitive to changes in economic assumptions – particularly to the level of nominal gross domestic product (GDP) and interest rates. The following sensitivity estimates capture the direct fiscal impacts of changes in these variables. These are partial calculations that capture the impact of the changes, one economic variable at a time. For example, in the nominal income sensitivity estimate, there is no feed-through of the change in nominal income to other variables, such as interest rates and unemployment.

Sensitivity to changes in nominal income

A 1-per-cent increase in the level of nominal GDP leads to higher tax bases and thus higher revenues. The ultimate budgetary impact would depend on the source of the increase in nominal income. The most favourable impact on the fiscal situation would occur if all of the increase in nominal GDP resulted from increased real output. Revenues would be higher, while interest rates would be relatively stable.

If, however, the improvement in nominal GDP was solely due to inflation, then higher spending on those programs indexed to inflation would offset some of the positive impact of government revenues. Higher inflation would also likely raise interest rates.

Assuming the increase in nominal income comes solely from an increase in output, with no impact on interest rates and no net effect on the Employment Insurance Program, the budgetary balance would improve by $1.3 billion in the first year, rising to $1.7 billion after four years (Table A5.1).

Table A5.1
Fiscal sensitivity analysis: 1-per-cent increase in nominal income

	Estimated changes in fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue increases	1.2	1.3	1.4	1.6
Expenditure reductions	0.1	0.2	0.1	0.1
Budgetary balance improvement	1.3	1.5	1.5	1.7

Sensitivity to changes in interest rates

In contrast to the uncertainties of the sensitivity of the deficit to changes in nominal GDP, the direct impact of interest rate changes on public debt charges can be calculated with considerable precision.

A sustained 100-basis-point increase in all interest rates would cause the budgetary balance to deteriorate by $1.0 billion in the first year (Table A5.2). As longer-term debt matures and is refinanced at the higher interest rates, the negative impact on the budgetary balance goes up, reaching $2.4 billion by year four.

Table A5.2
Fiscal sensitivity analysis: 100-basis-point increase in interest rates

	Estimated changes in fiscal position			
	Year 1	Year 2	Year 3	Year 4
	(billions of dollars)			
Budgetary transactions				
Revenue increases	0.4	0.5	0.5	0.6
Expenditure increases	1.4	2.2	2.6	3.0
Budgetary balance deterioration	1.0	1.7	2.1	2.4

The second, third and fourth year impacts are somewhat lower than those presented in the 1997 budget, reflecting downward revisions to the stock of the debt, due to the much better-than-expected deficit outcome for 1996-97 and the commitment to balanced budgets in 1998-99 and 1999-2000.

Over the past several years, the government has taken a number of actions to reduce the sensitivity of the budgetary balance to changes in interest rates. The most significant of these have been the overall fiscal actions to eliminate the deficit. The actions put in place in the 1994, 1995 and 1996 budgets provided annual savings of $28 billion by 1998-99. Between 1994-95 and 1998-99, the cumulative effect of these actions was to lower the debt by close to $90 billion. With an effective interest rate on the debt of about 7 per cent, these actions have lowered debt charges by about $6 billion annually.

The government has also reduced the sensitivity of the budgetary balance by pursuing a prudent debt management strategy. The objective of the government's debt management strategy is to raise funds at stable and low costs. Greater cost stability has been achieved over the past several years by increasing the share of the government's gross debt in fixed-rate form (i.e. debt maturing or being repriced in more than 12 months) to 65 per cent, up from about 50 per cent in 1992-93. A higher proportion of fixed-rate debt provides protection against unexpected changes in interest rates and brings Canada in line with other major sovereign borrowers. In the mid 1990s, the impact of a 100-basis-point increase in interest rates was estimated to raise public debt charges by $1.8 billion. Today the same increase in interest rates would increase debt charges by $1 billion.

Ensuring that the government, and other credit-worthy borrowers in the economy, can raise funds at stable and low costs requires well-functioning capital markets. The government's debt programs are being progressively restructured over time to maintain a well-functioning market, within the context of ongoing reductions in market debt. Last fall, the government switched from weekly to bi-weekly Treasury bill auctions and consultations have taken place with market participants on restructuring the bond program.

Some concerns have arisen as a result of disruptive activities by some market participants in the government securities market and these are being addressed on a priority basis, in conjunction with market participants. Initiatives include changes to the auction rules, and the development of an Investment Dealers Association Code of Conduct governing secondary markets.

Further information on the government's debt strategy can be obtained from the *Debt Management Report 1997*, Department of Finance.

Annex 6

The Government's Response to the Auditor General's Observations on the 1997 Financial Statements

The 1997 *Public Accounts of Canada* contains the Auditor General's opinion of the government's financial statements for 1996-97. As well, the Auditor General raises a number of accounting issues in his observations on the government's financial statements. These are:

- accounting for employee pensions;
- accounting for environmental liabilities and contingencies;
- full accrual accounting for capital assets;
- enterprise Crown corporations;
- accrual accounting for tax revenues; and
- Statement of Transactions of the Debt Servicing and Reduction Account (DSRA).

The government's response to the Auditor General's opinion and observations on the 1997 financial statements are discussed in this annex.

Audited opinion of the Government's Financial Statements

After five consecutive years of expressing a clean opinion on the government's financial statements, the Auditor General expressed a qualified opinion on the 1997 financial statements. According to the Auditor General, the 1996-97 deficit is overstated by $800 million, relating to the recording of a transaction to the Canada Foundation for Innovation. The Auditor General is of the view that this liability did not exist at March 31, 1997 and that the $800 million expenditure should be recorded in 1997-98 and not in 1996-97.

The government strongly disagrees with this assessment. The government made a commitment in the 1997 budget to provide funding of $800 million to the Canada Foundation for Innovation. Legislation establishing the Foundation and authorizing the payment was passed by Parliament before the financial statements for 1996-97 were closed. The government believes that these actions created a liability which should appropriately be recorded in 1996-97.

The government believes that transparency and accountability to Parliament and Canadians are best served by recording liabilities in the year in which they are incurred. This is good public policy. The government has been consistent in this practice and will continue to be so in the future. As such, non–recurring liabilities will be recognized in the year in which the decision to incur the expenditures is made, provided the enabling legislation or authorization for payment receives parliamentary approval before the financial statements for that year are closed.

Accounting for employee pensions

The Auditor General notes that, "although the Government accounts for employee pensions in accordance with its stated accounting policies and related legislation", he is concerned about the growing difference between actuarial obligation for employee pensions and the liability shown in the Statement of Assets and Liabilities. He is recommending that the government fully comply with generally accepted accounting practices enunciated by the Public Sector Accounting and Auditing Board (PSAAB). In his observations, he indicated that he intends "to consider the impact of this matter in formulating my opinion on the Government's financial statements in future years, should the accounting for employee pensions remain unchanged".

The PSAAB recommends that, for government accounting purposes, pension interest should be calculated on the actuarial obligation rather than on the pension account balances. Over time, this method of accounting would reduce the difference between the actuarial obligation and the liability reported in the Statement of Assets and Liabilities.

The government is responsible for the pension benefit plans covering almost all of its permanent employees (including the public service, Canadian Forces, Royal Canadian Mounted Police and certain Crown corporations), as well as federally appointed judges and Members of Parliament. Under current legislation, it must generally fully fund benefits as they accrue and is responsible for any unfunded liability. The various pension accounts in the government's financial statements fully reflect the financing requirements set out in the applicable legislation.

The government is concerned with the growing difference between the actuarial obligation and the liability reported in the Statement of Assets and Liabilities. As a result, it will accept the recommendation of the Auditor General and change its accounting for employee pensions. In addition, the President of the Treasury Board will be undertaking consultations with plan members regarding fundamental reform of the management and financing of public service pensions.

Accounting for environmental liabilities and contingencies

The Auditor General recommends that the government:

- develop policies to define clearly what constitutes environmental obligations and the liabilities (both potential and actual) that relate to these obligations;
- prepare a complete inventory of areas of federal responsibility where there are obligations to make significant future expenditures to clean up environmental damage;
- determine to what extent the government, the provinces, the private sector or some combination of the three, bear responsibility for the cost of environmental clean-up in these areas; and
- develop a methodology to determine when potential environmental liabilities become actual liabilities.

The Auditor General notes that progress is being made in these areas. The Treasury Board Secretariat is working on developing appropriate accounting policies and obtaining cost estimates from applicable departments. Environmental liabilities will be included in the financial statements once the implications of such an accounting change have been fully assessed.

Capitalization of physical assets and accrual accounting for tax revenues

The government records most of the expenditures for operations and non-tax revenues on an accrual basis of accounting. In contrast, tax revenues, some international financial obligations and capital assets are recorded on a cash basis of accounting.

The government has indicated its intention to move to full accrual accounting in previous budgets. The Auditor General applauds this move but cautions that such changes represent significant challenges.

The government recognizes the challenges that full accrual accounting will present. To that end, the government will continue to work closely with the Office of the Auditor General to implement full accrual accounting in an appropriate manner.

Enterprise Crown corporations

The Auditor General encourages the government to adopt the PSAAB's recommendations to use the equity method to account for enterprise Crown corporations in its financial statements. This is in contrast with the practice that the government has been following since 1989-90 of recording such investments at cost and making appropriate adjustments for net profits and losses through allowances. These two methods give similar results and, therefore, the change in accounting will not materially affect the annual budgetary balance.

However, there would be a positive impact on the Statement of Assets and Liabilities reflecting the financial position of these Crown corporations prior to 1989-90. The government will change its accounting when other accounting changes are implemented.

Debt Servicing and Reduction Account

In his observations on the 1996-97 public accounts, the Auditor General recommends that the government re-examine the need and usefulness of the Debt Servicing and Reduction Account (DSRA).

The DSRA was established by statute in June 1991. Under that legislation, all goods and services tax (GST) revenues, net of applicable input tax credits, rebates and the low-income credit, along with the net proceeds from the sale of Crown corporations and gifts to the Crown explicitly identified for debt reduction, must be deposited into this Account. The funds in this Account are earmarked to pay interest on the public debt and, ultimately, to reduce the debt. In 1996-97, net revenues, primarily from the GST, amounted to $18.2 billion. In contrast, public debt expenditures chargeable to the Account were nearly twice this amount. It will be some time before these revenues match the public debt expenditures chargeable to the Account.

The Auditor General notes that, “given the fundamental concept of the Consolidated Revenue Fund (CRF) underlying the government’s accounting system, the Account is an internal mechanism that may not be necessary”. All revenues received by the government must be deposited in the CRF and any disbursements from the CRF must be authorized by Parliament. Therefore, the specific revenues of the DSRA must be deposited in the CRF and the public debt expenditures chargeable to the Account must be appropriated from the CRF by Parliament. As all of the information relating to the DSRA is already reported in other parts of the government’s financial statements, there is no requirement for a separate financial statement.

The government will ask the House of Commons Standing Committee on Finance to review this recommendation.

Annex 7

Tax Measures: Supplementary Information and Notices of Ways and Means Motions

Table of Contents

Tax Measures: Supplementary Information

Overview

This budget begins a process of general tax relief targeted at low- and middle-income Canadians: an increase in tax-free income for low-income individuals through the introduction of a supplement to the basic personal, spousal, and equivalent-to-spouse amounts; and the elimination for most, and reduction for many others, of the 3-per-cent general surtax.

The budget proposes many tax measures to achieve the nation's economic and social objectives. The budget also proposes a number of measures designed to enhance the fairness of the Canadian tax system. The appendix to this annex provides a summary table of these measures and those announced in the four previous budgets to enhance tax fairness. The budget also contains an extension of the temporary tax on the largest deposit-taking institutions and the recently announced increase to the excise tax on tobacco products.

Table A7.1
Federal revenue impact of new measures

	1998-1999	1999-2000	2000-2001
		($ millions)	
Personal income Tax Measures			
General income tax relief			
Increasing tax-free income for low-income Canadians	-170	-270	-315
General surtax	-710	-1,175	-1,365
Canadian Opportunities Strategy			
Tax relief for interest on student loans	-80	-130	-145
Tax-free RRSP withdrawals for lifelong learning	-15	-40	-45
Tax relief for part-time students	-25	-90	-90
Canada Education Savings Grants[1]	-150	-200	-275
Improving Canada's health care system			
Deductibility of health and dental premiums for the self-employed	–	-90	-110
Retirement income system			
Alternative minimum tax & RRSPs	-70	-20	-20
Support for families			
Raising limits for child care expense deduction	-20	-45	-45
Further increase in Canada Child Tax Benefit[2]	–	-320	-750
New tax credit for caregivers	-30	-120	-125
Enhanced tax assistance for persons with disabilities	-5	-5	-5
Strengthening communities and the voluntary sector			
Emergency volunteers	-5	-10	-10
Other measures			
Underground economy: reporting of federal and construction contracts	–	–	–
Meal expenses	–	–	–
Clarify the tax treatment of relocation expenses	–	–	–
Strengthening the integrity of certified cultural property regime	–	–	–
Tax treatment of employee options to acquire mutual fund trust units	–	–	–
Business Income Tax Measures			
Temporary capital tax surcharge on large deposit-taking institutions	25	50	–
Countervailing and anti-dumping duties	–	–	–
Distributions by mutual fund trusts after year-end	–	–	–
Large corporations tax: Prescribed financial institutions	–	–	–
Earthquake reserves	-15	-20	-25
Prevent unintended benefits under the SR&ED regime	–	–	–
Indirect assistance	–	–	–
International Taxation	–	–	–
Sales Tax Measures			
The Visitors' Rebate Program	-5	-5	-5
Measures relating to charities	–	–	–
Respite care	–	–	–
Direct sellers	–	–	–
Excise Tax Measures			
Tobacco tax increases	70	70	70
First Nations Taxation	–	–	–
Total	-1,205	-2,420	-3,260

– Small, non-existent or prevents revenue loss.
1 Affects both spending and tax revenues.
2 The Canada Child Tax Benefit is proposed to increase by a further $425 million on July 1, 1999 and another $425 million on July 1, 2000. The fiscal cost estimates reported are somewhat smaller as they reflect increase over only three-quarters of the fiscal years.

Personal Income Tax Measures

General income tax relief

There are two tax measures providing general personal income tax relief to low- and middle-income Canadians in this budget. They are: increasing the amount of tax-free income for low-income Canadians; and eliminating the 3-per-cent general federal surtax for Canadians earning up to about $50,000, and reducing the surtax for Canadians earning between $50,000 and $65,000. These measures will result in a $1.4 billion personal income tax reduction in 1999-2000.

Increasing tax-free income for low-income Canadians

The income tax system currently includes basic personal and spousal/equivalent-to-spouse credits to allow individuals to receive a basic amount of income on a tax-free basis. These credits are available to all individuals.

The amount used to establish the basic personal credit is $6,456, while the spousal and equivalent-to-spouse amounts have a maximum value of $5,380. The spousal and equivalent-to-spouse amounts are reduced on a dollar-for-dollar basis by the income of the claimed dependant in excess of $538.

These non-refundable tax credits provide federal tax relief equal to 17 per cent of the gross amounts ($1,098 in the case of the basic personal amount, and up to $915 for the spousal and equivalent-to-spouse amounts). The credit effectively eliminates income tax on taxable income equal to the basic personal and spousal/equivalent-to-spouse amounts claimed.

This budget proposes to introduce a supplement of $500 to the basic personal, spousal, and equivalent-to-spouse credits for low-income tax filers. This effectively increases the amount of income received on a tax-free basis by up to $500 for single individuals with incomes under $20,000, and up to $1,000 for individuals with incomes up to about $40,000 who also have an eligible dependant. This will reduce federal income tax by up to $85 for a single individual, and up to $170 for a family.

The increase to the basic personal and spousal/equivalent-to-spouse amounts will be implemented by way of a supplementary non-refundable amount, calculated separately on the tax form. Single individuals will have the $500 supplementary amount reduced at a rate of 4 per cent of income in excess of $6,956. Individuals with an eligible dependant may claim an additional amount equal to the lesser of $500 or their dependant's adjusted income, defined as $6,956 minus the dependant's income. The total amount claimed by an individual with an eligible dependant will be reduced by 4 per cent of the filer's income minus the total of $6,956 and the dependant's adjusted income. If the dependant's net income is greater than $6,956, then the additional amount in respect of the dependant will be zero, and the dependant must file a tax return to claim a supplementary personal amount directly.

Under the current provisions relating to the transfer of tax credits between spouses, an individual must first use transferable credits to eliminate any tax liability on income in excess of $6,456 before any unused portion of these credits can be transferred to a spouse. Effective with the supplementary credit amount increases, individuals will be required to eliminate their tax liability on income in excess of $6,956 before any transfer of unused non-refundable credits to a spouse can be made. This increases the potential amount of credits that can be transferred between spouses.

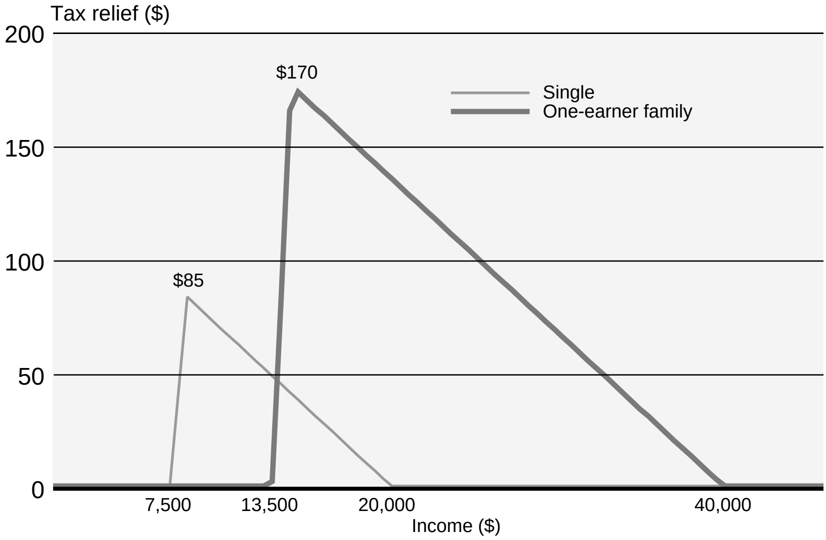
This measure targets tax relief to low income Canadians. It effectively removes approximately 400,000 low income individuals from the tax rolls, and provides tax relief to an additional 4.6 million low-income individuals.

For a single parent with $20,000 in employment income, this measure will reduce federal income tax by $108 (table A7.6). A one-earner couple with $20,000 in income will pay $132 less in income tax (Table A7.4), while a one-pensioner elderly couple with income of $20,000 will benefit from a tax reduction of $103 (Table A7.8).

This measure will come into effect July 1, 1998, and will reduce taxes paid by low income individuals and families by $170 million in 1998-1999, and $270 million in 1999-2000.

Chart A7.1

Federal tax relief – increased tax-free income



General surtax

Individuals are currently required to pay a general surtax of 3 per cent of basic federal tax. This surtax raises about $2.2 billion in annual revenues, and has been in place since 1986 when it was introduced as a temporary measure to reduce the deficit.

The budget proposes to eliminate the general surtax for individuals with income up to about $50,000. Individuals with income between approximately $50,000 and $65,000 will see their surtax reduced on a sliding scale.

To ensure that tax relief is focused on low- and middle-income levels, the surtax reduction will have a maximum value of $250 per taxable individual by 1999, and will be reduced at a rate of 6 per cent of basic federal tax over $8,333. For 1998, individuals will receive half the full value of the 1999 surtax reduction.

Approximately 13 million individuals, or 83 per cent of all taxable filers, will no longer pay any surtax whatsoever, while another one million individuals having incomes between approximately $50,000 and $65,000 will see their surtax reduced.

For a typical single individual earning $35,000, this measure provides an annual tax reduction of $150 (Table A7.3). A typical one-earner family of four with $50,000 in wage income will receive surtax relief of $238. (Table A7.4)

This measure will provide tax relief of $710 million in 1998-1999, and $1,175 million in 1999-2000.

Chart A7.2

Federal tax relief – general surtax: typical single

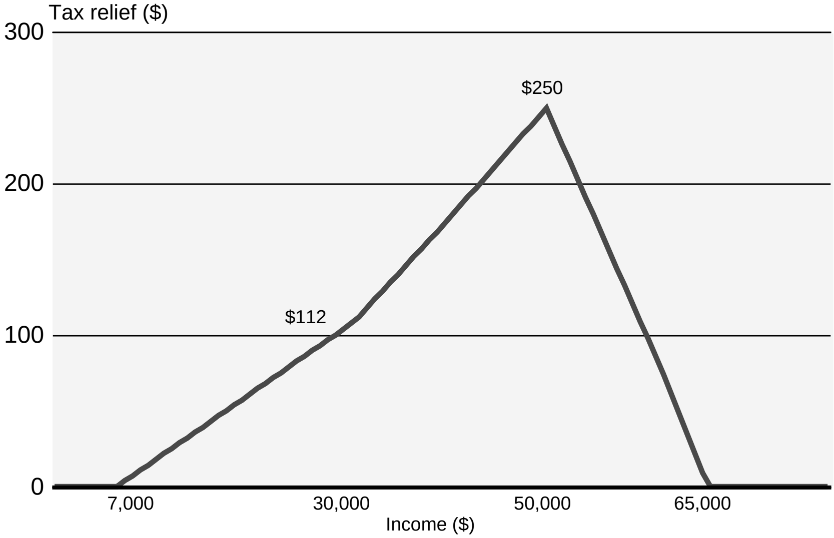


Table A7.2
Impact on taxpayers – 1999

	Number of taxpayers
General tax relief	
Increasing tax-free income for low income Canadians	
Those made non-taxable	400,000
Those with tax reductions	4,600,000
Total number of taxpayers benefiting	5,000,000
General Surtax	
Those with surtax eliminated	12,600,000
Those with surtax reductions	1,400,000
Total number of taxpayers with surtax relief	14,000,000

Table A7.3
Typical Single Individual – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

Total income	Current federal tax[1]	Tax relief measures: Low-income supplement		Surtax elimination/ reduction		Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2]
7,500	-97	-84	n.a.[3]	-1	n.a.[3]	-85	n.a.[3]
10,000	264	-66	-25.1	-14	-5.2	-80	-30.2
12,500	640	-49	-7.6	-26	-4.1	-75	-11.7
15,000	1,051	-31	-3.0	-39	-3.7	-70	-6.6
17,500	1,461	-14	-0.9	-51	-3.5	-65	-4.4
20,000	1,872	0	0	-63	-3.4	-63	-3.4
25,000	2,693	0	0	-87	-3.2	-87	-3.2
30,000	3,756	0	0	-112	-3.0	-112	-3.0
35,000	5,141	0	0	-150	-2.9	-150	-2.9
40,000	6,445	0	0	-188	-2.9	-188	-2.9
45,000	7,784	0	0	-227	-2.9	-227	-2.9
50,000	9,123	0	0	-219	-2.4	-219	-2.4
55,000	10,462	0	0	-141	-1.3	-141	-1.4
60,000	11,826	0	0	-61	-0.5	-61	-0.5
65,000	13,341	0	0	0	0	0	0
75,000	16,473	0	0	0	0	0	0
100,000	24,303	0	0	0	0	0	0

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table A7.4
Typical One-Earner Family of Four – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

		Tax relief measures					
Total income	Current federal tax[1]	Low-income supplement		Surtax elimination/ reduction		Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2]
13,500	-3,705	-169	n.a.[3]	-5	n.a.[3]	-174	n.a.[3]
15,000	-3,458	-168	n.a.[3]	-7	n.a.[3]	-175	n.a.[3]
17,500	-3,048	-150	n.a.[3]	-20	n.a.[3]	-170	n.a.[3]
20,000	-2,637	-132	n.a.[3]	-33	n.a.[3]	-165	n.a.[3]
25,000	-992	-97	n.a.[3]	-57	n.a.[3]	-154	n.a.[3]
30,000	461	-62	-13.5	-83	-18.0	-145	-31.4
35,000	2,246	-27	-1.2	-122	-5.4	-149	-6.6
40,000	3,953	0	0	-160	-4.1	-160	-4.0
45,000	5,542	0	0	-199	-3.6	-199	-3.6
50,000	7,131	0	0	-238	-3.3	-238	-3.3
55,000	8,720	0	0	-195	-2.2	-195	-2.3
60,000	10,335	0	0	-116	-1.1	-116	-1.1
65,000	12,078	0	0	-29	-0.2	-29	-0.3
75,000	15,485	0	0	0	0	0	0
100,000	23,315	0	0	0	0	0	0

1 Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

2 Negative values indicate a reduction in net tax paid to the federal government.

3 Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table A7.5

Typical Two-Earner Family of Four – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

Total income	Current federal tax[1]	Tax relief measures: Low-income supplement		Tax relief measures: Surtax elimination/ reduction		Tax relief measures: Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2]
20,000	-3,342	-169	n.a.[3]	-4	n.a.[3]	-173	n.a.[3]
25,000	-2,683	-141	n.a.[3]	-24	n.a.[3]	-165	n.a.[3]
30,000	-1,363	-108	n.a.[3]	-49	n.a.[3]	-157	n.a.[3]
35,000	2	-52	–	-68	–	-120	–
40,000	1,324	-70	-5.3	-92	-6.9	-162	-12.2
45,000	2,624	-56	-2.1	-116	-4.4	-172	-6.5
50,000	3,733	-42	-1.1	-141	-3.8	-183	-4.9
55,000	5,082	-28	-0.5	-174	-3.4	-202	-4.0
60,000	6,432	-14	-0.2	-206	-3.2	-220	-3.4
65,000	7,789	0	0	-239	-3.1	-239	-3.1
75,000	10,464	0	0	-305	-2.9	-305	-2.9
100,000	16,530	0	0	-198	-1.2	-198	-1.2

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table A7.6

Typical Single Parent with One Child – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

Total income	Current federal tax[1]	Tax relief measures: Low-income supplement		Surtax elimination/reduction		Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2]
17,500	-1,826	-122	n.a.[3]	-5	n.a.[3]	-127	n.a.[3]
20,000	-1,489	-108	n.a.[3]	-15	n.a.[3]	-123	n.a.[3]
25,000	-764	-77	n.a.[3]	-37	n.a.[3]	-114	n.a.[3]
30,000	659	-42	-6.3	-62	-9.4	-104	-15.8
35,000	1,986	-7	-0.3	-91	-4.6	-98	-4.9
40,000	3,663	0	0	-129	-3.5	-129	-3.5
45,000	5,127	0	0	-168	-3.3	-168	-3.3
50,000	6,591	0	0	-207	-3.1	-207	-3.1
55,000	8,055	0	0	-246	-3.1	-246	-3.1
60,000	9,519	0	0	-180	-1.9	-180	-1.9
65,000	11,040	0	0	-99	-0.9	-99	-0.9
75,000	14,232	0	0	0	0	0	0
100,000	22,062	0	0	0	0	0	0

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table A7.7

Typical Elderly Single – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

Total income	Current federal tax[1]	Tax relief measures					
		Low-income supplement		Surtax elimination/ reduction		Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2-]
12,500	-30	-49	n.a[3]	-7	n.a[3]	-56	n.a[3]
15,000	407	-31	-7.7	-20	-4.9	-51	-12.5
17,500	845	-14	-1.6	-33	-3.9	-47	-5.5
20,000	1,283	0	0	-46	-3.6	-46	-3.6
25,000	2,158	0	0	-72	-3.3	-72	-3.3
30,000	3,383	0	0	-101	-3.0	-101	-3.0
35,000	4,953	0	0	-144	-2.9	-144	-2.9
40,000	6,424	0	0	-187	-2.9	-187	-2.9
45,000	7,894	0	0	-230	-2.9	-230	-2.9
50,000	9,341	0	0	-206	-2.2	-206	-2.2
55,000	10,877	0	0	-132	-1.2	-132	-1.2
60,000	12,765	0	0	-66	-0.5	-66	-0.5
65,000	14,785	0	0	0	0	0	0
75,000	18,947	0	0	0	0	0	0
100,000	27,962	0	0	0	0	0	0

[1] Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

[2] Negative values indicate a reduction in net tax paid to the federal government.

[3] Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Table A7.8
Typical Elderly Couple – 1999
Full-year impact of proposed measures on the low-income supplement to personal amounts and surtax

Total income	Current federal tax[1]	Tax relief measures: Low-income supplement		Surtax elimination/ reduction		Total change in federal tax	
$	$	$	% federal tax[2]	$	% federal tax[2]	$	% federal tax[2]
20,000	-295	-103	n.a.[3]	0	0	-103	n.a.[3]
25,000	438	-97	-22.2	-22	-4.9	-119	-27.2
30,000	1,498	-62	-4.2	-47	-3.2	-109	-7.3
35,000	2,713	-27	-1.0	-78	-2.9	-105	-3.9
40,000	4,183	0	0	-122	-2.9	-122	-2.9
45,000	5,654	0	0	-165	-2.9	-165	-2.9
50,000	7,124	0	0	-207	-2.9	-207	-2.9
55,000	8,572	0	0	-250	-2.9	-250	-2.9
60,000	10,107	0	0	-177	-1.7	-177	-1.7
65,000	11,995	0	0	-111	-0.9	-111	-0.9
75,000	16,059	0	0	0	0	0	0
100,000	25,589	0	0	0	0	0	0

1 Includes federal income tax, refundable Child Tax Benefit (CTB), and the goods and services tax (GST) credit. Does not include provincial income tax. Negative values indicate that refundable CTB and GST credits received are greater than income tax paid.

2 Negative values indicate a reduction in net tax paid to the federal government.

3 Typical individuals at and below this income level receive more in federal refundable credits (CTB and GST credit) than they pay in federal income tax. An income tax reduction will therefore increase the net benefits they receive from the tax and transfer system.

Canadian Opportunities Strategy

Tax relief for interest on student loans

To ease the burden of student debt, the budget proposes to allow all individuals repaying student loans to claim a credit on the interest they pay.

A non-refundable federal credit of 17 per cent will be provided on the interest portion of student loan payments made in the year. The proposed credit covers interest only, not repayments of principal. It does not apply to interest accrued but not paid or to any forgiven interest.

The credit applies to interest payments on loans, both new and outstanding, approved under the Canada Student Loans Program and provincial student loan programs.

The credit may be claimed in the year it is earned or in any of the following five years. It is not transferable.

Statements reporting eligible interest payments will be provided to taxpayers by financial institutions or, where appropriate, by the Department of Human Resources Development Canada and provincial government departments administering these loans.

This measure is effective for 1998 and subsequent years, and is expected to provide tax relief of about $130 million in 1999-2000.

Tax-free RRSP withdrawals for lifelong learning

Lifelong learning is a key factor in preserving future employment income. However, individuals may have limited access to financial resources when the need for training occurs. For many people, the most readily available source of funds is their registered retirement savings plans (RRSPs). Although saving for retirement is important, keeping or finding a job is crucial to preserving retirement income.

The budget therefore proposes to allow RRSP withdrawals for skills enhancement. Eligible individuals will be able to make tax-free withdrawals from an RRSP (other than a locked-in RRSP) to finance full-time training or education for themselves or their spouses. Withdrawals may not exceed $10,000 in a year. More than one withdrawal may be made in any given year from any number of specific RRSP accounts, provided that the annual limit is not exceeded. Withdrawals under this plan are permitted for a withdrawal period of up to four calendar years, provided that the total amount withdrawn does not exceed $20,000. However, the withdrawal period for a participant in the plan must end before the start of a year for which repayment by the participant is required in accordance with rules described below.

RRSP funds may be withdrawn under the plan where the recipient, or the recipient's spouse, is enrolled, or committed to enrol, as a full-time student in a qualifying educational program of at least three month's duration at an eligible educational institution. However, a disabled student may qualify as a student under the plan whether or not studying on a full-time basis. Where RRSP funds are withdrawn before the enrolment of the recipient or the recipient's spouse, the enrolment must occur in the year of the RRSP withdrawal or in January of the following year.

Special rules apply where RRSP funds are withdrawn under the plan and the student does not finish the qualifying educational program. Under these circumstances, an RRSP withdrawal in respect of a program is still considered to have been received under the plan if any of the following three conditions are met: (a) the student withdraws from the program more than two months after the year of the RRSP withdrawal; (b) less than 75 per cent of the student's tuition is refundable as a consequence of leaving a program; or (c) the student enrols in another qualifying educational program on a timely basis. In all other cases, the RRSP withdrawal will be included in the recipient's income unless the recipient repays the RRSP withdrawal and files an approved form with Revenue Canada. Where this procedure is followed, the RRSP withdrawal is not included in computing income and the recipient is treated as having not participated in the plan.

Where RRSP withdrawals have been made under the plan for a student's education, the recipient is not permitted to withdraw RRSP funds under the plan for the education of the student's spouse while the recipient has an outstanding balance under the plan. This restriction will limit administrative complexity associated with the calculation of repayments required under the plan.

RRSP withdrawals under the plan will generally be repayable by the recipient, without interest, in equal instalments over a period of 10 years to any RRSP under which the recipient is the annuitant. The first repayment must be made no later than 60 days after the fifth year following the year of the first withdrawal. However, repayments will be required to start earlier if the student fails to qualify for a full-time education tax credit for at least three months in each of two consecutive years in the four years following the year of the first withdrawal. Where this is the case, the earlier repayment is required to start no later than 60 days after the second of those two years. As under the Home Buyers' Plan, any amount not repaid for a year as required by a recipient will be included in computing the recipient's income for the year, and a recipient will be permitted to repay amounts faster than required.

There is no specific limit on the number of times an individual can participate in the plan. However, an individual may not participate in a new plan before the end of the year in which all repayments from any previous participation have been made.

Recipients of RRSP withdrawals under the plan must be Canadian residents. If a recipient subsequently emigrates from Canada, the recipient's outstanding balance under the plan will generally be included in the recipient's income to the extent that the recipient does not repay the balance within 60 days from the time of emigration. This is consistent with a similar rule under the Home Buyers' Plan. Rules on the death of a participant under the plan will also parallel those under the Home Buyers' Plan.

As the purpose of the plan is to provide access to existing RRSP funds, no deduction will be provided for an RRSP contribution made less than 90 days before its withdrawal under the plan.

RRSP withdrawals may be made under the plan after 1998.

This measure is expected to cost about $40 million in 1999-2000.

Tax relief for part-time students

More than one-third of all students, including a significant number of adults, are enrolled in part-time studies. However, apart from the tuition credit, little tax relief is available to those engaged in part-time education. The budget proposes to increase tax assistance to part-time students by allowing them to claim the education credit and the child care expense deduction. This measure is effective for 1998 and subsequent years.

To be eligible for the part-time education credit, students will be required to be enrolled at an educational institution in Canada in an eligible program lasting at least three consecutive weeks, and involving a minimum of 12 hours of courses each month. For each month during which these conditions are satisfied, the student will be entitled to an education amount of $60, on which a 17-per-cent tax credit is provided. An eligible student may claim either one part-time education credit or one full-time education credit in respect of a particular month, but not both. As with the full-time education credit, the unused portion of the part-time credit arising in any year may be transferred to a supporting person or carried forward for future use by the student.

In general, the child care expense deduction is available in respect of child care services which enable an individual either to earn income or to study on a full-time basis. The budget proposes to extend this deduction to cover child care expenses incurred by an individual in order to pursue part-time education. The child care expense deduction for part-time education will largely parallel the existing deduction.

For two-parent families where one spouse is a part-time student while the other is in the workforce, the working spouse may claim a deduction while the other spouse is studying. The deduction will be equal to the least of:

(1) actual expenses;

(2) two-thirds of earned income of the working spouse; and

(3) $175 per child under age 7, and $100 per child age 7 to 16, for each month for which a part-time education credit is claimed.

Child care expenses incurred by a single parent in order to attend school part-time will be deductible against all types of income. This will also apply to two-parent families when both parents are attending school at the same time. The budget also proposes that part-time attendance at secondary school be recognized for the purpose of the child care expense deduction. In the case of secondary education, the student is not entitled to the education credit, but must meet the requirements concerning the duration of the program and the number of hours of courses.

These two measures will provide tax relief of $90 million per year.

Canada Education Savings Grants

The budget proposes significant measures to make registered education savings plans (RESPs) a more attractive vehicle for saving for children's education, by introducing Canada Education Savings Grants.

Background on Registered Education Savings Plans

Registered education savings plans provide a vehicle for individuals to accumulate income for post-secondary education. Contributions to RESPs are held in trusts in order to generate income to be used to finance the full-time post-secondary education costs of the beneficiaries under the plan. In practice, most contributors are parents saving for their children's education. Contributions to RESPs are not deductible from the income of the contributor and normally return to the contributor on a tax-free basis. However, the income generated by the contributions is tax sheltered until paid out to named beneficiaries, when it is included in beneficiaries' incomes. Since beneficiary students typically have little other income, they pay little or no tax on educational assistance payments out of an RESP.

To ensure that the amount of tax-assisted savings sheltered by an RESP bears a reasonable relationship to the costs of full-time post-secondary education, there is an overall lifetime limit of $42,000 on contributions per beneficiary. To encourage regular savings for education over a long period, contributions to a particular RESP may be made for up to 22 years, and there is an annual limit of $4,000 on contributions in respect of a beneficiary. The $4,000 limit provides flexibility by allowing taxpayers to make up for missed contributions, and recognizes that many parents may not be in a financial position to set money aside for their children's education when the children are very young. An RESP must be terminated by the end of the year that includes the twenty-fifth anniversary of the plan.

Canada Education Savings Grant

To provide additional assistance to individuals saving for children's education, the budget proposes a new Canada Education Savings Grant (CESG) for RESP contributions made after 1997. Subject to certain limits, the Canada Education Savings Grant will be equal to 20 per cent of annual contributions made to RESPs for beneficiaries up to and including age 17. The Canada Education Savings Grant will be provided directly to the plan trustee to be invested in the plan into which the relevant contributions are made. The Canada Education Savings Grant itself is not included in calculating the annual and lifetime RESP contribution limits. Together with the accumulating investment income, the Canada Education Savings Grant will be available to be paid to a student as part of educational assistance payments made out of the RESP. If the beneficiary does not pursue higher education or training, the Canada Education Savings Grant will be required to be repaid to the government.

Beginning January 1, 1998, each child under age 18 will accumulate CESG contribution room of $2,000 per year, up to and including the year in which they attain age 17. The CESG will be payable on contributions made in the year to the extent that the contributions in respect of the child do not exceed the lesser of $4,000 and the unused CESG contribution room available in the year. While unused CESG contribution room will be carried forward for use in future years, contributions made in one year that exceed the amount of available CESG contribution room cannot be carried forward for purposes of attracting a CESG payment in a subsequent year. Contributions made by any subscriber in respect of a beneficiary can qualify for the CESG. The maximum total amount of CESG that can be paid in respect of any individual born after 1997 will be $7,200 (i.e. 20 per cent x $2,000 x 18 years).

Example

A child is born in February 1999. The child's CESG contribution room for that year is $2,000. In March 1999, the father makes an RESP contribution of $800 in respect of the child. A CESG of $160 (20 per cent of $800) is paid to the plan trustee. In November of the same year, the child's grandmother makes a $2,500 contribution to another RESP on behalf of the child. Since only $1,200 of the child's CESG contribution room is available at the time of the grandmother's contribution, only $1,200 of the grandmother's contribution qualifies for a CESG. The remaining $1,300 will not qualify for a CESG in the following year.

If no contributions other than the father's contribution were made, the remaining $1,200 worth of CESG contribution room would be carried forward for use in the future.

CESGs will not be paid in respect of RESP beneficiaries for years in which they are age 18 or older since, at this point, most will be pursuing, or preparing to pursue, their post-secondary education. When beneficiaries are age 18 or older, family resources are typically directed to assisting children to meet current needs, not directed to saving for the future. However, to accommodate beneficiaries whose higher education begins after age 18, subscribers may continue to make RESP contributions up to the end of the year that includes the twenty-first anniversary of the plan, but are not eligible to receive the CESG for the years in which the child is age 18 or older.

To encourage systematic savings over the longer term, contributions in a year in respect of beneficiaries attaining age 16 or 17 in the year will receive a CESG only where:

- a minimum of $4,000 of RESP contributions were made in respect of the beneficiary before the year in which the beneficiary attains 16 years of age; or
- a minimum of $300 in annual RESP contributions were made in respect of the beneficiary in any four years before the year in which the beneficiary attains 16 years of age.

Subject to certain limits described below, CESGs paid into family plans (i.e. plans with multiple beneficiaries, all of whom are related to the subscriber by blood or adoption) on contributions made in respect of a particular beneficiary can be used for the education of other beneficiaries under the plan. Similarly, CESGs paid to an RESP that is part of a group arrangement may, under certain circumstances, be reallocated to other RESPs in the group arrangement.

CESGs will not be paid in respect of an RESP beneficiary who is not resident in Canada. In addition, CESGs will not be paid on contributions made after 1999 to an RESP submitted for registration before 1999 unless the plan has been amended in accordance with the registration requirements that apply to plans submitted for registration in January 1999.

To ensure compliance with administrative requirements in respect of CESG repayments, trustees for RESPs will be required to maintain a notional account recording all transactions relating to CESG payments made into and out of the plan.

Educational assistance payments

The income of an RESP can be paid out to a beneficiary once the beneficiary enrolled as a full-time student in a qualifying educational program at a designated educational institution. Such payments are referred to as educational assistance payments (EAPs). A specific portion of each EAP will be considered to be attributable to CESGs paid into the plan. The CESG portion of an EAP will be based on the ratio of CESGs paid into the plan to total investment earnings held in the plan, and will reduce the remaining balance in the plan’s CESG account. In certain situations, the CESG portion of an EAP will be considered to be nil. This can occur, for example, when an EAP is paid to an RESP beneficiary who became a beneficiary under the plan after attaining 21 years of age, or when an EAP is paid to an RESP beneficiary who is not resident in Canada.

There will be a lifetime limit of $7,200 on the amount of CESG money that a student can receive out of RESPs. Since the maximum CESGs that will be paid into RESPs in respect of a beneficiary will also be limited to $7,200, this lifetime limit will be relevant only for beneficiaries where CESG money is “shared” with other beneficiaries (e.g., family plans and group plans). In this regard, each RESP will be required to limit the total portion of EAPs paid as CESGs to $7,200. Thus, for example, if the total amount of CESGs paid into a family plan with two beneficiaries was $10,000 and only one beneficiary pursues post-secondary education, only $7,200 of the CESGs may be paid to that beneficiary. The remaining $2,800 in the plan’s CESG account would be required to be repaid.

If an individual is a beneficiary under more than one RESP, the total amount of CESGs paid to the individual may exceed $7,200, even though each plan must limit CESG payments to that amount. In such a case, the individual will be required to repay the excess amount to the government. Since EAPs (including the CESG portion) are included in computing the individual’s taxable income, the individual will be entitled to claim an offsetting deduction for the excess amount.

CESG repayments

Generally, RESPs may retain CESG money until it is used to assist in the beneficiary’s post-secondary education (through EAPs) or it has been determined that it will not be used for that purpose. This section describes in more detail the circumstances in which an RESP trustee will be required to make CESG repayments to the government.

When contributions are withdrawn for non-educational purposes from an RESP which has received a CESG, the RESP trustee will be required to make a CESG repayment equal to 20 per cent of the withdrawal. Where a plan also contains unassisted contributions (i.e. any contributions made before 1998, and contributions made after 1997 that were not eligible for a CESG), assisted contributions will be considered to be withdrawn before unassisted contributions.

Example

A father establishes an RESP for his new-born daughter in 1998 and contributes $1,500 a year for six years. Total CESGs paid to the plan equal $1,800. In 2005, the father withdraws $3,000 of contributions from the plan. In this situation, the RESP trustee is required to make a $600 CESG repayment to the government (20 per cent of $3,000).

An RESP trustee will also be required to repay CESG money in the following situations:

- when the plan is terminated or revoked;
- when a payment of RESP income is made for non-educational purposes;
- when a beneficiary under the plan is replaced, except where the new beneficiary is under 21 years of age and either the new beneficiary is a brother or sister of the former beneficiary or both beneficiaries are related to the subscriber by blood or adoption; and
- when there is a transfer from the plan to another RESP involving either a change of beneficiaries or a partial transfer of funds.

The requirement to repay CESG money when an RESP beneficiary does not pursue post-secondary education will generally not apply to group plans which operate on the basis of age cohorts, provided the CESG money is reallocated to other RESPs in the group arrangement. The $7,200 limit on the amount of CESG money that can be paid for educational purposes to any RESP beneficiary under the group arrangement will apply.

An RESP trustee will be prohibited from making a refund of contributions, or a payment of RESP income for non-educational purposes, that would result in the value of the remaining property in the RESP being insufficient to cover the CESG repayment requirement.

Loss of CESG contribution room

With certain exceptions as noted below, the withdrawal after February 23, 1998 of unassisted contributions from an RESP for non-educational purposes, or a transfer after that date of unassisted contributions from one RESP to another, will result in restrictions on future CESG payments in respect of beneficiaries under the plan.

Specifically, contributions made to any RESP during the remainder of the year of the withdrawal, or in the following two years, in respect of such beneficiaries will not be eligible for the CESG. In addition, the beneficiaries will not earn new CESG contribution room for those two following years. However, these restrictions will not apply to a withdrawal in a year of unassisted contributions if the total withdrawals of unassisted contributions in the year are not more than $200. Nor will they apply where there is a full transfer of funds held in an RESP and there is no change in beneficiaries. These restrictions are intended to prevent unassisted RESP contributions from being recycled in order to attract a CESG and are designed to be administratively simple. The government intends to monitor future withdrawals of unassisted contributions with a view to determining whether further adjustments to the calculation of CESG assistance room may be warranted to take into account large withdrawals of such contributions.

Example

An RESP with two beneficiaries contains $10,000 of pre-1998 contributions. In March 1998, the RESP subscriber withdraws $4,000 from the plan and, in April 1998, recontributes that amount ($2,000 in respect of each beneficiary) to a newly established RESP.

Results:

1. Although the CESG contribution room available for each beneficiary in 1998 is $2,000, no CESG is paid on the contributions made to the new RESP. Furthermore, there will be no CESG paid on any other RESP contributions made in respect of either beneficiary before 2001.
2. Neither beneficiary earns new CESG room in 1999 or 2000. Thus, the amount of unused CESG contribution room carried forward to 2001 is $2,000.

Administrative and interim arrangements

The Canada Education Savings Grant program will be administered by the Department of Human Resources Development (HRD), while Revenue Canada will continue to administer the registration of RESPs and the auditing of compliance. The departments will be provided with the authority to share information necessary to ensure the integrity of the CESG program.

The government and the RESP industry will work together to put in place, as soon as possible, the administrative arrangements needed to implement this program. When these administrative arrangements are complete, CESGs will be paid on all eligible contributions made since January 1, 1998. Thereafter, the government will transfer CESG funds to the plans on a regular and ongoing basis. Authority will be provided to the government to pay interest in the event that there is any substantial delay in making CESG payments.

Trustees of RESPs to which CESGs are paid will be required to maintain notional accounts for each such plan recording contributions which have attracted a CESG, the amount of those CESGs and the extent to which CESG amounts are paid out to beneficiaries as part of educational assistance payments. In addition, RESP trustees will be required to report the following information for all plans on a timely basis: all transactions involving contributions or withdrawals of capital; and educational assistance payments and accumulated income payments, indicating the date of the transaction and the contributor and beneficiaries involved. HRD will be authorized to provide information to RESP trustees on whether CESG contribution room is available for any particular beneficiary.

While RESPs may be established without the Social Insurance Number (SIN) of the beneficiary, CESGs will only be paid when the SIN has been provided to the government.

Additional resources will be provided to HRD and Revenue Canada to ensure that the requirements associated with eligibility for educational assistance payments are met, that the RESP registration rules and the reporting requirements applicable to RESP trustees are complied with, and that systems are in place to audit compliance.

Additional RESP changes

A contributor may set up a “family plan” in which each of the beneficiaries is related to the subscriber by blood or adoption. Family plans, which are typically established for several siblings under age 18, are subject to the same contribution limits per beneficiary, but provide additional flexibility for the contributor because educational assistance payments need not be limited to the proportion of each child’s “share” of the contributions. This allows a contributor who has named his or her three children as beneficiaries, for example, to direct the entire income to the two children pursuing education if the third child is not eligible. To ensure that family plans do not provide unintended benefits, no contributions may be made to a family plan in respect of a beneficiary who is added to that plan when that beneficiary is 21 years of age or older. The budget proposes to extend this restriction by prohibiting the addition of any beneficiary age 21 or older to a family plan. This change will apply to new plans submitted for registration after 1998.

As indicated earlier, contributions made after 1999 to an RESP submitted for registration before 1999 will not qualify for CESG payments unless the plan has been amended to restrict new beneficiaries to those under 21 years of age. In addition, no portion of an educational assistance payment made to an individual who became an RESP beneficiary after attaining 21 years of age will be attributable to CESG payments made to the plan.

The budget proposes to extend relief from the overcontribution penalty when an individual who is under 21 years of age replaces another individual as a beneficiary under an RESP and both beneficiaries are related to the subscriber by blood or adoption. Currently, the new beneficiary must be a brother or sister of the former beneficiary. This measure will provide comparable treatment of individual and family plans. The proposed measure will apply after 1997.

The purpose of an RESP is to help post-secondary students, and the vast majority of children named as beneficiaries do pursue higher education. However, if the beneficiary named by the subscriber does not pursue higher education, and no replacement beneficiary has been named, subscribers may receive the investment income under certain conditions. A number of conditions must be met before investment income can be returned to the subscriber, in the form of "accumulated income payments". In particular, the plan must have been existence for at least 10 years, all beneficiaries must be at least 21 years of age and not pursuing higher education, and the subscriber must be resident in Canada. If these conditions are met, the subscriber is allowed to receive an accumulated income payment. The subscriber may choose to transfer the payment to a registered retirement savings plan, without penalty, if the subscriber has sufficient room to absorb the amount of the transfer. To the extent that an accumulated income payment is not fully offset by RRSP deductions, a charge of 20 per cent applies in addition to the inclusion in income of the RESP amount. There is a lifetime limit of $40,000 of the amount of accumulated income payments that may be transferred to an RRSP tax free. To provide additional flexibility to individuals attempting to save for education and retirement with limited resources, the budget proposes to increase the lifetime limit to $50,000. This change will apply after 1998.

At present, a beneficiary may receive the entire amount of investment income in an RESP as an educational assistance payment in one payment, if the terms of the plan allow it. In some instances, a beneficiary enrolled in an educational program of as little as three weeks may qualify for an EAP. The additional assistance provided by the CESG requires more stringent criteria regarding eligible education and training programs in order to maintain the integrity of the tax and transfer system. Therefore, to ensure that bona fide short-term courses remain eligible while minimizing abuse of the advantages offered by contributions to an RESP, the budget proposes to limit EAPs in respect of courses of less than three months to the costs of tuition plus $300 per week of study (or any higher amount approved by HRD on a case-by-case basis). This change will apply to new plans submitted for registration after 1998. As previously noted, contributions made after 1999 to an RESP submitted for registration before 1999 will not qualify for CESG payments unless the plan has been amended to restrict EAPs in this manner.

Legislation to implement the Canada Education Savings Grant program will be tabled shortly.

Improving Canada's health care system

Deductibility of health and dental premiums for the self-employed

Currently, self-employed individuals cannot deduct amounts paid for private health services plan (PHSP) coverage, while owner-managers of incorporated businesses may receive tax-exempt coverage through their business. The budget seeks to improve the fairness of the tax system by introducing provisions governing deductibility of amounts paid for PHSP coverage for the self-employed.

Individuals will be allowed to deduct amounts paid for their PHSP coverage in computing business income provided they are actively engaged alone or as a partner in their business, and either self-employment is their primary source of income in the current year or their income from other sources does not exceed $10,000.

The following provisions will apply to amounts paid for PHSP coverage for the self-employed:

- Amounts paid for PHSP coverage will qualify for a deduction provided equivalent coverage is extended to all permanent full-time arm's-length employees. A similar condition already applies to owner-managers of incorporated businesses. Provisions will be introduced to ensure this condition cannot be avoided by hiring employees through a management corporation.

- Coverage will be deductible to a maximum of $1,500 each for the individual and spouse and $750 per child. No limits will apply where the number of arm's-length employees receiving coverage represents at least one-half of the total number of employees in that business.
- A PHSP will only be recognized if it is purchased from a third party normally in the business of selling insurance, or it is operated by trustee that is in the business of operating such plans.
- Where a deduction is claimed, no amount paid for PHSP coverage will be eligible for the medical expense tax credit.

These changes will improve access to supplementary health and dental coverage for the self-employed. They will be effective for fiscal periods commencing after 1997.

Retirement income system

Alternative minimum tax and RRSPs

Under the alternative minimum tax (AMT), a number of tax preferences are added back to taxable income. The adjusted taxable income is reduced by a basic exemption of $40,000 to ensure that individuals whose total tax preferences do not exceed that amount are not subject to AMT. The remainder is then subject to tax at a rate of 17 per cent, plus applicable surtax and provincial income taxes. The AMT gives rise to additional tax where the tax liability calculated with the AMT is greater than the regular tax liability. Most individuals subject to AMT are able to recoup the additional tax through a seven-year carry-forward mechanism.

Recent developments suggest that the existing rules are unduly restrictive and have unintended consequences in certain circumstances. Of particular importance is the increase in recent years in the number of people who are subject to the AMT due to severance packages they have received on lay-off or voluntary downsizing. In many cases, taxpayers can recover this tax through the seven-year carry-forward provision. However, workers who have low incomes in the years following the termination of employment often cannot do so. This could be the case, for example, where a 50-year-old worker has been laid off and has little or no income until "normal" retirement age. This worker could be forced to draw on after-tax assets – such as guaranteed investment certificates (GICs) or a house – or on RRSP savings, in order to pay the AMT, without the possibility of recovering it within the seven-year period.

Improvements to tax assistance for retirement savings introduced in recent budgets include the indefinite carry-forward of unused RRSP contribution room and the introduction of the pension adjustment reversal which allows individuals to make extra RRSP contributions to compensate for the loss of employer-provided pension benefits. These measures contribute to a continuing increase in high one-time RRSP contributions.

Given the importance of retirement savings to Canadians, and the fact that comprehensive limits already apply to the tax assistance provided for them, the AMT should not further limit the ability of taxpayers to set aside income for their retirement.

Accordingly, the budget proposes that RRSP roll-overs and contributions, as well as contributions to registered pension plans, be exempted from the AMT.

To reflect recent increases in the volume of severance arrangements, this change will be effective from 1994. For taxation years prior to 1998, Revenue Canada will identify affected taxpayers and refunds will be made once the enabling legislation has received Royal Assent.

This measure will provide $70 million in tax relief in 1998-99, as a result of its application to previous years, and about $20 million annually thereafter.

Support for families

Raising limits for the child care expense deduction

The child care expense deduction recognizes the additional financial burden borne by families incurring those expenses.

To better reflect the costs incurred by those paying for child care on a full-time, full-fee basis, the budget proposes that the deduction limits be increased by $2,000 for children under age 7 and by $1,000 for older children. For 1998 and subsequent years, the maximum annual child care expense deduction that may be claimed will be:

- $7,000 for each eligible child who is under age 7 at the end of the year or in respect of whom a disability tax credit has been claimed; and

- $4,000 for each eligible child who is over age 7 and under age 16 at the end of the year or who is not eligible for the $7,000 deduction but has a mental or physical infirmity.

This measure will provide about $45 million in additional tax assistance to about 65,000 Canadian families.

The Canada Child Tax Benefit

The Child Tax Benefit (CTB) currently provides about $5.3 billion in assistance to families with children under age 18. The CTB provides an annual basic benefit of $1,020 per child, a supplement of $75 for the third and each subsequent child, and an additional supplement of $213 for each child under age 7 when no child care expenses are claimed. The basic benefit is reduced by 5 per cent of family net income in excess of $25,921 (2.5 per cent for one-child families). The Child Tax Benefit includes a Working Income Supplement (WIS) that was enriched by $195 million and restructured from a per-family to a per-child benefit as of July 1997. The maximum WIS is $605 for a one-child family and $1,010 for a two-child family. For larger families, the maximum WIS is $1,010 plus $330 for the third and each additional child. The WIS is phased in over the family-earned income range of $3,750 to $10,000, and is phased out based on family net income in excess of $20,921. The reduction rates are 12.1 per cent for a one-child family, 20.2 per cent for a two-child family and 26.8 per cent for larger families.

The 1997 federal budget announced that the federal-provincial-territorial governments had agreed to establish a National Child Benefit (NCB) System. That budget indicated that this new initiative would become effective in July 1998 and would involve actions from both levels of government. As an initial step, the federal government committed to increase by a total of $850 million its existing income support to low-income families with children. At the same time, provinces and territories agreed to adjust the child component of their social assistance programs and redirect savings to provide benefits and services more broadly to all low-income families.

As outlined in the 1997 budget, the government proposes to meet this commitment by replacing the existing Child Tax Benefit and WIS by an enriched and simplified program, the Canada Child Tax Benefit (CCTB). Effective in July 1998, the CCTB will provide benefits of $1,625 for the first child and $1,425 for each additional child for all families with net income up to $20,921. The CCTB will have two major components: the CCTB basic benefit and the CCTB National Child Benefit Supplement. The basic benefit will have the same level and structure as the existing basic benefit and will include the existing supplements of $75 and $213 described above. The CCTB National Child Benefit Supplement will provide $605 for the first child, $405 for the second child and $330 for each additional child for all families with net income up to $20,921. The supplement will be phased out based on family net income above $20,921 in the same manner as the existing WIS.

In this budget, the government is announcing the allocation of a further $850 million annually – phased in at $425 million as of July 1999 and the remaining $425 million as of July 2000 – to meet the federal government's commitment to further enrich the Canada Child Tax Benefit. Details of the benefit increases will be announced in the 1999 budget following discussions with provincial and territorial partners and Canadians.

Caregiver tax credit

Many Canadians provide care and support for family members who are seniors or who have disabilities. The tax system includes various measures that assist caregivers and supporting individuals. For example:

- individuals supporting a spouse, child, grandchild, parent or grandparent with a severe and prolonged mental or physical impairment may claim unused amounts of the disability tax credit;
- supporting individuals may claim the medical expense tax credit for qualifying expenses incurred on behalf of a dependent relative (spouse, child, grandchild, parent, grandparent, brother, sister, uncle, aunt, niece or nephew);
- expenses for an attendant providing respite care may be claimed under the medical expense tax credit. The limit on the amount of this expense that can be claimed was increased from $5,000 to $10,000 last year;
- single individuals may claim the equivalent-to-spouse credit for dependent parents, grandparents, or other relatives either under age 18 or dependent because of a mental or physical infirmity; and
- individuals supporting a relative (child age 18 or over, parent, grandparent, brother, sister, aunt, uncle, niece or nephew) with a mental or physical infirmity may claim the credit for infirm dependants. The credit was enriched in 1996 by increasing the maximum credit amount from $270 to $400 and increasing the threshold at which the phase-out of the credit begins from $2,690 to $4,103 of the dependant's net income. The change provided more tax assistance to individuals supporting infirm relatives with less than $6,456 of net income.

To provide additional tax assistance to Canadians providing in-home care for elderly or infirm relatives, the budget proposes to introduce a new tax credit for caregivers.

The caregiver tax credit will reduce federal tax by up to $400 for individuals residing with and providing in-home care for a parent or grandparent (including in-laws) 65 years of age or over or an infirm dependent relative. The credit amount will be reduced by the dependant's net income in excess of $11,500. This change will increase or extend assistance to about 450,000 caregivers providing in-home care for relatives with less than $13,853 of net income. Many of these individuals could not claim the infirm dependant credit before because they were providing care to elderly relatives with Old Age Security and Guaranteed Income Supplement benefits that put them beyond the net income threshold for dependants.

This measure is effective for 1998 and subsequent years.

With the introduction of the new caregiver tax credit, tax relief provided by the existing infirm dependant credit will be of benefit primarily to individuals providing care and support for infirm relatives who qualify as dependants even if they do not live in the same residence.

Enhanced tax assistance for persons with disabilities

The government is committed to continue helping Canadians with disabilities and their families by building on the significant level of tax assistance provided under existing legislation. Last year, a number of tax measures were introduced to better recognize disability-related costs. These included the addition of several new expenses to the medical expense tax credit and the introduction of a refundable supplement for low-income working Canadians with high medical expenses.

The budget proposes to further improve tax assistance for persons with disabilities.

The Home Buyers' Plan (HBP) and people with disabilities

The HBP allows first-time home buyers to withdraw up to $20,000 of their RRSP funds on a tax-free basis to purchase a home or an interest in a home. Amounts withdrawn under the HBP are repayable in instalments over a period of 15 years. To the extent a scheduled repayment for a year is not made, it is added in computing the participant's income for the year.

The budget proposes to change the HBP so that, in certain circumstances, an individual will not be prevented from participating in the plan because the individual has previously owned a home. This extension of the HBP will apply to RRSP withdrawals by an individual where:

- the individual qualifies for the disability tax credit (DTC) and is buying a home which is more accessible for the individual or is better suited for the care of the individual;
- the individual is related to a disabled individual who qualifies for the DTC and the individual is buying a home for the benefit of the disabled individual which is more accessible for, or better suited for, the care of the disabled individual; or
- the individual is related to a disabled individual who qualifies for the DTC and the individual is withdrawing an amount for the disabled individual to buy a home which is more accessible for, or better suited for, the care of the disabled individual.

The HBP will also be changed to allow an individual to participate in the HBP more than once in the individual's lifetime, provided the individual's outstanding HBP balance is satisfied by the beginning of the year in which a subsequent participation occurs. However, except where the above special rules apply, a participant must still qualify as a first-time home buyer under the HBP.

These new measures apply to RRSP funds withdrawn after 1998.

Training expenses for caregivers

The medical expense tax credit (METC) recognizes the burden of above-average medical expenses by providing tax relief for eligible medical expenses. For 1998, the METC reduces the federal tax of a claimant by 17 per cent of qualifying unreimbursed medical expenses in excess of the lesser of 3 per cent of net income and $1,614.

The budget proposes to allow supporting individuals to claim under the METC expenses for training courses related to the care of dependent relatives with mental or physical infirmities.

This measure is effective for 1998 and subsequent years.

Certification of the DTC by occupational therapists and psychologists

The DTC provides tax relief to individuals with a severe and prolonged mental or physical impairment that markedly restricts their ability to perform basic activities of daily living: perceiving, thinking and remembering; feeding and dressing oneself; speaking; hearing; eliminating (bowel or bladder functions); and walking. Eligibility for the credit must currently be certified by either a medical doctor, an optometrist (for sight impairments), or an audiologist (for hearing impairments).

To improve the DTC application process, the budget proposes to allow occupational therapists and psychologists to certify eligibility for the credit after February 24, 1998. Occupational therapists will be allowed to certify eligibility in respect of mobility impairments while psychologists will assess eligibility in respect of intellectual impairments.

Strengthening communities and the voluntary sector

Emergency volunteers

Volunteer firefighters currently enjoy a $500 tax exemption for the allowances they receive from a public authority in the course of their duties. The budget proposes to increase the $500 exemption for volunteer firefighters to $1,000. In addition, this treatment will be extended to ambulance technicians and other emergency service volunteers who, in their capacity as volunteers, are called upon to assist in emergencies or disasters. The $1,000 exemption will be reduced by any compensation in excess of $3,000 received by the taxpayer from the same public authority for the same or similar services.

The budget also proposes to convert the current exemption to a deduction in computing employment income. Eligible volunteers will be required to include in their income compensation they receive from a public authority in respect of their volunteer duties, but will benefit from a corresponding deduction of up to $1,000.

This provision is effective beginning January 1, 1998.

Other measures

Underground economy: reporting of federal and construction contracts

The federal government has a comprehensive strategy to fight the underground economy. The budget proposes further measures to improve tax compliance and the fairness of the tax system.

Experience has shown that the accuracy of income reporting for tax purposes is better for sources of income for which information slips are issued. For instance, virtually all wages and salaries are voluntarily reported for income tax purposes compared to approximately 85 per cent of self-employment income. The higher tax compliance for wage and salary income is partly due to the mandatory requirement on employers to report to Revenue Canada the wage and salary payments made to each of their employees. To further improve tax compliance, the budget proposes enhanced reporting requirements for contract payments.

Federal government departments and agencies will begin issuing information slips for contract payments made after 1997, as will federal Crown corporations for contract payments made after 1998.

The construction contract reporting system introduced in the 1995 budget will become mandatory for payments made after 1998. Contract reporting was first introduced in the construction industry because Revenue Canada's compliance activities revealed an active underground economy and consultations with industry associations indicated that it was becoming difficult for complying businesses to remain competitive. The construction contract payment reporting system was introduced to help restore a level playing field in the industry by improving compliance in the reporting of income.

The reporting system was introduced on a voluntary basis in 1995 to allow the federal government to develop, with the construction industry, a system that would be simple for the industry to comply with and would deliver the information needed by Revenue Canada for enforcement. The industry's suggestions have resulted in numerous modifications to the original reporting system. Experience with the voluntary system also demonstrated that mandatory reporting is necessary to obtain the level of participation needed to achieve effective compliance.

Subject to further consultation with industry stakeholders, it is intended that:

- mandatory reporting be required of individuals, partnerships, trusts and corporations whose principal business is construction;
- reporting to Revenue Canada be required on an annual basis for payments made to contractors for construction services;
- construction services include activities such as erection, installation, alteration, modification, repair, improvement, demolition, dismantling and removal of a structure, surface or subsurface construction or any similar property; and
- reporting be required for service and mixed service and goods contracts, but not goods-only contracts.

Revenue Canada will consult with representatives of the construction industry on the specifics of the reporting system. It will also consult on how best to ensure that the intended purposes are achieved. The Minister of National Revenue will shortly issue a press release with details on the consultation process.

Finally, the federal government will continue discussing contract reporting with provincial governments and assessing the extent of underground activity in other sectors of the economy to determine if further action is warranted.

Meal expenses

Generally, only 50 per cent of the cost of otherwise deductible expenses for meals or entertainment is deductible for income tax purposes. This limitation is intended to reflect the personal consumption element inherent in these expenses. However, there is an exception to this rule that allows 100-per-cent deductibility for meal expenses incurred by employers in respect of employees at remote work sites. Currently, remote work sites are considered by Revenue Canada to be those that are at least 80 kilometres from the nearest established community of over 1,000 people. Employers have suggested that the remote work site criteria are too strict and exclude many sites which are significantly removed from urban areas.

The budget proposes that the exception for meals provided at a remote work site be expanded to include meals provided at work sites which are at least 30 kilometres from the nearest urban area of at least 40,000 people, where the employee is not expected to return daily to his or her principal residence. Reasonable meal expenses incurred by employers at these work sites will be fully deductible. This change will better reflect the type of work sites that pose logistical difficulties for employers and employees such that full deductibility by the employers is warranted. Benefits received by northern residents in respect of meals at these work sites will not affect their northern residents deductions.

The budget will also clarify that the full deductibility of the cost of meals and entertainment provided by employers for the general benefit of all employees is restricted to those meals and entertainment expenses incurred by employers for occasional events, not exceeding six such events in any calendar year, and not regularly provided meals or allowances.

These measures will apply to expenses incurred after February 23, 1998.

Clarify the tax treatment of relocation expenses

To facilitate labour mobility within Canada, taxpayers who move to take up employment or carry on a business may currently deduct many of the costs associated with relocation, where the new residence is at least 40 kilometres closer to the new job location. The budget proposes changes to the moving expense deduction that will provide further assistance to individuals who relocate to take advantage of new employment or business opportunities in Canada. The budget also seeks to improve the fairness of the tax system by ensuring that certain employer-provided relocation benefits are included in the income of relocated employees.

Moving expenses deductible for income tax purposes will now include certain costs of maintaining a vacant former residence (including mortgage interest and property taxes). The deductibility of these expenses will be limited to the least of the following amounts: the actual amount of the maintenance expenses, the portion of the expenses attributable to a period of three months, and $5,000. In addition, a number of incidental moving expenses such as the costs of changing the address on legal documents, replacing automobile and driving licenses and utility hook-ups and disconnects will become deductible.

This change is effective for expenses incurred after 1997.

To improve the fairness of the tax system, the budget also proposes changes to the tax treatment of amounts paid by employers for a loss on a sale or diminishment in value of a former residence and for higher mortgage interest payments at the new location. The exclusion from income of these amounts provides a significant tax advantage to employees who are reimbursed by their employer for such expenses compared to those who must bear the costs themselves. The budget proposes that these employer-paid relocation expenses be included in the employee's income. However, to recognize that many employers require employees to relocate in circumstances where the employee would not have chosen to do so, the first $15,000 of amounts paid by the employer for a loss or diminishment in value of a former residence will not be taxed. One-half of such amounts in excess of $15,000 will be included in the employee's income.

These provisions apply to employees who commence employment at their new work locations after June 1998, in respect of payments made after February 23, 1998. For payments to employees commencing employment at the new work location before July 1998, these provisions will apply for 2001 and subsequent years.

In response to the recent *Siwik* decision, the budget proposes to clarify that, where an employer provides an interest-free or low-interest housing loan to an employee, the provisions of the *Income Tax Act* determining the value of the benefit of the loan will apply effective for loans made after February 23, 1998. The provisions of the Act allowing a deduction in computing taxable income in respect of benefits included in income from a home relocation loan of up to $25,000 will continue to apply.

Strengthening the integrity of the certified cultural property regime

The budget proposes two measures to secure the benefits of Canadian cultural property donations for all Canadians and to ensure that the generous tax incentives for charitable donations are based on the fair market value of the property donated, as determined by the Canadian Cultural Property Export Review Board.

It is important that Canadian cultural properties are retained in Canada and made accessible to the public. Consequently, tax incentives are provided to encourage the donation of cultural property that meets certain criteria contained in the *Cultural Property Export and Import Act* to designated institutions such as museums and art galleries. In addition to the charitable donations tax credit for individuals and the charitable donations tax deduction for corporations, capital gains that arise through donations of eligible cultural property to designated institutions are exempt from capital gains taxation. An institution that receives a donation of cultural property is required to retain it for a minimum period of five years. If disposition is made within the five-year period, the institution is liable to pay a special penalty tax.

The budget will increase the effectiveness of this policy by lengthening, from five to 10 years, the period during which cultural property must be retained by designated institutions to avoid the imposition of the penalty tax. The longer period will apply in respect of dispositions made after February 23, 1998. Extending the mandatory retention period will ensure that these donated cultural properties will remain accessible to the public.

In addition, the budget proposes that, where the fair market value of a property has been determined by the Canadian Cultural Property Export Review Board, that value will apply to the property for all income tax purposes related to charitable donations and gifts for a period of two years from the date of the determination. This measure will apply to determinations of fair market value made by the Canadian Cultural Property Export Review Board after February 23, 1998.

Tax treatment of employee options to acquire mutual fund trust units

Existing income tax rules provide preferential treatment with regard to options granted by a corporation to its employees to acquire shares issued by the corporation. No income arises for an employee because of the granting of such an option. Instead, the recognition of income is deferred until the option is exercised or, in the case of Canadian-controlled private corporations, generally until the share acquired pursuant to the option is disposed of. In addition, in many cases, only 75 per cent of the gain arising from the exercise of an option is subject to tax.

However, the existing rules do not apply to options granted to employees of mutual fund trusts. In order to provide a level playing field, the budget proposes to extend the existing income tax rules for options granted to employees of public corporations to options granted after February 1998 to employees of mutual fund trusts.

Business Income Tax Measures

Temporary capital tax surcharge on large deposit-taking institutions

The temporary capital tax surcharge on large deposit-taking institutions, which was introduced in the 1995 budget, and extended in the 1996 and 1997 budgets, will be further extended to October 31, 1999.

This temporary surcharge applies to financial institutions as defined under Part VI of the *Income Tax Act* except life insurance companies. The surcharge will continue to apply at a rate of 12 per cent of the capital tax imposed under Part VI, calculated before any credit for income taxes and with a capital deduction of $400 million. The surcharge is not eligible to be offset by tax payable under Part I of the Act.

For taxation years that include October 31, 1999, the surcharge will be prorated on the basis of the number of days in the taxation year that are before November 1, 1999.

Countervailing and anti-dumping duties

In accordance with the rules established under the World Trade Organization, countervailing and anti-dumping duties may be imposed by countries to offset the injurious effect of imports which are subsidized or dumped. These actions may result in Canadian taxpayers paying such amounts in order to sell their products. The amount of the duty to be paid is not under the control of the taxpayer. While these amounts may be subsequently refunded, in whole or in part, this process can take several years.

In view of these facts, the budget proposes that cash outlays for duties be deductible in computing income subject to tax in the year that they are paid. Any refunds or additional amounts received by the taxpayer, such as interest, as a result of the final determination of the liability would have to be included in income in the year of receipt.

This amendment will be effective for duties that become payable and are paid after February 23, 1998.

Distributions by mutual fund trusts after year-end

Mutual fund trusts typically attempt to make sufficient distributions of trust income in a taxation year to their beneficiaries such that there is no tax payable at the trust level. Under the existing rules, trust distributions of income for a taxation year must be fixed by the end of the year in order to ensure that this result is obtained. Particularly in cases where foreign assets are involved, it may be difficult for mutual fund trusts to make accurate determinations of income on a timely basis.

The budget proposes to allow mutual fund trusts to elect to fix such distributions for a taxation year within one month after the end of the year. Where this election is made, the distribution is treated as if it had been made before the trust's year-end. The election applies for the purposes of determining the tax position of both the trust and its unitholders. Consequently, taxable unitholders will be required to add the deemed distributions in computing their income for the earlier year and to take the deemed distributions into account in computing the adjusted cost base of their trust units.

This measure applies to income calculations for taxation years that end after November 1998. Input from the mutual fund industry with regard to details of the design of this proposal is welcome.

Large corporations tax: Prescribed financial institutions

The large corporations tax (LCT) is levied at the rate of 0.225 per cent on a corporation's "taxable capital employed in Canada" in excess of $10 million. For most corporations, taxable capital employed in Canada is the amount of a corporation's debt and equity, less the amount of its inter-corporate investments, that is considered to be used in connection with its activities carried on in Canada.

The tax base of a financial institution under the LCT is different. The most important difference is that a financial institution's taxable capital employed in Canada does not include short-term debt or secured long-term debt.

Corporations that are not "traditional" financial institutions, but compete with financial institutions in their day-to-day business, may be prescribed as financial institutions for the purposes of the LCT, in order to be subject to these special rules. This ensures that such corporations are subject to a tax regime comparable to that applying to their traditional financial institution competitors.

Currently, a corporation may be prescribed as a financial institution for LCT purposes without necessarily being treated as a financial institution for other purposes of the Act. Those other purposes include the "mark-to-market" rules in Part I of the Act, and the Act's special rules relating to preferred share financing. Such inconsistent treatment runs counter to the basic objective of prescribing these corporations: to tax them in the same manner as their competitors.

The budget proposes that companies that are prescribed financial institutions for the purposes of the LCT be treated as financial institutions for the purposes of Part I, and as specified financial institutions and restricted financial institutions for the purposes of the Act generally. This measure will apply after 1998.

Earthquake reserves

There are presently no special reserves for insurance companies in respect of earthquake losses. Over the past few years, both the property and casualty insurance industry and the federal regulator (the Office of the Superintendent of Financial Institutions (OSFI)) have become increasingly concerned that in the case of a major earthquake in an urban area – such as south-western British Columbia and the St. Lawrence Valley, which are two of the most earthquake-prone regions of Canada – losses would be so great that many insurance companies would not be financially prepared to pay for the insured losses to property.

This concern has led to the development of a framework to build the financial capacity of insurers to prepare for the cost of a major earthquake. This framework is set out in an OSFI guideline on Earthquake Sound Practices (Guideline B-9) issued in August 1997. The guideline establishes sound practices for the management and measurement of earthquake exposures.

Based on this guideline, federally regulated insurance companies selling earthquake protection will be required to meet target levels of preparedness to ensure they have sufficient financial capacity to pay insured earthquake losses when they occur. The specific requirement is set out in a draft appendix to the guideline released in November 1997. The draft appendix proposes an earthquake reserve to be composed of two parts: the first element, the "earthquake premium reserve", is based on a percentage of net earthquake premiums written; the second element, the "earthquake reserve complement", takes into account the earthquake exposure reinsured with another insurance company and a proportion of the capital and surplus of the company. Both elements are combined to assess whether companies meet the required level of preparedness. These reserves will first be required in 1998.

The budget proposes that the first element, the "earthquake premium reserve" set aside pursuant to OSFI's guideline, will be deductible for income tax purposes. This will help ensure that sufficient capacity is achieved in a timely fashion. No deduction will be allowed for tax purposes for the "earthquake reserve complement". This measure is effective starting with the 1998 taxation year.

Prevent unintended benefits under the SR&ED regime

The cost of materials used in scientific research and experimental development (SR&ED) does not generally qualify for the SR&ED tax incentives unless it is consumed in the course of performing the SR&ED. At the outset of an SR&ED project, a taxpayer may not know whether materials used in a project will be consumed or will instead be incorporated into a product that has some value either to the taxpayer or to another party.

Therefore, the budget proposes to allow as eligible SR&ED inputs, both materials that have been consumed as well as materials that will be transformed into another product in the course of performing SR&ED. Where, however, the product of the SR&ED project is sold or converted to commercial use, taxpayers will be required to reduce their SR&ED investment tax credit (ITC) pools by the lesser of the proceeds of disposition of property and the cost of the SR&ED materials included in the property. If these calculations result in an investment tax credit pool balance that is less than zero, the taxpayer will be required to repay the negative ITC that year.

This "netting" provision will apply to dispositions and conversions of property after February 23, 1998.

Indirect assistance

Some taxpayers receive funding from certain not-for-profit entities that have, in turn, obtained their funds from government or from other persons. In some of these situations, the amounts received may not be considered to be assistance under the current rules by reason only of the interposition of the not-for-profit entity in the flow of funds. The budget proposes to ensure that taxpayers are treated consistently, whether they receive the funding directly or indirectly from government or other persons. The change will apply to amounts received by a taxpayer after February 23, 1998, other than such amounts received before 1999 pursuant to an agreement in writing entered into by the taxpayer before February 24, 1998.

International Taxation

Co-ordinating Canadian tax rules and tax treaties

Canada has over 60 income tax treaties with other countries. Tax treaties help to ensure that the same income is not taxed by more than one country. For example, a resident of Canada who earns income in another country might be subject to both Canadian tax and that other country's tax. A tax treaty between Canada and the other country will establish how the income is to be taxed. In some cases, the treaty will limit the rate of tax one country can apply to the income, and require the other country to give credit for that tax. In other cases, the treaty will give one country or the other the exclusive right to tax the income.

Canada's large and growing network of tax treaties is an essential tool for Canadian business. It is also important for the many individual residents of Canada who own property in other countries, work abroad or invest internationally. Tax treaties also help tax authorities co-operate to prevent tax evasion.

For the Canadian income tax system to work properly, it must take the effects of tax treaties into account. The budget proposes several measures designed to harmonize Canada's domestic tax rules with the rules in our tax treaties, and to ensure that the treaties themselves are applied appropriately.

Treaty-exempt income

Under the *Income Tax Act*, non-residents of Canada are generally taxed on their income, including capital gains, from sources in Canada. The total amount on which a non-resident is taxed for a year under Part I of the Act is referred to as the non-resident's "taxable income earned in Canada" for the year. This total includes, among other things, the non-resident's income from employment performed in Canada, income from businesses carried on in Canada, and taxable capital gains on taxable Canadian property.

The definition of "taxable income earned in Canada," however, does not currently take certain effects of tax treaties into account. As a result, a non-resident's income that is not subject to tax in Canada may fall within the definition. A non-resident may thus be able to apply certain losses to reduce the non-resident's Canadian tax liability, even though any income or gain from the loss property or business itself would have been exempt under a tax treaty.

As part of updating Canada's income tax system to take better account of tax treaties, the budget proposes to compute non-residents' taxable income earned in Canada without reference to income, gains or losses from businesses and property where those amounts are exempt from tax under Part I of the Act because of a tax treaty. This change will apply for the 1998 and subsequent taxation years. In addition, the budget proposes that income, gains and losses from a taxpayer's "treaty-protected" businesses and properties not be taken into account in calculating losses for other years that can be applied to reduce the taxpayer's taxable income or taxable income earned in Canada for the 1998 and subsequent taxation years.

Foreign tax credit and treaty-protected foreign income

Canadian residents are subject to income tax on their worldwide income. To prevent double taxation of income earned in foreign countries, Canada allows taxpayers to claim a foreign tax credit (FTC) for income tax paid in foreign jurisdictions.

Generally speaking, under current rules a resident taxpayer is entitled to deduct from the taxpayer's Canadian tax the amount of foreign income tax paid in a country to the extent the foreign tax does not exceed that proportion of the taxpayer's Canadian tax otherwise payable that the taxpayer's income in that country bears to the taxpayer's total income. This formula reflects the notion that the FTC should only be available to reduce Canadian tax that is attributable to the foreign income. Given the effect of tax treaties, however, this formula in some cases applies too broadly.

Income of a Canadian resident from a source in a foreign country is sometimes made exempt from tax in that country by the terms of a tax treaty between Canada and that country. Under the current FTC formula, Canadian tax on the exempt foreign income is available for reduction by the credit even though no foreign tax is payable with respect to that income. To correct this anomaly, the budget proposes to amend the FTC limit so that such treaty-protected foreign income is excluded from foreign income in determining the ratio of income from that country to total income. Treaty-protected foreign income will continue to enter into the formula, however, if it is subject to an income or profits tax to which the treaty does not apply (such as a tax imposed by the government of a political subdivision of the foreign country).

This proposal applies in calculating FTCs for the 1998 and subsequent taxation years.

Dual-resident individuals

In some circumstances, two countries' tax systems may each treat an individual as resident in that country. Since most countries tax residents on their income from all sources, this raises the possibility of double taxation. To prevent that result, tax treaties include rules that can be used to decide in which country the individual is resident for the purposes of the treaty.

Currently, however, Canada's income tax system does not explicitly take these treaty "tie-breaker" rules into account. An individual may attempt to argue that the individual is at one and the same time resident in Canada under Canadian domestic rules (and therefore not subject to Canadian non-resident tax), and resident in the treaty country under the treaty (and therefore not subject to taxation as a resident of Canada).

To ensure that treaty and domestic rules cannot be set off in this contradictory manner, the budget proposes to treat as a non-resident any individual who would otherwise be resident in Canada but has become entitled under a tax treaty, as a resident of another country, to an exemption from or reduction in Canadian income tax. This change, which is comparable to a rule that already applies to corporations, will apply to individuals who become entitled to treaty benefits after February 24, 1998.

Treaty-based exemption – information return

Under Part I of the *Income Tax Act*, non-residents of Canada are taxable on the income from businesses they carry on in Canada. Where a person resides in a country with which Canada has a tax treaty, however, Canada's ability to tax such income may be constrained. In particular, Canada may be able to tax income from a business carried on by the non-resident person only if it is attributable to a permanent establishment situated in Canada.

In most cases, Revenue Canada will not know that a non-resident has relied on a tax treaty to claim an exemption from Canadian income tax. To help Revenue Canada administer such treaty-based claims, the budget proposes to require non-resident corporations to file an information return where they claim a treaty exemption from tax under Part I of the Act on their Canadian-source business income. The reporting requirement will apply to taxation years that begin after 1998.

Income Tax Conventions Interpretation Act

Given the large number of Canada's tax treaties and the growing variety of international business and other transactions, it is important that the treaties be applied consistently and in conformity with the intentions of Canada and its treaty partners. To make consistent application easier, the *Income Tax Conventions Interpretation Act* sets out a number of interpretive rules and definitions.

One important area in which some tax treaties lack precision is the tax treatment of amounts paid to non-residents of Canada out of Canadian RRSPs, RRIFs and other retirement income arrangements. The budget therefore proposes changes to the *Income Tax Conventions Interpretation Act* to confirm the appropriate treatment of these amounts.

In particular, these changes will provide that:

- pension payments are not annuities for the purposes of tax treaties;
- where a treaty does not define "pension," the term nonetheless includes payments under registered pension plans, RRSPs, registered retirement income funds (RRIFs) and other retirement arrangements; and
- where a treaty does define "pension," the term extends to include as well periodic payments under the above arrangements.

These clarifying changes will apply to amounts paid after 1996.

The *Income Tax Conventions Interpretation Act* will also be changed to clarify the connection between Canada's rules for taxing gains and the rules in Canada's tax treaties. The change confirms that, where a taxpayer disposes of a "taxable Canadian property" (a defined term which includes, among other things, Canadian real estate and certain shares of corporations) for the purpose of applying a treaty, any income, losses or capital gains are considered to arise in Canada. This clarification applies to dispositions after February 23, 1998.

Deemed residence

The distinction between residence and non-residence for tax purposes is an important one. Residents of Canada pay Canadian tax on their worldwide income; non-residents pay Canadian tax only on their Canadian-source income.

In most situations, whether or not an individual is resident in Canada is a question of fact: the answer depends on the nature of the individual's ties to Canada and the individual's intentions. In some cases, however, the *Income Tax Act* deems an individual to be resident in Canada whether or not those factual tests are met.

One of the deeming rules treats members of the Canadian Forces, certain development workers, Canadian Forces school staff, and officers and employees of the Government of Canada or a province (including ambassadors, ministers, high commissioners and others) as residents of Canada irrespective of where they are posted. In its current form, the rule also deems the spouses and dependent children of these persons to be Canadian residents.

The budget proposes to eliminate the special rule for spouses. In its place, a new rule is proposed which will deem as residents those individuals who, by virtue of their relationship to a Canadian resident, are exempt from tax in another country under a tax treaty or international agreement.

These changes will apply to individuals who would, but for the current deeming rule, cease to be residents of Canada after February 23, 1998. Individuals who, but for the current rule, would have ceased to be resident prior to February 24, 1998 will be permitted to elect that these changes also apply to them after February 23, 1998. If they make this election, they will be treated as having ceased to be resident in Canada on February 24, 1998.

Example

Louise is an employee of the Government of Canada who in 1996 was posted to the Canadian Embassy in Country X. Louise, her spouse David and their dependent child Celeste all moved to Country X, and all ceased to be factually resident in Canada. Under the existing rules, however, Louise, David and Celeste are all deemed to have remained resident in Canada.

Under the proposed new rule, Louise will still be treated as a Canadian resident, as will Celeste (assuming Celeste depends for support on Louise and does not have income exceeding the basic personal exemption amount). However, David will be treated as a Canadian resident only if, because of his relationship with Louise, a tax treaty or international agreement prevents Country X from taxing him.

Since David would, but for the special deeming rule, have ceased to be resident in Canada before February 24, 1998, he can choose whether or not the new rule will apply to him after February 23, 1998. If he chooses to have the new rule apply, and if he is not exempt from Country X tax, David will be treated as having ceased to be resident in Canada on February 24, 1998. It should be noted that this change in residence may itself have income tax consequences for David.

Canadian tax on former residents' foreign employment income

It is a general principle of Canada's tax system that non-residents are taxable in Canada only on their Canadian-source income. Employment income is usually considered to be sourced where the employment is exercised, not where the employer happens to reside. Thus, a non-resident who works in Canada will pay Canadian tax (assuming no tax treaty applies) whether or not the non-resident's employer is itself resident in Canada. Similarly, a non-resident who works outside Canada will not ordinarily be subject to Canadian tax, even if the employer happens to be a Canadian resident.

A special exception currently applies, however, to former residents of Canada. These individuals are taxable by Canada on income paid to them by a Canadian resident in respect of their employment abroad, unless the income is subject to tax in their new country of residence. This special rule was originally enacted to ensure that individuals temporarily absent from Canada (e.g., teachers on sabbatical leaves) could not escape taxation on the salaries paid to them by Canadian employers by ceasing to be resident in Canada. However, subsequent changes to Canada's tax treaties have largely eliminated the problem by removing the limits on other countries' rights to tax such persons.

The budget proposes that the rule taxing former Canadian residents on foreign employment income be repealed. In its place, a new rule is proposed that allows Canada to tax the foreign employment income of an expatriate only if the other country has agreed to refrain from doing so in a tax treaty or other international agreement with Canada.

These changes will apply to the 1998 and subsequent taxation years.

Immigrating corporations

Section 128.1 of the *Income Tax Act* provides a set of rules applying to taxpayers that become resident in Canada. For corporations, these rules include a deemed year-end immediately before becoming resident, a deemed disposition and reacquisition of all property (other than property which would, ignoring any relevant tax treaty, be subject to tax in Canada), and an adjustment to the corporation's paid-up capital designed to reflect the new net tax cost of its property.

The current rules are designed to defer, but not eliminate, the taxation in Canada of the immigrating corporation's accrued gains on Canadian property, of its surplus from Canadian business operations, and of the surplus of Canadian corporations of which it is a shareholder. However, the sale of the immigrating corporation's shares, before it becomes resident, to a corporation resident in Canada can frustrate this objective.

Example

A non-resident individual owns all the shares of a non-resident corporation (call it "Forco") whose only property is the stock of a Canadian subsidiary ("Canco"). The individual sells the Forco shares to a new Canadian corporation ("Newco") for Newco shares that have a cost and paid-up capital equal to the fair market value of the Forco shares. Such a sale would generally be non-taxable in Canada, since it involves the sale by a non-resident of shares of a non-resident company. After the sale, Forco becomes resident in Canada, with no effect on the tax cost of its shares in Canco. At this point, the surplus of Canco could potentially be remitted through the (now Canadian) corporate chain as non-taxable dividends, and distributed to the non-resident individual as a tax-free return of capital; alternatively, Newco might be sold to an arm's-length purchaser, with the non-resident individual having precluded the application of Canadian capital gains tax as a result of the fair market value cost base created on the prior sale of the Forco shares to Newco.

Although the general anti-avoidance rule may apply in cases such as this, it is also appropriate to address more specifically the opportunity for such schemes. To that end, the budget proposes that corporations that become resident in Canada after February 23, 1998 be treated as having disposed of all of their property, including Canadian property, at its fair market value at the time of immigration. Where the immigrating corporation owns a share of a corporation resident in Canada (other than a share on which any gain of the immigrating corporation is taxable in Canada), a dividend equal to the amount by which the share's value exceeds its paid-up capital will be deemed to have been paid to the immigrating corporation before it became resident. In this way, the corporation's immigration is treated in the same manner as a sale of the share for fair market value proceeds by the non-resident corporation to a resident company. Finally, the immigrating corporation will be unable to claim an investment allowance under Part XIV of the Act for its last taxation year in which it was non-resident and, as a result, will be held to account for any branch tax arising in the year or deferred in respect of previous years.

As a consequence of these changes, the current rule in subsection 128.1(2) of the Act will be modified to establish the total paid-up capital of the immigrating corporation, upon it becoming resident in Canada, at a level representing the fair market value of its net assets.

Surplus stripping

Section 212.1 of the *Income Tax Act* is an anti-avoidance rule designed to prevent a non-resident shareholder of a Canadian corporation from withdrawing taxable surplus from the corporation in the form of tax-free proceeds of disposition on the sale of the corporation's shares to another Canadian corporation with which the non-resident does not deal at arm's length.

The budget proposes three changes, applying to dispositions after February 23, 1998, to ensure that this anti-avoidance rule fulfils its original purpose.

First, the rule currently applies only to dispositions of shares of Canadian corporations to Canadian corporations; it will be extended to apply to transfers of shares of any corporation resident in Canada to any other corporation resident in Canada. This change reflects the fact that the concern with the potential avoidance of tax under Part XIII of the Act exists equally with respect to all resident corporations, whether or not they are Canadian corporations.

Second, the rule will be amended to apply explicitly to partnerships of which a non-resident person (or non-resident-owned investment corporation) is a majority interest partner.

Finally, the rule will not apply where the transferred shares are taxable Canadian property on which Canada's right to tax gains is *not* limited by tax treaty. Where Canada retains the right to tax the transaction as a share disposition generating proceeds of disposition, no tax avoidance exists and thus the recharacterization of the proceeds as taxable surplus may be viewed as unnecessary and inappropriate.

Foreign tax credit limits

A taxpayer may earn a foreign tax credit (FTC) as a result of paying foreign tax on foreign-source income but be unable to use the credit. This may occur because the taxpayer is either exempt from Canadian tax (as in the case of pension funds, RRSPs and other deferred income plans) or not currently taxable because of current losses, loss carry-forwards, or other tax preferences. A non-resident likewise may pay foreign taxes for which a credit is not available in the non-resident's country of residence.

A person who is subject to a foreign withholding tax on particular income, but is unable to obtain an FTC, can sometimes effectively transfer that income to another person who is able to use the tax as a credit against Canadian tax on income from other sources in that foreign country. This type of trading in tax credits is inappropriate if the amount of foreign tax credited is excessive relative to the pre-tax profit generated by the transaction.

In order to limit this type of activity, the budget proposes two new rules. The first rule applies only to short-term securities acquisitions and only when the more general second rule described below does not deny an FTC. The first rule will restrict the amount of foreign withholding tax in respect of dividends and interest on a foreign security that is creditable under the foreign tax credit by reference to the gross profit realized by the taxpayer from the underlying security. The second rule will deny the credit where the profit from a property, net of foreign tax, is not material relative to the amount of foreign tax. These rules will apply to property acquired after February 23, 1998.

Short-term securities acquisitions

The application of withholding taxes to dividend and interest payments on foreign shares and debts can create opportunities to trade in FTCs by means of trading in the securities themselves. For example, a taxpayer (the buyer) purchases a foreign share or bond from its owner (the holder) before payment of a dividend or interest. The after-tax value of the income payment is greater to the buyer than to the holder because the buyer is able to claim a credit for the foreign tax. The purchase price reflects the value of the underlying security plus the value of the declared dividend or the accrued interest (net of any foreign withholding tax payable). The buyer receives the dividend or interest, out of which foreign tax has been withheld, and then resells the share at its value net of that payment either to the holder (possibly at a pre-agreed price) or in the market.

In this type of transaction, the time period between purchase and sale is typically quite short. If the security is resold to the original owner at a pre-agreed price, that party effectively retains its economic interest in the security while it is in the hands of the buyer. In all cases, the purchase price may be set so that some of the benefit of the FTC is transferred to the original holder as compensation for entering into the arrangement. This type of transaction is illustrated in the first example below.

To counter this type of arrangement, the budget proposes to introduce a new rule applicable where a taxpayer disposes of a share or debt not held as capital property within one year of its acquisition. In general terms, the amount of foreign withholding tax eligible to be recognized for FTC purposes will be limited to 40 per cent or 30 per cent (depending on whether the foreign tax constitutes business or non-business income tax) of the taxpayer's gross profit from the share or debt. Withholding tax for this purpose includes any tax levied on the gross amount of the income payment. Gross profit from the security will include both the income payment and any gain or loss on resale. This rule will ensure that the FTC provisions continue to prevent double taxation of the net income earned from the share or debt, while limiting the tax benefits that can shelter other unrelated income.

Denial of credit where profit is not material

Trading in FTCs is not limited to situations involving short-term securities acquisitions. A case of FTC trading through an interest rate swap is set out in the second example below.

In response, the budget proposes a more general rule that will apply where a taxpayer has acquired a property and it is reasonable to expect that the profit from the property, and from other transactions entered into as part of the arrangement in which the property was acquired, will not be material in relation to the amount of foreign income tax paid on income from the property that would otherwise be eligible for the FTC. This rule will apply more broadly to income and profits taxes and not only to withholding taxes.

Under this rule, profit will be calculated by deducting the expected direct costs of acquiring, holding and disposing of the property and any foreign tax expected to be payable on income from the property. Direct costs of acquisition would include, for example, financing costs incurred for the purpose of acquiring the property. Where the profit thus calculated is not material in relation to the foreign tax, that tax will not be eligible to be recognized for purposes of calculating the taxpayer's FTC. Instead, a deduction from income will be allowed, but only to the extent of the taxpayer's income in respect of the property.

Example

Holder has a bond of a foreign corporation with an underlying value of $100, on which a regular $5 interest payment is about to be paid. The interest is subject to a 15-per-cent withholding tax in the source country, so that Holder would receive $4.25 net after 75 cents in foreign tax had been withheld. Holder is not able to use an FTC.

Buyer purchases the foreign bond just prior to the interest payment date for $104.50, and receives the $5 interest payment on which 75 cents has been withheld. A few months later, Buyer sells the bond either back to the Holder or on the market, for $101, the appreciation reflecting the interest accrued during the holding period. This transaction on its face is moderately profitable to Buyer:

Proceeds	$101.00
Interest	5.00
Less: Acquisition cost	(104.50)
Taxable income	1.50
Less: Foreign tax withheld	(0.75)
Economic profit (loss) before Canadian tax	$0.75

Under existing rules, however, Buyer would be entitled to include the full 75 cents of foreign tax in its pool of foreign business or non-business income tax eligible for the FTC in respect of that particular country. Assuming that Buyer faces a 30-per-cent Canadian federal tax rate, 45 cents of the FTC would be needed to offset the tax payable on the $1.50 of taxable income from the transaction. This would leave Buyer with an FTC balance of 30 cents, which could be used to offset tax on income from other sources in that country. The availability of the FTC significantly enhances Buyer's return from the transaction:

Economic profit (loss) before Canadian tax	$0.75
Unused foreign tax credit balance	0.30
Profit after Canadian tax	$1.05

The proposed rule would limit the amount of foreign taxes eligible for credit to 30 per cent (assuming the income is not connected with a foreign business) of Buyer's gross profit from the share ($1.50): 45 cents. Therefore, while the FTC would eliminate the Canadian tax payable in respect of the transaction, no excess credit would be available to offset tax on income from other sources.

Example

Assume a tax-exempt investor (Investor) wishes to borrow funds at short-term interest rates (say, 7 per cent) in order to purchase a $1,000 long-term foreign bond which pays interest at 8 per cent. Investor is not able to use the credit for the 15-per-cent non-resident withholding tax payable in the country of source on the bond interest. (Even though the return after withholding tax is only 6.8 per cent, which is lower than the 7 per cent cost of funds, Investor anticipates that the bond will appreciate due to interest rate movements.)

If the foreign interest payments are channelled through Taxpayer who is able to use an FTC, both parties can effectively obtain some benefit from the foreign tax credit. Taxpayer borrows funds at the short-term rate and buys the bond. At the same time, it enters into an interest rate "swap" agreement with Investor: Investor agrees that it will reimburse Taxpayer for the 7 per cent interest expense on the short-term loan, while Taxpayer agrees to pay over to Investor the net interest payments received on the bond, which Investor would otherwise have received directly (6.8 per cent), plus an additional 0.3 per cent to make the arrangement attractive to Investor. The arrangement could be set up to operate over a period of several years.

Before Canadian tax, the transaction would create a loss for Taxpayer:

Interest income on bond	$80.00
Income (loss) on swap agreement ($70 from Investor minus $71 to Investor)	(1.00)
Interest expense on short-term loan	(70.00)
Taxable income	9.00
Less: Foreign tax withheld	(12.00)
Economic profit (loss) before Canadian tax	$ (3.00)

Taxpayer, however, would be entitled under existing rules to add the $12.00 of withholding tax to its pool of potentially creditable foreign tax. Assuming that taxpayer faces a 40 per cent Canadian tax rate, $3.60 of the FTC would be needed to offset the tax payable on $9.00 of taxable income from the transaction. This leaves an FTC balance of $8.40 which could be used to offset taxes on income from other sources in the foreign country. The availability of the FTC makes an otherwise unprofitable transaction attractive for Taxpayer:

Economic profit (loss) before Canadian tax	($3.00)
Unused FTC balance	8.40
Profit (loss) after Canadian tax	$5.40

In this case, the second proposed rule would apply since, after foreign taxes, the anticipated profit to Taxpayer from the bond and the related swap agreement – in fact, a $3.00 loss – is not material in relation to the foreign tax of $12.00 otherwise creditable. The rule would deny the FTC. Instead, Taxpayer would be entitled to deduct the $12.00 in foreign tax from its $9.00 in income in respect of the property, to the extent of that income. Taxpayer's income for Canadian tax purposes from the transaction therefore could be reduced to zero, but no credit would be available to shelter other income.

Non-residents' certificates of exemption

Interest income paid to non-residents from Canadian sources is normally subject to withholding tax under Part XIII of the *Income Tax Act*. This tax is, however, often modified by Canada's tax treaties and by exceptions within Part XIII itself. Under one of the exceptions, Canada provides an opportunity for certain foreign pension funds to apply for an exemption from the tax which would otherwise be payable. Provided that they meet certain eligibility restrictions, such as being tax exempt in their own country, the Minister of National Revenue may grant them a certificate of exemption for interest payments they receive from arm's-length persons in Canada.

The budget proposes changes to the elegibility criteria for certificates of exemption to provide more certainty in their application. While the continuation of this exemption is justified for active foreign pension funds, the current wording of the Act requires only that the fund have been established or incorporated for the purpose of providing benefits under a pension or superannuation fund. There is currently no obligation that the fund continue to be principally engaged in providing benefits under such funds.

The budget proposes that, to be eligible for a certificate of exemption, a foreign pension fund demonstrate not only that it was established or incorporated to provide benefits under pension, retirement or superannuation funds but also that it continues to do so as its principal activity. This requirement will apply to all certificates of exemption issued after February 23, 1998.

Amounts owing by non-residents

Subsection 17(1) of the *Income Tax Act* deems a corporation resident in Canada to have earned a prescribed rate of interest on loans outstanding for one year or longer made to a non-resident person at less than a reasonable rate. This rule currently applies only to loans that are made by corporations resident in Canada. An exemption to this rule is provided in subsection 17(2) of the Act where tax has been paid on the loan under Part XIII of the Act. A further exemption is provided in subsection 17(3) of the Act where the loan has been made to a "subsidiary controlled corporation" and the money was used in the subsidiary controlled corporation's business for the purpose of gaining or producing income.

The budget proposes to extend the rule in subsection 17(1) of the Act to apply to all amounts owing to corporations resident in Canada, trusts with such corporate beneficiaries and partnerships with such corporate partners by non-residents where interest is not paid at a reasonable rate. The amendments also ensure that the rule in subsection 17(1) of the Act applies where amounts are owing either directly or indirectly by a non-resident. The exception in subsections 17(2) and (3) of the Act will be modified to refer to "amount owing" rather than to "loans". The budget also proposes to modify the exception in subsection 17(3) so that it only applies where the amount owing arose in the course of the carrying on of an active business by the subsidiary controlled corporation.

This measure applies to taxation years and fiscal periods beginning after February 23, 1998.

Mergers of foreign corporations

Currently, the *Income Tax Act* provides shareholders of a taxable Canadian corporation (a predecessor) a tax-deferred rollover in respect of a disposition of shares of the predecessor where it amalgamates with one or more other taxable Canadian corporations and those shareholders receive in exchange for their shares of the predecessor either:

- shares of the new corporation formed as a result of the amalgamation (a vertical or horizontal amalgamation); or
- shares of the taxable Canadian corporation that controls the new corporation formed as a result of the amalgamation (triangular amalgamation).

The Act also provides taxpayers who are shareholders of a foreign corporation (a predecessor) a tax-deferred rollover in respect of a disposition of shares of the predecessor where it undergoes a vertical or horizontal merger with one or more other foreign corporations and the other corporation and the predecessor are resident of the same foreign jurisdiction. The Act does not, however, provide for such a tax-deferred rollover in respect of a disposition of shares in the case of a triangular foreign merger of such foreign corporations. In the case of a triangular foreign merger, the shareholders of the predecessor receive shares of the foreign corporation that controls the new corporation formed on the merger, rather than shares of the new corporation.

The budget proposes that taxpayers that are shareholders of a foreign corporation be allowed a tax-deferred rollover in respect of a disposition of shares of the foreign corporation where the foreign corporation has been the subject of a triangular foreign merger. This proposal will apply to a disposition of shares as a result of a triangular foreign merger that occurs after February 24, 1998. As well, where a taxpayer elects, the proposal will apply to any other such disposition in any taxation year of the taxpayer for which the normal reassessment period has not expired before 1999.

Sales Tax Measures

This budget proposes a number of measures designed to simplify the goods and services tax (GST) and harmonized sales tax (HST) and to ensure consistency and fairness in their application. These measures relate to:

- the Visitors' Rebate Program;
- certain activities undertaken by charities;
- respite care provided to individuals with an infirmity or disability; and
- the alternate collection mechanism for direct sellers.

The Visitors' Rebate Program

The 1997 budget announced a review of the GST/HST Visitors' Rebate Program in order to determine whether the current design and administration of the program could be improved to target resources more effectively, promote Canada as a tourist destination and support the tourism industry in the creation of employment.

The Visitors' Rebate Program provides rebates of GST/HST to non-residents on eligible goods exported from Canada, short-term accommodation and certain goods and services used in the course of a foreign convention.

Since the review was announced, extensive consultations have been undertaken with the tourism industry. These consultations indicated that the program is generally viewed as an important tool in promoting tourism, particularly the accommodation and convention measures.

This budget proposes several enhancements to the design and delivery of the program to further promote Canada as a tourist destination and a place to convene conventions.

Extension of the rebates for foreign conventions to include food and beverages

Sponsors and non-registered organizers of foreign conventions (i.e., where at least 75 per cent of participants are non-residents) are permitted to claim rebates of the GST/HST paid on eligible expenses, such as the rental of meeting rooms, short-term accommodation and certain other purchases of goods and services used in the course of the convention. Currently, the list of eligible expenses excludes food, beverages and catering services.

The budget proposes that the existing rebate to a sponsor or organizer of a foreign convention be extended to rebate 50 per cent of the tax paid in respect of food, beverages and catering services relating to the convention. This extension of the rebate will increase the competitiveness of Canadian convention facilities marketed to non-resident non-registrant businesses. This proposal applies to foreign conventions held after February 24, 1998 where no admissions to the convention have been sold on or before that day.

Extension of short-term accommodation rebate to campsites

Non-resident individuals and businesses are entitled to a rebate of the GST/HST paid on accommodation in a hotel, motel or similar establishment for a period of less than one month. Currently, a short-term accommodation rebate is available for campsites only if the campsite is part of a tour package that also includes food and the services of a guide.

The budget proposes that visitors to Canada be able to claim a rebate in respect of the GST/HST on campsite fees, including any charge for hook-ups. In the case of a separate supply of a campsite, the claimant will be able to choose between claiming the actual amount of tax paid and $1 per night. Similarly, the formula for calculating the rebate for tour packages based on a flat amount per night will be amended to allow a rebate of $1 per night for each night for which a campsite is included in the package. The $5-per-night amount will continue in effect for any accommodation currently qualifying as short-term accommodation. This measure will ensure equitable tax treatment of campsite rentals whether or not they are included as part of a tour package.

This proposal applies to campsites not included in a tour package where the campsite is made available after June 1998. The extension of the rebate to campsites included in a tour package applies where any accommodation in Canada (whether short-term accommodation or a campsite) that is part of the tour package is first made available after June 1998.

Program administration

The review of the Visitors' Rebate Program also focused on how the administration of the program could be improved in order to deliver the rebate in the most efficient and effective manner.

There are two principal methods by which a non-resident visitor may claim a rebate of GST/HST:

- in person, when departing Canada at certain land-based crossings at duty-free shops operating under contract with Revenue Canada, provided the rebate amount does not exceed $500; or
- by mailing an application form to Revenue Canada, in which case the rebate is subsequently mailed to the foreign visitor at his or her home address.

As well, private sector operators have set up businesses at certain international airports and other locations to provide instant cash rebates to non-residents.

Currently, non-resident individuals may file only one rebate application each calendar quarter and non-resident businesses can file only one rebate claim each month. In order to enhance the delivery of the rebate, the budget proposes to eliminate these filing restrictions. The proposal applies to rebate applications received after February 24, 1998.

Revenue Canada uses a number of methods to verify the validity of rebate claims. To continue to ensure the integrity of the program, Revenue Canada will implement an enhanced verification procedure relating to rebate claims filed in respect of goods exported from Canada. This will entail inspection of goods at border crossings, airports and other exit points. This verification method is consistent with procedures in other value-added tax jurisdictions that relieve the tax on purchases made by non-residents.

In addition, Revenue Canada will continue to consult with industry members on additional measures which may enhance the delivery and accessibility of the program.

Measures relating to charities

The budget proposes two measures intended to improve the fairness of the GST/HST as it applies to charities.

Services provided by charities

Under the GST/HST, a general exemption is provided for most services supplied by charities. Input tax credits are not available to the extent that a charity makes exempt supplies, although the charity is able to recover, by way of rebate, 50 per cent of the otherwise unrecoverable tax.

The budget proposes a measure for charities whose main purposes include the provision of care, employment, employment training or employment placement services for individuals with disabilities or the provision of instructional services to assist such individuals in securing employment. Where these charities supply services on a regular basis that are in whole, or in part, performed by individuals with disabilities, the charity may apply to the Minister of National Revenue to have all services it supplies to registrants excluded from the general exemption for charities. However, this will not affect services that are specifically exempt under other provisions, such as educational or health care services. Moreover, the charity's services of providing care and employment-related assistance for individuals with disabilities will remain exempt when supplied to a public sector body or to a board, commission or other body established by a government or a municipality.

This measure addresses the special circumstances faced by these designated charities. It will enable them to charge tax on their supplies of services to registered customers and to claim input tax credits on their related purchases. Their registered customers may, in turn, be entitled to claim input tax credits for the tax charged and collected on the charities' services. As a result, the GST/HST will not place these charities at a competitive disadvantage vis-à-vis other suppliers who provide services to registered businesses. While the mandatory streamlined accounting method for charities will not apply to these designated charities, they will be eligible to use the existing special quick method that applies to other public sector bodies for the purpose of calculating their net tax remittances. This measure applies to supplies made by designated charities in reporting periods commencing after February 24, 1998.

Charities operating bottle return depots

Special rules apply to deposits paid on returnable beverage containers for taxable consumer products, such as soft drink bottles, liquor bottles and beer cans. These rules provide for the return of the GST/HST paid on the refundable deposit where the container is returned to a retailer or an authorized depot engaged in taxable activities. However, where a charity operates an authorized depot in the course of exempt activities and refunds a provincially mandated refundable deposit, the special rules do not provide for the recovery of the GST/HST originally paid on the refundable deposit.

The budget proposes that, in the latter circumstances, a charity operating a bottle return depot in a province be allowed to claim a net tax deduction or refund equal to 7 per cent (or 15 per cent where the province is an HST-participating province) of the refundable deposit. The charity must pay the refundable deposit, plus an amount equal to the deduction or refund, to the person from whom it collects the container. This measure will ensure fairer treatment of charities operating bottle return depots. The measure applies in respect of containers returned after March 1998.

Respite care

The budget proposes that an exemption from the GST/HST be provided for care and supervision of individuals who have limited capacity for self-supervision and self-care due to an infirmity or disability. The exemption applies where the service is rendered principally at an establishment of the supplier. For example, this would include daytime or overnight care of an individual with an infirmity or disability while the individual's primary caregiver is working or otherwise unavailable. The measure would extend to situations where care and supervision, including lodging, is provided during the transition from a health care facility to a home environment, or vice versa. This measure complements GST/HST relief already available for nursing home and home care services. Together with the proposed increased income tax assistance for caregivers, this measure enhances federal support for Canadians striving to meet the growing demands of caring for family members with an infirmity or disability. This measure applies to services performed after February 24, 1998.

Direct sellers

Under the GST/HST, direct sellers have the option of determining their net GST/HST liability as if sales of their exclusive products had been made by them directly to final purchasers, rather than through independent sales contractors, for the suggested retail price of those products. The legislation also provides that, where a distributor of a direct seller has jointly elected with the direct seller, it is the distributor who calculates its net GST/HST liability as if its sales had been made directly to final purchasers for the suggested retail price of the exclusive products.

As a result, independent sales contractors are treated, under these rules, as "small suppliers", regardless of their level of sales, and do not have to register and file returns.

The budget proposes two changes to improve the operation of the special rules for direct sellers and independent sales contractors.

Shipping, handling and order processing charges

Under the current rules, charges for shipping, handling and order processing from the direct seller to an independent sales contractor or between independent sales contractors are taxable to the independent sales contractor. In order to recover the GST/HST paid on these charges, the independent sales contractor must be a registrant. This reduces the benefits of the special rules for direct sellers and independent sales contractors.

The budget proposes that the GST/HST not apply to shipping, handling and order processing fees relating to exclusive products of the direct seller or sales aids when charged by the direct seller or the distributor to the independent sales contractor, or between independent sales contractors. This measure applies to amounts that become due after February 24, 1998 and are not paid on or before that day.

Bad debts

Currently, the general bad debt provisions under the GST/HST cannot be applied with respect to remittances under the special rules for direct sellers and independent sales contractors. The bad debt rules provide relief only to the person who made the sale giving rise to the bad debt, and do not accommodate the "deemed sale" under the special rules for direct sellers and independent sales contractors.

The budget proposes bad debt relief in respect of bad debts relating to an account receivable of an independent sales contractor (ISC) on a sale to a final purchaser in circumstances in which the sale was accounted for under the special rules as if it were made by the direct seller or a distributor instead of the ISC. The direct seller or the distributor, as the case may be, may claim a deduction in determining its net tax where it has paid or credited the amount of the deduction to the ISC who has written off the bad debt in the ISC's books of account. The allowable deduction is calculated on the basis of the same formula as is used by other registrants in claiming bad debt relief under the GST/HST.

Similar to the general rules under the GST/HST relating to bad debts, the direct seller or distributor who has taken a bad debt deduction is required to add an amount to its net tax in respect of any subsequent recovery of the bad debt.

These measures apply to bad debts in respect of supplies made after February 24, 1998.

Excise Tax Measures

Tobacco tax increases

The federal government will be introducing legislation amending the *Excise Tax Act* to implement increases in the excise taxes on tobacco products proposed on February 13, 1998.

These proposals include:

- an increase in the federal excise tax on cigarettes by 60 cents per carton of 200 cigarettes for retail sale in Ontario, Quebec, Nova Scotia and Prince Edward Island; and 40 cents per carton for retail sale in New Brunswick; and
- an increase in the federal excise tax on tobacco sticks by $1.52 per carton of 200 tobacco sticks for sale in Ontario and Quebec; 94 cents per 200 tobacco sticks for sale in Prince Edward Island; and 80 cents per 200 tobacco sticks for sale in other parts of Canada.

These tax increases apply to cigarettes and tobacco sticks sold or imported after February 13, 1998.

These changes are part of the co-ordinated federal-provincial process for the restoration of tobacco taxes in a gradual and sustainable manner so as not to encourage contraband activity.

Phase-out of the air transportation tax

Legislation will be introduced to implement reductions in the air transportation tax announced in 1997 as part of the government's program to commercialize air navigation services. The air transportation tax is being reduced and will be phased out this year as Nav Canada, a private Canadian corporation that now owns and operates the air navigation system, implements user fees to be paid by air carriers to fund its services. Further details on these tax reductions are contained in press releases of August 13 and December 4, 1997.

First Nations Taxation

In the 1997 budget, the federal government indicated its willingness to put into effect taxation arrangements with interested First Nations. Since that time, Parliament has passed legislation that allows the Cowichan Tribes and the Westbank First Nation to levy taxes on tobacco products sold on their respective reserves. In the case of the Westbank First Nation, a tax collection agreement has been concluded under which Revenue Canada will collect Westbank's tax.

The federal government has also been working, this past year, with the self-governing First Nations in the Yukon to facilitate the exercise of taxation powers provided in their self-government agreements. The discussions have focused on the co-ordination of the First Nations tax system with that of Canada through the use of tax collection agreements. The successful conclusion of these first tax collection agreements will open a new and important revenue source for these communities. The first such agreements will address the co-ordination of our respective personal income tax systems. The government has also identified co-ordination of corporate income taxes and sales taxes as subjects for discussion in the next year.

Building on the work of the last year, the federal government is once again expressing its willingness to continue discussions and to put into effect taxation arrangements with the First Nations that indicate an interest in exercising taxation powers.

Appendix

Measures for tax fairness and to achieve economic and social objectives

The budget reiterates the government's commitment to enhance fairness in the tax system and to provide targeted tax relief to achieve economic and social objectives. As explained in the 1997 budget, revenues must be raised in accordance with the following key principles:

- taxes must reflect the ability to pay – those with similar incomes and in similar circumstances should pay similar taxes, but those with higher incomes must pay more. When feasible, those with higher incomes should pay progressively more taxes. Corporations whether Canadian or foreign owned, must also pay taxes in Canada on their profits;
- those who need help get it – the tax system must recognize special circumstances that affect the ability to pay tax and should be capable of actually providing assistance to, rather than levying taxes on, those in greatest need; and
- taxes that are owed must be paid – this involves compliance with the tax system. The government must ensure that Canadians clearly understand their legal obligations and that Revenue Canada collects taxes that are owed in a fair and efficient manner both for the government and taxpayers.

Maintaining tax fairness requires a constant monitoring of the tax system. Tax measures which were appropriate when introduced may no longer be suitable due to changes in the economy, new social priorities, aggressive tax planning and the need to improve compliance.

Since 1994, the government has introduced a number of tax measures to enhance fairness and achieve economic and social objectives. The following table summarizes measures taken in previous years and in this budget.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998)

Families and seniors

1996

- introduced new tax treatment of child support payments with payments non-deductible for the payer and non-taxable for the recipient.
- announced two-step enrichment of the Working Income Supplement (WIS) of the Child Tax Benefit (CTB) of $250 million.
- proposed new Seniors Benefit, which is more progressive, fully indexed and tax free, will replace Old Age Security (OAS) and the Guaranteed Income Supplement (GIS).
- replaced the seven-year limit by an unlimited carry-forward of unused RRSP room.

1997

- announced a $6 billion Canada Child Tax Benefit by simplifying and enriching the current Child Tax Benefit, starting July 1998.
- enrichment of the WIS in July 1997 from the $125 million announced in the 1996 budget to $195 million and restructuring from a per-family to a per-child basis.

1998

- proposing to raise the limits to $7,000/$4,000 under the child care expense deduction.
- proposing to enrich the Canada Child Tax Benefit by another $425 million on July 1, 1999 and a further $425 million on July 1, 2000.
- removing contributions to registered retirement savings plans (RRSPs) and registered pension plans RPPs from the base for the alternative minimum tax.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Education

1996

- increased the education amount from $80 to $100 per month.
- raised the annual limit on the transfer of the tuition fee and education amounts to those who support students from $4,000 to $5,000.
- increased the annual limit on contributions to registered education savings plans (RESPs) from $1,500 to $2,000, and the lifetime limit from $31,500 to $42,000.
- broadened eligibility for the child care expense deduction to assist parents who undertake education or retraining.

1997

- doubled the basis for the education credit over two years to $200 per month.
- made ancillary fees eligible for the tuition credit.
- allowed a carry-forward of unused tuition and education credits.
- increased annual contribution limits for RESPs from $2,000 to $4,000.
- allowed transfers of RESP funds to an RRSP or to the contributor.

1998

- proposing to provide a Canada Education Savings Grant of 20 per cent on annual contributions of $2,000, along with carry-forward flexibility.
- proposing to introduce a tax credit for interest on student loans.
- proposing to allow RRSP withdrawals for lifelong learning.
- proposing to enhance tax support for part-time education through the education credit and the child care expense deduction.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Tax assistance for charities and public institutions

1994

- lowered the threshold at which charitable donations begin to earn the 29-per-cent tax credit from $250 to $200.

1996

- increased the limits on charitable donations eligible for tax credits from 20 per cent to 50 per cent of net income, and to 100 per cent of net income in the year of death and the preceding year.
- expanded zero-rating of hospital beds to all health care facilities, including long-term care facilities.
- allowed most charitable and public organizations to raise funds without collecting and remitting goods and services tax (GST) on sales.
- extended GST relief on purchases of vehicle modifications necessary to serve individuals with disabilities.
- provided a 100-per-cent GST rebate on books purchased by public libraries, educational institutions and other specified bodies.

1997

- reduced the inclusion rate on capital gains arising from the donation of publicly listed securities from 75 per cent to 37.5 per cent.
- changed the income limit for donations to 75 per cent.
- included 25 per cent of capital cost allowance (CCA) recapture in the net income limit.
- sanctioned a new method of valuation for easements of ecologically sensitive lands.
- increased resources for Revenue Canada to enhance information and compliance from charities.
- simplified GST accounting, reporting and remittance requirements for charities.

1998

- proposing to increase tax free allowances for emergency service volunteers.
- proposing to allow designated charities to treat certain services they supply to business customers as GST/HST taxable, thereby competing on an equal footing with other suppliers.
- proposing to provide equivalent GST/HST treatment to charities operating authorized bottle return depots vis-à-vis commercial operators.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Persons with disabilities

1996

- expanded zero-rating of orthopaedic and orthotic devices under GST.
- enriched the tax credit for infirm dependants.

1997

- broadened the medical expense tax credit.
- removed the limit on the attendant care deduction.
- introduced a refundable medical expense credit for earners.
- broadened the definition of preferred beneficiary for trusts benefiting people with disabilities.

1998

- proposing a new tax credit for caregivers who care for related seniors and persons with disabilities.
- proposing to extend the Home Buyers' Plan to persons with disabilities.
- proposing eligibility of training expenses for caregivers for the medical expense tax credit.
- proposing to allow certification for the disability tax credit by occupational therapists and psychologists.
- proposing to exempt respite care services from GST/HST.
- proposing to allow RRSP withdrawals for lifelong learning for full-time or part-time education.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Personal income tax measures to better target tax preferences

1994

- eliminated the $100,000 lifetime capital gains exemption.
- extended the base for the alternative minimum tax.
- restricted the use of tax shelters.
- extended the taxation of employer-paid life insurance premiums to the first $25,000 of coverage.
- introduced income-testing of the age credit.

1995

- eliminated tax advantages available through trusts.
- reduced the overcontribution allowance for RRSPs from $8,000 to $2,000.
- capped the RRSP and money purchase RPP dollar limits at $13,500 through 2003 and 2002 respectively.
- eliminated the retiring allowance roll-overs for years of service after 1995.
- eliminated double claims of personal credits in year of personal bankruptcy.

1996

- released new rules on taxpayer migration to ensure that gains that accrue while a taxpayer is a resident of Canada are subject to Canadian tax.
- capped the maximum pension limit for defined benefit RPPs at $1,722 per year of service until 2005 (only affecting individuals earning over $75,000).
- reduced the maximum age limit for deferring tax on savings in RRSPs and RPPs from age 71 to 69.
- further constrained tax shelters relying on a mismatch of income and expenses.

1998

- proposing to allow deductibility of health and dental premiums for the self-employed.
- proposing to expand the remote worksite concept.
- proposing to clarify the tax treatment of relocation expenses.
- proposing to strengthen the integrity of the certified cultural property regime.
- proposing to expand rules regarding employee options to allow the acquisition of units of mutual fund trusts.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Business income tax measures to better target tax preferences

1994

- eliminated the small business deduction and phased out enhanced scientific research and experimental development (SR&ED) benefits for large private corporations.
- reduced the deduction for business meals and entertainment expenses from 80 per cent to 50 per cent to better reflect the personal consumption element of these expenditures.
- increased the rate of tax on corporate dividends received by private investment corporations.
- implemented measures to ensure that the income of financial institutions is measured appropriately for tax purposes.
- eliminated the preference for sole-purpose SR&ED performers.
- reduced regional investment tax credits.
- modified the basis upon which insurance companies may claim reserves for income tax purposes.
- phased out accelerated depreciation deductions for air and water pollution equipment and reduced CCA rate for energy conservation equipment.
- eliminated "purchase butterflies".
- tightened the rules applicable to foreign affiliates.
- tightened the rules applicable on forgiveness of debt.

1995

- increased the large corporations tax (LCT) and corporate surtax.
- introduced temporary surcharge on banks and other large deposit-taking institutions.
- eliminated the deferral of tax on unincorporated business income.
- eliminated the deferral advantage for investment income earned by private holding companies.
- replaced film tax shelter mechanism for certified Canadian films with a tax credit.
- tightened rules relating to non-arm's-length contract SR&ED.
- introduced voluntary measure for construction industry reporting.
- tightened rules concerning superficial losses.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

1996

- reduced tax assistance for labour-sponsored venture capital corporations.
- repealed joint exploration corporation rules.
- restricted eligibility of seismic data for flow-through share treatment.
- limited SR&ED benefits for non-arm's-length wages.

1997

- replaced tax shelters used to finance non-Canadian films with a tax credit.

1998

- proposing to extend temporary capital tax surcharge on large deposit-taking institutions.
- proposing to allow deductibility of countervailing duties and anti-dumping charges.
- proposing to allow more time for year-end distributions for mutual fund trusts.
- proposing to harmonize financial institution designation for LCT and other purposes.
- proposing to allow earthquake reserve deduction.
- proposing to prevent unintended benefits under the SR&ED regime.
- proposing to improve a range of international taxation rules.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

Sales tax measures to better target tax preferences

1996-97

- tightened the GST rules governing the claiming of input tax credits and rebates by large businesses and exempt entities.
- reinforced the GST rules relating to trusts, estates and partnerships to ensure fair and consistent treatment of similar businesses that are organized differently.
- refined the criteria for businesses to be treated for GST purposes as being in competition with financial institutions.
- permitted warranty companies to recover GST paid on reimbursements to warranty holders.
- extended the GST accommodation rebate for visitors to Canada to non-resident businesses.
- expanded zero-rating and rebate provisions for exported goods and services.
- tightened the GST real property rules to ensure that all builders of multiple-unit residential buildings are treated equitably.

1998

- proposing to enhance the GST/HST Visitors' Rebate Program.
- proposing to enhance alternate collection mechanism for direct sellers.

Simplifying tax administration and improving enforcement

1994-97

- strengthened outreach and education programs.
- enhanced easy-to-understand automatic telephone information systems.
- met with special taxfiler groups such as senior citizens and immigrants to help them comply.
- established a single Business Number for streamlining registration for GST remitters, employers, corporations and importers/exporters.
- new "Business Window" initiative to provide one-stop service for small businesses.
- simplified payroll reporting for small businesses.
- reduced compliance costs for small and medium-sized businesses by co-ordinating GST, income tax and excise tax audits.
- streamlined procedures to simplify and expedite Customs clearance.

Measures to enhance tax fairness and achieve economic and social objectives (1994-1998) (cont'd)

- implemented a new approach to large business audits including audit protocol.
- reinforced measures to target the underground economy.
- earlier identification of abusive tax avoidance and tax shelter schemes.
- continued improvement of sophisticated risk models to identify areas of high risk and a sector approach to compliance for small and medium-sized businesses.
- forgiveness of penalties on voluntary tax disclosures to encourage taxpayers to comply voluntarily.
- included exchange of information provisions to help deal with tax havens.
- new rules requiring residents of Canada to file an information return when they own foreign assets in excess of $100,000 in value.
- required adequate documentation of transactions relating to transfer pricing and introduced new penalty provisions related to Revenue Canada reassessments.
- increased resources for Revenue Canada for transfer pricing audits.

1998

- proposing to introduce mandatory reporting of federal and construction contracts.

Notices of Ways and Means Motions

Notice of Ways and Means Motion to Amend the *Income Tax Act*

That it is expedient to amend the *Income Tax Act* to provide among other things:

Supplementary personal tax credit

(1) That, for the 1998 and subsequent taxation years, an individual (other than a trust) be allowed to deduct in computing the individual's tax payable for the year under Part I of the Act 17 per cent of the amount by which the total of

(*a*) $500, and

(*b*) where a spouse tax credit or equivalent-to-spouse tax credit is deducted in respect of another person in computing the individual's tax payable under Part I of the Act for the year (or would have been deducted if that person had no income for the year), the lesser of

(i) $500, and

(ii) the amount by which the total of $500 and the basic personal amount for the year exceeds the other person's income for the year

exceeds

(*c*) 4 per cent of the amount by which

(i) the individual's income for the year

exceeds

(ii) the total of

(A) the total of $500 and the basic personal amount for the year, and

(B) the amount determined under clause (*b*)(ii) for the year

and that the amount of $500 be adjusted to reflect the portion of annual increases in the Consumer Price Index in excess of 3 per cent, except that, for the 1998 taxation year, this tax credit be equal to 50 per cent of the credit otherwise determined.

Individual surtax

(2) That, for the 1998 and subsequent taxation years, the 3 per cent surtax required to be paid by an individual for the year be reduced by the amount by which

(*a*) $250

exceeds

(*b*) 6 per cent of the amount by which

(i) the individual's tax payable under Part I of the Act

exceeds

(ii) $8,333

except that, for the 1998 taxation year, this surtax reduction be equal to 50 per cent of the surtax reduction otherwise determined.

Credit for interest on student loans

(3) That, for the 1998 and subsequent taxation years, an individual be entitled to deduct, in computing tax payable for the year under Part I of the Act, 17 per cent of amounts paid in the year or in any of the 5 preceding taxation years ending after 1997 on account of interest on a loan under the *Canada Student Loans Act* or a provincial statute governing the granting of financial assistance to students at the post-secondary school level.

RRSP withdrawals for learning

(4) That provisions be introduced governing withdrawals from registered retirement savings plans used for learning in accordance with the proposals described in the Budget Papers tabled by the Minister of Finance in the House of Commons on February 24, 1998.

Part-time education

(5) That provisions relating to the part-time education of individuals be introduced in accordance with the proposals described in the Budget Papers tabled by the Minister of Finance in the House of Commons on February 24, 1998.

Registered education savings plans (RESPs)

(6) That measures consequential on the introduction of the Canada Education Savings Grant (CESG) program be introduced in accordance with the proposals described in the Budget Papers tabled by the Minister of Finance in the House of Commons on February 24, 1998.

(7) That, for 1998 and subsequent years, measures be introduced to provide for

(*a*) the recovery of CESGs to the extent that the total of all amounts each of which is the CESG portion of an educational assistance payment made under an RESP to a taxpayer in the year or a preceding year exceeds $7,200, and

(*b*) a deduction in respect of the CESG recovery amount in computing the taxpayer's income.

(8) That, for 1999 and subsequent years, the lifetime limit on RESP income distributions that can be exempted from the 20 per cent tax payable under Part X.5 of the Act, where there are corresponding deductions in respect of contributions to registered retirement savings plans, be increased from $40,000 to $50,000.

(9) That, as a condition for registration, an education savings plan submitted after 1998 for registration prohibit educational assistance payments to an individual enrolled in an educational program of less than 3 months duration, unless the program is of at least 3 weeks duration and either

(*a*) the payment does not exceed the individual's cost of tuition plus $300 times the number of weeks in the program, or

(*b*) the payment is approved by the Department of Human Resources Development.

(10) That, as a condition for registration, an education savings plan submitted after 1998 for registration that allows more than one beneficiary at any one time not allow an individual to become a beneficiary after the individual attains 21 years of age.

(11) That, where an individual under 21 years of age replaces another individual as a beneficiary under an RESP after 1997 and both individuals are connected to the RESP's subscriber by blood relationship or adoption, none of the contributions made to the RESP in respect of the other individual be taken into account in determining the amount of overcontributions to RESPs that have been made in respect of the new beneficiary.

PHSP premiums

(12) That amounts paid or payable in a fiscal period that begins after 1997 as a premium, contribution or other consideration to a private health services plan, in respect of one or more of an individual and the individual's spouse and children be deductible in computing the individual's income for the period from a business carried on by the individual, alone or as a partner actively engaged in the business, if

(*a*) either

(i) the total of the individual's incomes from all such businesses for all fiscal periods ending in the taxation year in which the fiscal period of the business ends exceeds 50 per cent of the individual's income for the year, or

(ii) the portion of the individual's income for the year that exceeds the total referred to in clause (i) does not exceed $10,000,

on the assumption that all such incomes are computed without reference to this paragraph and subdivision e of Division B of Part I of the Act,

(*b*) the amounts are paid or payable under a contract between the individual and a person licensed or otherwise authorized under the laws of Canada or a province to carry on in Canada an insurance business or the business of offering to the public its services as trustee,

(*c*) none of the amounts paid is included, in whole or in part, in computing an individual's medical expense tax credit for any taxation year, and

(*d*) where the individual employs, directly or indirectly, one or more persons on a full-time basis (other than persons employed on a temporary or seasonal basis) with whom the individual is dealing at arm's length who have accumulated at least three consecutive months of service with the individual, all such persons are entitled to benefits under the plan that are at least equivalent to the benefits to which the individual is entitled under the plan

except that, where in the period the individual does not employ, directly or indirectly, any person to whom subparagraph (*d*) applies or the number of persons employed by the individual in the business with whom the individual deals at arm's length and to whom coverage is extended under the plan is less than 50 per cent of the number of persons employed by the individual in the business, no such amount be deductible for the period except to the extent of $1,500 for each of the individual and the individual's spouse and $750 for each of the individual's children, on an annual basis.

Alternative minimum tax

(13) That the provisions relating to the alternative minimum tax be modified

(*a*) for the 1998 and subsequent taxation years, to allow an individual to deduct, in computing the individual's adjusted taxable income for the year, amounts paid to a registered pension plan or a registered retirement savings plan to the extent that they are deductible in computing the individual's income for the year, and

(*b*) for the 1994 to 1997 taxation years, to provide for the refund to an individual who at the end of 1997 is resident in Canada and is not bankrupt of an amount equal to the portion of that tax that

(i) can reasonably be regarded as being attributable to the non-deductibility of one or more amounts referred to in subparagraph (*a*) in computing the individual's adjusted taxable income for the year, and

(ii) has not been deducted in computing the individual's tax payable under Part I of the Act for any other taxation year.

Child care expense deduction

(14) That, for the 1998 and subsequent taxation years, the maximum annual amounts deductible for child care expenses be increased

(*a*) from $5,000 to $7,000 for each eligible child under 7 years of age or in respect of whom a disability tax credit may be claimed, and

(*b*) from $3,000 to $4,000 for each other eligible child.

Canada Child Tax Benefit

(15) That, with respect to payments arising during months after June 1998, an eligible individual be entitled to the full amount of the National Child Benefit Supplement of the Canada Child Tax Benefit to the extent that the individual's adjusted income does not exceed $20,921.

Caregiver Tax Credit

(16) That where, during the 1998 or a subsequent taxation year, an individual maintains (alone or jointly with another individual) a self-contained domestic establishment which is the ordinary place of residence of the individual and of a person who

(*a*) has attained the age of 18 years before the end of the year,

(*b*) is the individual's

(i) child or grandchild, or

(ii) parent, grandparent, brother, sister, aunt, uncle, nephew or niece, resident in Canada, and

(*c*) is, except where the person is the individual's parent or grandparent and has attained the age of 65 years before the end of the year, dependent on the individual by reason of mental or physical infirmity,

the amount by which

(*d*) $400

exceeds

(*e*) 17 per cent of the amount by which the person's income for the year exceeds $11,500

be deductible in computing the individual's tax payable under Part I of the Act for the year, except that no such amount be deductible by the individual for a taxation year if an amount is deducted for the year by any individual as an equivalent-to-spouse tax credit or a dependant tax credit in respect of the person and that the amounts of $400 and $11,500 be adjusted to reflect the portion of annual increases in the Consumer Price Index in excess of 3 per cent.

Home Buyers' Plan (HBP): general

(17) That where, by the beginning of 1999 or a subsequent year, an individual has repaid all amounts previously received under the HBP, the individual's eligibility to subsequently participate in the HBP be determined as if no amounts had previously been received under the HBP.

Home Buyers' Plan: disabled persons

(18) That the restriction of the HBP to first-time homebuyers be eliminated in connection with a payment received at any time after 1998 by an individual in a taxation year out of an RRSP where

(*a*) the individual is entitled to claim a deduction under subsection 118.3(1) of the Act in computing tax payable for the year or would be so entitled if that subsection were read without reference to paragraph (*c*) thereof, and

(*b*) the purpose of receiving the payment is to enable the individual to acquire and live in a dwelling

(i) that is more accessible by the individual or in which the individual is more mobile or functional, or

(ii) that is better suited for the personal needs and care of the individual.

(19) That the restriction of the HBP to first time homebuyers be eliminated in connection with a payment received out of an RRSP at any time after 1998 by an individual (referred to below as the "supporting individual") in a taxation year where

(*a*) a disabled individual is entitled to claim a deduction under subsection 118.3(1) of the Act in computing tax payable for the year or would be so entitled if that subsection were read without reference to paragraph (*c*) thereof,

(*b*) the supporting individual is related to the disabled individual, and

(*c*) the purpose of receiving the payment is to enable the supporting individual or the disabled individual to acquire a dwelling for the disabled individual to live in

(i) that is more accessible by the disabled individual or in which the disabled individual is more mobile or functional, or

(ii) that is better suited for the personal needs and care of the disabled individual.

Medical expense tax credit

(20) That, for the 1998 and subsequent taxation years, there be added to the list of expenses eligible for the medical expense tax credit reasonable expenses for the training of an individual in connection with care to be provided to a person who

(*a*) is related to the individual,

(*b*) has a mental or physical infirmity, and

(*c*) is a member of the individual's household or is dependent on the individual for support.

Disability tax credit

(21) That, after February 24, 1998 for the purpose of the disability tax credit, persons authorized to practice as

(*a*) occupational therapists be allowed to certify the existence of a severe and prolonged impairment with respect to an individual's ability to walk or to feed and dress oneself, and

(*b*) psychologists be allowed to certify the existence of a severe and prolonged impairment with respect to an individual's ability to perceive, think and remember.

Volunteers

(22) That, for the 1998 and subsequent taxation years, the $500 exemption applicable to allowances paid to a volunteer firefighter be replaced by a deduction equal to the lesser of

(*a*) $1,000, and

(*b*) the total of all amounts received by an individual from a government, municipality or other public authority that are included in computing the individual's income for the year from the discharge of the individual's duties as

(i) a volunteer ambulance technician,

(ii) a volunteer firefighter, or

(iii) a volunteer who assists in the search or rescue of individuals or in other emergency situations

and that the amount of the deduction be reduced by the amount by which

(*c*) the total of amounts included in computing the individual's income and that are received in the year from the government, municipality or authority for the discharge of the duties referred to in subparagraph (*b*) or similar duties

exceeds

(*d*) $3,000.

Meal and entertainment expenses

(23) That the provisions relating to the deductibility of expenses for meals and entertainment be modified, for expenses incurred after February 23, 1998, to

(*a*) extend the exception in paragraph 67.1(2)(*d*) of the Act to expenses that

(i) would be required to be included in computing the income of an employee but for subparagraph 6(6)(*a*)(i) of the Act, and

(ii) are incurred in respect of employees working at work sites which are at least 30 kilometres away from the nearest urban area having a population of at least 40,000 persons, and

(*b*) limit the exception in paragraph 67.1(2)(*e*) of the Act, relating to expenses incurred for food, beverages or entertainment generally available to all of a taxpayer's employees at a particular place of business, to such expenses incurred in respect of occasional events, not exceeding six such events per year.

(24) That the receipt of amounts or enjoyment of benefits described in subparagraph (23)(*a*) not be taken into account in computing the amount of a taxpayer's northern residents deduction.

Relocation expenses

(25) That, for expenses incurred after 1997, the definition of "moving expenses" in subsection 62(3) of the Act be amended to include

(*a*) mortgage interest, property taxes, insurance premiums and costs associated with maintaining heat and power, to a maximum of $5,000, payable in respect of a vacant "old residence" of the taxpayer for a period that begins after 1997 and does not exceed three months, during which reasonable efforts are being made to sell the "old residence", and

(*b*) the cost of revising legal documents to reflect the taxpayer's new address, replacing driving licenses and automobile permits, and obtaining utility connections and disconnections.

(26) That,

(*a*) for the 2001 and subsequent taxation years, for relocations effected in circumstances where the employee has begun employment at the "new work location" before July 1998, and

(*b*) for the 1998 and subsequent taxation years, in respect of amounts provided or paid after February 23, 1998 for relocations effected in circumstances where the employee has begun employment at the "new work location" after June 1998,

an employee be required to include in income, to the extent that it is not otherwise so included,

(*c*) any reimbursement or compensation provided directly or indirectly in the year by an employer in respect of the employee's financing for his or her residence, and

(*d*) one-half of the amount in excess of $15,000 paid directly or indirectly to an employee by an employer in respect of a decrease in value or impairment of proceeds of disposition of the employee's residence.

Employee loans

(27) That, for loans made after February 23, 1998, the provisions relating to employee loans be amended to clarify that section 80.4 of the Act applies to loans provided directly or indirectly by an employer, where it is reasonable to conclude that, but for the employee's office or employment, the loan would not have been made.

Certified cultural property

(28) That where, at any time after February 23, 1998, the Canadian Cultural Property Export Review Board makes a determination of the fair market value of a property, the amount of the determination be deemed to be the fair market value of the property for the purposes of all provisions of the Act relating to charitable donations and gifts of property for a period of two years from the date of the determination.

(29) That the period during which an institution or public authority will incur a liability to pay a penalty tax under Part XI.2 of the Act, if it disposes of a property which it received as a gift of certified cultural property, be increased from five years to ten years from the date of acquisition of the property, applicable to dispositions by such institutions or authorities that occur after February 23, 1998.

Mutual fund trust unit options

(30) That the provisions of the Act governing the tax treatment of options granted by public corporations to their employees to acquire shares be extended to options granted after February 1998 by mutual fund trusts to their employees to acquire trust units.

Part VI surtax

(31) That the 12 per cent surtax on financial institutions (other than life insurers) be extended to October 31, 1999, prorated for taxation years that end after October 1999.

Countervailing and anti-dumping duties

(32) That

(*a*) amounts that become payable by a taxpayer after February 23, 1998 in respect of countervailing or anti-dumping duties be deductible by the taxpayer in the year in which they are paid, and

(*b*) where the taxpayer has deducted an amount described in subparagraph (*a*), any refund or repayment made to the taxpayer in respect of the amount be included in the taxpayer's income in the year in which the refund or repayment is received.

Distributions by mutual fund trusts after year-end

(33) That, for taxation years that end after November 1998, a mutual fund trust that fails to pay or make payable an amount of its income for the year by the end of the year and that satisfies the amount within one month after the end of the year be permitted to elect that its income and the income of its unitholders at the end of the year be determined as if the satisfaction of the amount had occurred at the end of the year.

Large corporations tax: prescribed financial institutions

(34) That corporations prescribed to be financial institutions for the purposes of Part I.3 of the Act be treated after 1998 as financial institutions for the purposes of Part I of the Act, and as restricted financial institutions and specified financial institutions for all purposes of the Act.

Scientific research and experimental development

(35) That, for the purpose of determining the amount of a taxpayer's investment tax credit in respect of scientific research and experimental development, where

(*a*) the cost of a material was included in an amount a percentage of which was included in the taxpayer's investment tax credit at the end of any taxation year, and

(*b*) after February 23, 1998, the taxpayer disposes of, or converts to commercial use, a property that contains the material,

the taxpayer's investment tax credit be reduced by the amount obtained by applying that percentage to the lesser of

(*c*) either

(i) where the material was acquired by the taxpayer from a person with whom the taxpayer was dealing at arm's length, the cost to the taxpayer of the material, or

(ii) in any other case, the fair market value of the material at the time it was acquired by the taxpayer, and

(*d*) either

(i) where the property is disposed of to a person who deals at arm's length with the taxpayer, the proceeds of disposition of the property, or

(ii) in any other case, the fair market value of the property at the time of the disposition or conversion to commercial use

and, for these purposes, where the amounts required to be deducted from a taxpayer's investment tax credit exceed the amounts required to be added thereto at the end of a taxation year, the excess be added to the taxpayer's tax payable under Part I of the Act for the year.

Indirect assistance

(36) That, for amounts received after February 23, 1998 (other than amounts received before 1999 by a taxpayer pursuant to an agreement in writing made by the taxpayer before February 24, 1998), paragraph 12(1)(*x*) of the Act be amended to clarify that an amount described in subparagraph (iii) or (iv) thereof, and received by a taxpayer in circumstances in which it is reasonable to conclude that the indirect source of the amount is a payer, government, municipality or public authority described in subparagraph (i) or (ii) thereof, is included in the taxpayer's income to the same extent as if the amount had been received directly.

Treaty-exempt income

(37) That, for the 1998 and subsequent taxation years,

(*a*) a non-resident taxpayer's taxable income earned in Canada be computed without reference to

(i) the taxpayer's income or loss for the year from a business (referred to as a "treaty-protected business") carried on in Canada, where any income of the taxpayer for the year from the business could, under an agreement between Canada and another country, be exempt from tax under Part I of the Act, and

(ii) the taxpayer's income, gain or loss from a property (referred to as a "treaty-protected property"), where any income or gain of the taxpayer from the disposition of the property in the year could, under an agreement between Canada and another country, be exempt from tax under Part I of the Act, and (*b*) the amount deductible by reason of section 111 of the Act in computing a taxpayer's taxable income or taxable income earned in Canada for the year, in respect of a loss for another taxation year, be determined without reference to any income, gain or loss of the taxpayer for the other year from a treaty-protected business or treaty-protected property.

Foreign tax credit: treaty-protected foreign income

(38) That, for the purposes of determining the foreign tax credit for taxation years that end after 1997, there be included in computing a taxpayer's income, but excluded in computing the taxpayer's income from a country other than Canada,

(*a*) the taxpayer's income or loss for the year from a business carried on in that country, where any income of the taxpayer for the year from the business would be tax-exempt in that country,

(*b*) the taxpayer's property income or loss for the year from a source in that country, where any income of the taxpayer for the year from the property would be tax-exempt in that country,

(*c*) the taxpayer's capital gain or loss in the year from a property, where any gain of the taxpayer from a disposition of the property in the year would be tax-exempt in that country, and

(*d*) the taxpayer's income or loss for the year from the duties of an office or employment performed in that country, where any income for the year from such duties would be tax-exempt in that country,

and, for the purposes of this paragraph, income or gain shall be considered to be tax-exempt in a country where

(*e*) under an agreement between Canada and that country, the income or gain could be exempt from any income or profits tax, imposed in that country, to which the agreement applies, and

(*f*) the income or gain would not be subject to any income or profits tax imposed in that country to which the agreement does not apply.

Dual-resident individuals

(39) That any individual who

(*a*) would otherwise be resident in Canada for the purposes of the Act at a particular time, and

(*b*) became after February 24, 1998, and is at the particular time, under an agreement between Canada and another country, entitled as a person resident in the other country for the purposes of the agreement to an exemption from, or a reduction in the rate of, a tax otherwise payable under the Act,

be deemed not to be resident in Canada at that time.

Treaty-based exemption: information return

(40) That, for taxation years that begin after 1998, a corporation (or a partnership of which a corporation is a member) that carries on a business in Canada in a taxation year be required to file an information return for the year if the corporation claims that it is, under an agreement between Canada and the corporation's country of residence, exempt from tax under Part I of the Act on any part of the income for the year attributable to the business.

Deemed residence

(41) That paragraph 250(1)(*e*) of the Act, which deems spouses of government employees and certain others to be residents of Canada, be repealed for spouses who, but for that paragraph, would cease to be residents of Canada after February 23, 1998 and for spouses who, but for that paragraph, would have ceased to be residents of Canada before February 24, 1998 and elect not to be subject to that paragraph after February 23, 1998.

(42) That a new rule be added to the Act, with application after February 23, 1998, to deem as a resident of Canada any person who, under an international agreement, is exempt from tax in their country of residence because of their relationship to a Canadian resident.

Former residents' foreign employment income

(43) That, for the 1998 and subsequent taxation years, the provision of the Act that applies tax under Part I of the Act to the foreign income of former Canadian residents from employment by Canadian residents be repealed and a new rule be added to tax those former residents on such income only if their country of residence has agreed, in an agreement with Canada, not to tax the income.

Immigrating corporations

(44) That, where a corporation becomes resident in Canada at any time after February 23, 1998,

(*a*) it be deemed, immediately before that time, to have disposed of each of its properties for proceeds equal to the property's fair market value and to have reacquired each such property at a cost equal to those proceeds,

(*b*) the paid-up capital of each class of its shares be proportionately increased or reduced at that time so that the total paid-up capital of the corporation upon becoming resident is equal to the amount by which the fair market value of its property exceeds its liabilities,

(*c*) where the immigrating corporation owned a share of the capital stock of another corporation resident in Canada at that time (other than a share described in subparagraph (45)(*b*)), that other corporation be deemed to have paid a dividend to the immigrating corporation, immediately before it became resident, equal to the amount by which the share's fair market value exceeds its paid-up capital at that time, and

(*d*) for the purpose of computing the immigrating corporation's branch tax payable under Part XIV of the Act for its last taxation year ending before that time, its investment allowance be deemed to be nil.

Surplus stripping

(45) That, with respect to dispositions after February 23, 1998,

(*a*) subject to subparagraph (*b*), section 212.1 of the Act apply with respect to the disposition of a share of the capital stock of a corporation resident in Canada by

(i) a non-resident person,

(ii) a non-resident-owned investment corporation, or

(iii) a partnership of which a non-resident person or non-resident-owned investment corporation is a majority interest partner,

to a corporation resident in Canada, and

(*b*) section 212.1 not apply in respect of the disposition at any time of a share of a corporation resident in Canada that is taxable Canadian property and that is not a property any profit or gain of the taxpayer from the disposition of which at that time could, under an agreement between Canada and another country, be exempt from tax under Part I of the Act.

Foreign tax credit: short-term securities acquisitions

(46) That the foreign tax credit be amended to provide that, subject to paragraph (47), the amount included in computing a taxpayer's business-income tax or non-business-income tax for a particular taxation year on account of foreign withholding tax imposed in respect of dividends or interest included in computing the taxpayer's income for any taxation year, from a property (other than a capital property) that is a share or debt obligation acquired by the taxpayer after February 23, 1998 and disposed of within one year after it was acquired, be limited to 40 per cent (where the tax would otherwise be included in the taxpayer's business-income tax) or 30 per cent (where the tax would otherwise be included in the taxpayer's non-business-income tax) of that proportion of

(*a*) the amount, if any, by which

(i) the total of the taxpayer's proceeds from the disposition of the property and the amount of all dividends or interest included in computing the taxpayer's income for any taxation year from the property

exceeds

(ii) the total of the taxpayer's cost of the property and all costs of the disposition

that

(*b*) the amount of foreign withholding tax in respect of the property that would otherwise be included in computing the taxpayer's business-income tax or non-business-income tax for the particular year

is of

(*c*) the total amount of foreign withholding tax in respect of the property that would otherwise be included in computing the taxpayer's business-income tax or non-business-income tax for any taxation year.

Foreign tax credit: where profit not material

(47) That, where a taxpayer acquires a property after February 23, 1998 in respect of which it is reasonable to expect that any profit, after

(*a*) deducting therefrom any amount expected to be incurred for the purpose of acquiring, holding and disposing of the property,

(*b*) deducting therefrom any foreign income or profits tax expected to be payable in respect of income from the property, and

(*c*) taking into account the taxpayer's profit or loss in respect of any other transactions entered into by the taxpayer as part of the arrangement in which the property was acquired,

will not be material in relation to the total amount of such tax that would otherwise be included in computing the taxpayer's business-income tax or non-business-income tax for any taxation year, the amount of any foreign income or profits tax paid in respect of the property not be included in computing the taxpayer's business-income tax or non-business-income tax for any taxation year, but be deductible to the extent of the taxpayer's income in respect of the property.

Non-residents' certificates of exemption

(48) That a certificate of exemption not be issued pursuant to subparagraph 212(14)(*c*)(ii) of the Act after February 23, 1998 to a non-resident corporation or trust unless it has as its principal activity the administration of, or the provision of benefits under, one or more superannuation, pension or retirement funds or plans or any funds or plans established to provide employee benefits.

Amounts owing by non-residents

(49) That the provisions in section 17 of the Act that apply to include interest at a prescribed rate in the income of a corporation resident in Canada for a taxation year in respect of a loan owing at any time during the year by a non-resident that has been outstanding for one year or longer be modified, for taxation years and fiscal periods that begin after February 23, 1998, to extend its application

(*a*) to a trust or partnership of which a corporation resident in Canada is a beneficiary or member, and

(*b*) to all amounts owing in a year or period by non-residents directly or indirectly to a corporation resident in Canada or a trust or partnership of which such a corporation is a beneficiary or member that have been outstanding for one year or longer and in respect of which interest at a reasonable rate has not been included in computing the income of the corporation, trust or partnership for the year or period (other than amounts owing to a corporation resident in Canada by a subsidiary controlled corporation to the extent that the amount owing arose in the course of the carrying on of an active business by the subsidiary, or amounts owing by a non-resident in respect of which tax has been paid under Part XIII of the Act).

Mergers of foreign corporations

(50) That the provisions of the Act relating to foreign mergers be modified, applicable to dispositions of shares that occur after February 24, 1998 and to other dispositions of shares in a taxation year for which the normal reassessment period does not expire before 1999, to provide a tax-deferred rollover in respect of a disposition of shares of a foreign corporation by a taxpayer on the merger of that corporation and one or more other foreign corporations where, on the merger, the taxpayer disposed of those shares in exchange for shares of the capital stock of another foreign corporation that, immediately after the merger, controlled the new foreign corporation formed on the merger.

Taxpayer information

(51) That the provisions with respect to communication of taxpayer information be expanded to permit certain taxpayer information to be provided by Revenue Canada to persons administering social assistance programs in a province for the purposes of adjusting, as part of the National Child Benefit System, the amount of social assistance or child benefit payable to a person.

Notice of Ways and Means Motion to Amend the *Income Tax Conventions Interpretation Act*

That it is expedient to amend the *Income Tax Conventions Interpretation Act* to provide among other things:

(1) That, with respect to amounts paid after 1996,

(*a*) an "annuity" be defined in section 5 of the Act not to include any pension payment,

(*b*) a "periodic pension payment" be defined in section 5 of the Act to mean a pension payment arising in Canada other than a payment described in any of paragraphs (*a*) to (*d*) of the definition of that term in the current Act, and

(*c*) the definition of "pension" in section 5.1 of the Act be repealed, and that that term be defined in section 5 to mean, in respect of the application of an agreement between Canada and another country to payments that arise in Canada,

(i) where the agreement does not include a definition of "pension", a payment under any plan, arrangement or contract that is described in any of paragraphs (*a*) to (*i*) of section 5.1 of the current Act, and

(ii) where the agreement includes a definition of "pension", a payment that is a pension for the purposes of the agreement or a payment (other than a payment of social security benefits) that would be a periodic pension payment under the Act if the agreement did not include a definition of "pension".

(2) That in respect of the disposition after February 23, 1998 of taxable Canadian property, for the purpose of applying an agreement between Canada and another country, for greater certainty, any income, gain or loss in respect of the disposition be deemed to arise in Canada.

Notice of Ways and Means Motion to Amend the *Excise Tax Act*

That it is expedient to amend the *Excise Tax Act* to provide among other things:

Direct sellers

(1) That the definition of a “sales aid” of a direct seller or an independent sales contractor of a direct seller be amended to include the service of shipping or handling, or processing an order for, property that is either defined under the existing definition to be a sales aid or that is an exclusive product of the direct seller, applicable to supplies of services for which no consideration becomes due, or is paid, on or before February 24, 1998.

(2) That where

(*a*) a direct seller has made a supply of an exclusive product of the direct seller in circumstances in which an amount was required to be added in determining the net tax of the direct seller,

(*b*) a particular supply of the product has (without reference to the deeming provision under paragraph 178.3(2)(*e*) of the Act) been made by a particular independent sales contractor of the direct seller to a person (other than the direct seller and another independent sales contractor of the direct seller) with whom the particular contractor was dealing at arm’s length,

(*c*) the direct seller has obtained evidence satisfactory to the Minister of National Revenue that the consideration and the tax payable in respect of the particular supply have become in whole or in part a bad debt and that the bad debt has, at a particular time, been written off in the particular contractor’s books of account, and

(*d*) the direct seller pays to, or credits in favour of, the particular contractor an amount in respect of the product equal to the amount determined by the formula

$$A \times B/C$$

where

A is the tax payable in respect of the particular supply,

B is the total of the consideration, tax, and any amount that can reasonably be attributable to a tax, duty or fee (in this paragraph referred to as “applicable provincial tax”) imposed under an Act of the legislature of a province and prescribed for the purposes of section 154 of the *Excise Tax Act*, in respect of the particular supply remaining unpaid and written off at the particular time as a bad debt, and

C is the total of the consideration, tax, and applicable provincial tax, payable in respect of the particular supply,

the direct seller may deduct the amount paid or credited, in determining the net tax for the particular reporting period of the direct seller in which the payment or credit is given or for a subsequent reporting period, in a return filed within four years after the day on or before which the return for the particular reporting period is required to be filed.

(3) That where all or part of a bad debt in respect of which a direct seller has made a deduction under any enactment founded on paragraph (2) is recovered, the direct seller shall, in determining the net tax for the reporting period of the direct seller in which the bad debt or part thereof is recovered, add the amount determined by the formula

$$A \times B/C$$

where

A is the amount of the bad debt recovered;

B is the tax payable in respect of the supply to which the bad debt relates; and

C is the total of the consideration, tax, and any amount that can reasonably be attributable to a tax, duty or fee imposed under an Act of the legislature of a province and prescribed for the purposes of section 154 of the *Excise Tax Act*, payable in respect of that supply.

(4) That where

(*a*) a distributor of a direct seller has made a supply of an exclusive product of the direct seller in circumstances in which an amount was required under subsection 178.4(1) of the Act to be added in determining the net tax of the distributor,

(*b*) a particular supply of the product has (without reference to the deeming provision under paragraph 178.4(2)(*d*) of the Act) been made by a particular independent sales contractor of the direct seller (other than the distributor) to a person (other than the direct seller, distributor and another independent sales contractor of the direct seller) with whom the particular contractor was dealing at arm's length,

(*c*) the distributor has obtained evidence satisfactory to the Minister of National Revenue that the consideration and the tax payable in respect of the particular supply have become in whole or in part a bad debt and that the bad debt has, at a particular time, been written off in the particular contractor's books of account, and

(*d*) the distributor pays to, or credits in favour of, the particular contractor an amount in respect of the product equal to the amount determined by the formula

$$A \times B/C$$

where

A is the tax payable in respect of the particular supply,

B is the total of the consideration, tax, and any amount that can reasonably be attributable to a tax, duty or fee (in this paragraph referred to as "applicable provincial tax") imposed under an Act of the legislature of a province and prescribed for the purposes of section 154 of the *Excise Tax Act*, in respect of the particular supply remaining unpaid and written off at the particular time as a bad debt, and

C is the total of the consideration, tax, and applicable provincial tax, payable in respect of the particular supply,

the distributor may deduct the amount paid or credited, in determining the net tax for the particular reporting period of the distributor in which the payment or credit is given or for a subsequent reporting period, in a return filed within four years after the day on or before which the return for the particular reporting period is required to be filed.

(5) That where all or part of a bad debt in respect of which a distributor of a direct seller has made a deduction under any enactment founded on paragraph (4) is recovered, the distributor shall, in determining the net tax for the reporting period of the distributor in which the bad debt or part thereof is recovered, add the amount determined by the formula

$$A \times B/C$$

where

A is the amount of the bad debt recovered;

B is the tax payable in respect of the supply to which the bad debt relates; and

C is the total of the consideration, tax, and any amount that can reasonably be attributable to a tax, duty or fee imposed under an Act of the legislature of a province and prescribed for the purposes of section 154 of the *Excise Tax Act*, payable in respect of that supply.

(6) That any enactment founded on any of paragraphs (2) to (5) apply to bad debts relating to supplies made after February 24, 1998.

Services supplied by certain charities to registrants

(7) That a charity whose main purposes include the provision of employment, training for employment or employment placement services for individuals with disabilities, or the provision of instructional services to assist such individuals in securing employment, be entitled to apply to the Minister of National Revenue to be designated for the purpose of having its supplies of specified services made to registrants excluded from the general exemption for supplies by charities under section 1 of Part V.1 of Schedule V to the Act, provided the charity supplies, on a regular basis, specified services that are, in whole or in part, performed by individuals with disabilities.

(8) That, for the purposes of any enactment founded on paragraph (7), a “specified service” be defined as any service, other than a service

(*a*) that is

(i) the care, employment, or training for employment, of individuals with disabilities,

(ii) an employment placement service for the benefit of such individuals, or

(iii) the provision of instruction to assist such individuals in securing employment; and

(*b*) the recipient of which is a public sector body or a board, commission or other body established by a government or municipality.

(9) That the Minister of National Revenue may, by notice in writing, designate a charity applying therefor under any enactment founded on paragraph (7), effective on the first day of a reporting period specified in the notice, where the Minister is satisfied that the conditions set out in that enactment are satisfied and the effective date is not earlier than one year after the effective date of a revocation of a designation of the charity pursuant to a request made by the charity.

(10) That the Minister of National Revenue may, by notice in writing, revoke a designation of a charity made under any enactment founded on paragraph (9), effective on the first day of a reporting period specified in the notice, where

(a) the Minister is satisfied that the charity no longer meets the conditions for designation; or

(b) the charity makes a request in writing to the Minister that the designation be revoked and the designation had been in effect for at least one year.

(11) That any enactment founded on any of paragraphs (7) to (10) be deemed to have come into force on February 24, 1998 and apply to reporting periods beginning after that day.

(12) That, for the purpose of determining the net tax of a charity for reporting periods beginning after February 24, 1998, the streamlined accounting method applicable to charities under section 225.1 of the Act not apply to the charity if, in that reporting period, a designation of the charity under any enactment founded on paragraph (9) is in effect.

(13) That a charity designated under any enactment founded on paragraph (9) be permitted to elect under section 227 of the Act to

determine the net tax of the charity in the manner prescribed thereunder for qualifying non-profit organizations for any reporting period beginning after February 24, 1998 during which the designation of the charity is in effect.

(14) That the supplies by a charity that are exempt supplies under section 1 of Part V.1 of Schedule V to the Act exclude a supply of a specified service (within the meaning assigned by any enactment founded on paragraph (8)) where the supply is made to a registrant at a time when a designation of the charity, under any enactment founded on paragraph (9), is in effect.

(15) That any enactment founded on paragraph (14) apply to supplies made by a charity in reporting periods of the charity beginning after February 24, 1998.

Charities operating bottle return depots

(16) That where, in the course of a business, a charity (whether or not a registrant) collects used, empty returnable containers (within the meaning of section 226 of the Act) in a province for the purpose of supplying the containers when empty, or the by-products of a process of recycling the containers, and the charity is not entitled to claim input tax credits in respect of the containers, the charity be entitled to claim a deduction in determining its net tax for the reporting period in which it collects the containers, provided that, in respect of each container for which the deduction is claimed,

(*a*) the charity did not acquire the container in circumstances in which tax under Part IX of the Act did not apply because of an election under section 156 (with a closely-related person) or section 167 (upon the sale of a business);

(*b*) if the charity makes a supply of the container in respect of which tax is or would, but for section 156 or 167 of the Act, be collectible, the charity is not relieved, under subsection 226(3) of the Act, from having to include that tax collectible in determining its net tax; and

(*c*) the charity pays to the person from whom the container is collected the total of

(i) the portion (in this paragraph referred to as the "refundable deposit") of all taxes or fees that are imposed in respect of the container under an Act of the legislature of the province respecting the regulation, control or prevention of waste and that, pursuant to that Act or any agreement entered into thereunder, is refundable to the person, and

(ii) an amount that is

(A) if tax is payable by the charity in respect of the supply to it of the container, the amount of the tax calculated on the refundable deposit, or

(B) in any other case, equal to tax under Part IX of the *Excise Tax Act*, calculated on the refundable deposit, that would be payable by the charity in respect of the supply to it of the container if that supply were a taxable supply by a registrant.

(17) That the deduction to which a charity is entitled under any enactment founded on paragraph (16) in respect of the supply to the charity of a returnable container in a province be determined by multiplying the amount referred to in that enactment as the “refundable deposit” by

(*a*) the total of 7 per cent and the tax rate for the participating province, in the case of a participating province, or

(*b*) 7 per cent, in any other case.

(18) That a charity not be entitled to make a deduction under any enactment founded on paragraph (16) in respect of a supply of a returnable container made to the charity unless the deduction is claimed in a return under Division V of Part IX of the Act filed not later than the day on or before which the return under that Division is required to be filed for the last reporting period of the charity ending within four years after the end of the reporting period in which the charity collects the container.

(19) That any enactment founded on any of paragraphs (16) to (18) apply to supplies of containers made to charities after March 1998.

Visitors’ Rebate Program

(20) That the definition “related convention supplies” in subsection 123(1) of the Act be amended to repeal the exclusion for food and beverages and for property or services that are supplied under a contract for catering.

(21) That section 252.3 of the Act be amended so that the rebate under that section in respect of related convention supplies for non-resident exhibitors at a convention who are not registered under Part IX of the Act be maintained for “related convention supplies” as defined in existing subsection 123(1) of the Act.

(22) That the rebate under subsection 252.4(1) of the Act to a sponsor of a foreign convention in respect of a supply of property or services relating to the convention made by a registrant who is the organizer of the convention be calculated as the total of

(*a*) the tax paid by the sponsor calculated on that part of the consideration for the supply that is reasonably attributable to the convention facility or related convention supplies other than food and beverages and property or services supplied under a contract for catering; and

(*b*) 50 per cent of the tax paid by the sponsor calculated on that part of the consideration for the supply that is reasonably attributable to related convention supplies that are food or beverages or property or services supplied under a contract for catering.

(23) That the rebate under subsection 252.4(1) of the Act to a sponsor of a foreign convention in respect of related convention supplies (other than those acquired from the organizer of the convention) be calculated as the total of

(*a*) 50 per cent of the tax paid by the sponsor in respect of the related convention supplies that are food or beverages or property or services supplied under a contract for catering; and

(*b*) all tax paid by the sponsor in respect of the remaining related convention supplies.

(24) That the rebate under subsection 252.4(3) of the Act to the organizer of a foreign convention in respect of related convention supplies be calculated as the total of

(*a*) 50 per cent of the tax paid by the organizer in respect of the related convention supplies that are food or beverages or property or services supplied under a contract for catering; and

(*b*) all tax paid by the organizer in respect of the remaining related convention supplies.

(25) That any enactment founded on any of paragraphs (20) to (24) apply for the purpose of determining a rebate under section 252.3 or 252.4 of the Act in respect of any property or

service acquired, imported or brought into a participating province for consumption, use or supply in connection with a convention all the supplies of admissions to which are made after February 24, 1998.

(26) That the existing provision under subsection 252.4(4) of the Act that enables a supplier, in specified circumstances, to pay or credit to a convention sponsor or unregistered organizer the amount of a rebate under section 252.4 to which the sponsor or organizer would be entitled in respect of certain short-term accommodation be amended to apply in the same circumstances to a supply of “camping accommodation”, where the convention begins after June 1998 and all the supplies of admissions to the convention are made after February 24, 1998.

(27) That, for the purposes of any enactment founded on any of paragraphs (26) to (32), “camping accommodation” be defined, as of February 24, 1998, as a campsite at a recreational trailer park or campground (other than a campsite included in the definition “short-term accommodation” in subsection 123(1) of the Act) that is supplied by way of lease, licence or similar arrangement for the purpose of its occupancy by an individual as a place of residence or lodging where the period throughout which the individual is given continuous occupancy of the campsite is less than one month, and includes water, electricity and waste disposal services, or the right to the use thereof, accessed by way of an outlet or hook-up at the campsite, when supplied with the campsite.

(28) That the provisions of the Act under which a rebate in respect of short-term accommodation or a tour package that includes short-term accommodation is, in specified circumstances, provided be amended to apply in the same circumstances to supplies of camping accommodation and tour packages that include camping accommodation.

(29) That the provisions of the Act that, in specified circumstances, provide for the calculation of a rebate in respect of a supply of short-term accommodation or a tour package that includes short-term accommodation on the basis of $5 for each night that the accommodation is made available under the agreement for the supply be amended to also provide for a rebate in the case of a supply of camping accommodation to be calculated, in the same circumstances, as $1 for each night camping accommodation is made available under the agreement for the supply.

(30) That the provision of the Act that, in specified circumstances, provides for the calculation of a rebate in respect of a supply of a tour package that includes short-term accommodation to be based on a formula that employs a factor of 50 per cent of the tax paid on the supply be amended to also apply to tour packages that include camping accommodation (including those that include a combination of short-term accommodation and camping accommodation) and that the amount of tax deemed, for the purposes of the rebate, to be paid in those circumstances in respect of all the accommodation included in the tour package be determined by the formula.

$$A/B \times C/2$$

where

A is the total number of nights for which either short-term accommodation or camping accommodation included in the tour package is made available under the agreement for the supply of the tour package;

B is the number of nights the non-resident individual to whom the accommodation is made available spends in Canada during the period commencing on the earlier of the first day on which either overnight lodging or camping accommodation included in the tour package is made available to the individual and the first day any overnight transportation service included in the tour package is rendered to the individual and ending on the later of the last day any overnight lodging or camping accommodation is made available to the individual and the last day any such transportation service is rendered to the individual; and

C is the tax paid in respect of the supply of the tour package.

(31) That the rules under subsections 252.1(6) and (7) of the Act dealing with multiple supplies by the same supplier of short-term accommodation for the same night be amended to apply to camping accommodation as well.

(32) That the rules under subsection 252.1(8) of the Act that permit, in specified circumstances, a registrant to pay or credit to a non-resident person the amount of a rebate under section 252.1 to which the person would be entitled in respect of a supply of short-term accommodation, or a tour package that includes short-term accommodation, be amended to apply, in the same circumstances, to a supply of camping accommodation or a supply of a tour package that includes camping accommodation, including tour

packages that include a combination of short-term accommodation and camping accommodation.

(33) That any enactment founded on any of paragraphs (28) to (32) apply to

(*a*) a supply of camping accommodation not included in a tour package where the camping accommodation is, under the agreement for the supply, first made available after June 1998, and

(*b*) a supply of a tour package that includes camping accommodation where no short-term accommodation and no camping accommodation included in the tour package is, under the agreement for the supply, made available in Canada before July 1998.

(34) That the limitations under paragraphs 252.2(*b*) and (*c*) of the Act on the number of applications that a non-resident person is entitled to make in a calendar month or quarter for rebates in respect of exported goods or accommodation be repealed, effective for applications received by the Minister of National Revenue after February 24, 1998 (without regard to the day on which the applications are deemed under subsection 334(1) of the Act to have been received).

(35) That the provision setting out the maximum total amount of rebates in respect of short-term accommodation that may be claimed in a single application on the basis of the formula that employs a factor of $5 per night be amended so that the same maximum applies to applications that include rebates calculated on the basis of a flat amount per night in respect of any accommodation, whether short-term accommodation, camping accommodation or both.

(36) That any enactment founded on paragraph (35) apply to applications received by the Minister of National Revenue after June 1998 (without regard to the day on which the applications are deemed under subsection 334(1) of the Act to have been received).

Respite care for individuals with an infirmity or disability

(37) That Part IV of Schedule V to the Act be amended to add an exemption for the supply of a service of providing care and supervision to an individual with limited physical or mental capacity for self-supervision and self-care due to an infirmity or disability, where the service is rendered principally at an establishment of the supplier.

(38) That any enactment founded on paragraph (37) apply to services performed after February 24, 1998 and, where a supply to which that enactment applies includes services provided during a period that includes, but ends after, that day, the provision of the services for the part of the period that is before February 25, 1998 and the provision of the remaining services each be deemed to be a separate supply and the total consideration for all the services be prorated accordingly such that the consideration reasonably attributable to the services performed after February 24, 1998 be treated as consideration for an exempt supply.

(39) That there not be any increase in a registrant's net tax for the reporting period that includes February 25, 1998 in respect of any decrease or cessation of use, in commercial activities, of capital property of the registrant to the extent that the change in use results from the application of any enactment founded on paragraph (37).