Department of Finance Canada / Ministère des Finances Canada

Tax Expenditures: Notes to the Estimates/Projections 2010

Canada

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Preface

This is the third edition of *Tax Expenditures: Notes to the Estimates/Projections*, the companion document to the main report, *Tax Expenditures and Evaluations.* This document sets out the approach used in developing the estimates and projections contained in the main report. It also provides a description and presents the objective of each tax expenditure. Measures that were in effect at any time over the 2004 to 2010 period are described in this document.

Since neither the descriptions and objectives of most of the tax expenditures nor the approach taken to developing the estimates and projections is likely to change from year to year, this document is produced less frequently than the main report, which is published annually.

The main report provides estimates and projections for all tax expenditures. It also presents evaluations and research related to specific tax expenditures or tax issues.

Disclaimer

The descriptions of the tax measures contained in this document are intended to provide only a general understanding of how each of the tax measures operates. These descriptions do not replace the law found in the relevant legislation or regulations and should not be relied upon by taxpayers in arranging their affairs. Taxpayers may also contact the Canada Revenue Agency or consult the agency's website at www.cra-arc.gc.ca/.

Chapter 1

Framework and Methodology

The principal function of the tax system is to raise the revenues necessary to fund government expenditures. The tax system can also be used directly to achieve public policy objectives through the application of special measures such as low tax rates, exemptions, deductions, deferrals and credits. These measures are often described as “tax expenditures” because they achieve policy objectives at the cost of lower tax revenue.

To identify and estimate tax expenditures, it is necessary to establish a “benchmark” tax structure that applies the relevant tax rates to a broadly defined tax base—e.g. personal income, business income or consumption. Tax expenditures are then defined as deviations from this benchmark. Reasonable differences of opinion exist about what should be considered a benchmark tax system and hence about what should be considered a tax expenditure.

This report takes a broad approach and includes all but the most fundamental structural elements of the tax system, such as the progressive personal income tax rate structure. Thus, the report contains not only measures that may reasonably be regarded as tax expenditures, but also some other measures that are considered part of the benchmark tax system. The latter are listed separately under “Memorandum Items.” Also included under this heading are measures for which there may be some debate over whether they should be considered tax expenditures or where data limitations do not permit a separation of the tax expenditure and benchmark components of the measure. This approach provides information on a full range of measures.

The remainder of this chapter discusses the tax expenditure concept in order to facilitate understanding of the quantitative estimates. It also discusses the calculation and interpretation of the costs of tax expenditures, including key assumptions used in the analysis.

Simplified descriptions of each tax expenditure, as well as information on data sources and the methodology used in constructing the estimates, are presented for personal income tax in Chapter 2, corporate income tax in Chapter 3 and the Goods and Services Tax (GST) in Chapter 4.[1] Many provisions relating to the taxation of business and property income and capital gains are common to both the personal and corporate income tax systems. In such cases, the provision is generally described in the chapter relating to the system—personal or corporate—in which the tax expenditure is more significant, and a cross-reference is provided in the other chapter.

1 Tax expenditures for other commodity taxes are not included (e.g. excise taxes) due to the inherent conceptual difficulties of defining an appropriate benchmark system for a tax that is applied to a specific commodity.

Benchmark for Tax Expenditures in the Personal and Corporate Income Tax Systems

The benchmark for the personal and corporate income tax systems is defined by considering the tax base, existing tax rates and brackets, the unit of taxation, the time frame of taxation, and the treatment of inflation for calculating income. In addition, the benchmark includes measures that reduce or eliminate double taxation, recognize expenses incurred to earn business income, and allow business losses to be claimed over a number of years. Finally, the constitutional immunity of Canada and the provinces from taxation is recognized as part of the benchmark system for income taxation.

A more detailed discussion of the features of the benchmark for both the personal and corporate income tax systems follows.

(1) The Tax Base

The benchmark income tax base is a variant of the Haig-Simons comprehensive income base, which requires the taxation of real current additions to purchasing power, or real increases in wealth. Under a Haig-Simons base, worldwide income from all sources—labour income, rents, dividends, interest, transfers, capital gains, imputed rent on owner-occupied dwellings, imputed value of household services, gifts and inheritances—is taxed as it is earned. A strict application of the Haig-Simons base would make corporate income tax redundant since income earned at the corporate level would be taxed as it accrued to individuals. The benchmark assumes, however, that corporate net income from all sources is subject to taxation.

In defining the personal income tax benchmark, the Haig-Simons definition is modified to exclude non-market transfers of money and property between taxpayers as well as the imputed values of rent and household services. With this definition of the tax base, measures that provide preferential tax treatment of savings, such as Registered Retirement Savings Plans and Tax-Free Savings Accounts, are considered tax expenditures. Non-market transfers of presumptively tax-paid amounts between taxpayers, such as gifts, inheritances and spousal/child support payments, are neither taxable in the hands of the recipient nor deductible by the donor under this benchmark.

(2) Treatment of Inflation

Both individuals and corporations report nominal income in determining their tax liability each year. Nominal income is therefore taken to be the appropriate basis for the benchmark income tax system. Indexation of the personal income tax brackets and the major credit amounts to inflation is considered to be part of the benchmark.

(3) Tax Rates and Income Brackets

For the personal income tax system, the existing rate structure, adjusted for inflation, is taken to be part of the benchmark system. The Basic Personal Amount is also presented as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. The cost of this credit is, however, included as a memorandum item.

With respect to the corporate income tax system, the benchmark is the general federal corporate income tax rate (including the former general corporate surtax when applicable). Provisions that alter this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the low tax rate for small business and the low tax rate for credit unions.

(4) Tax Unit

Personal income taxes in Canada are based on individual income. Consequently, the individual is taken as the benchmark tax unit for the purposes of identifying tax expenditures in this report. This choice leads to the classification of the various provisions related to dependants, such as the Spouse or Common-Law Partner Credit, as tax expenditures. For corporate income tax, the single corporation is generally adopted as the benchmark tax unit.

(5) Taxation Period

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

The benchmark taxation period for the corporate income tax system is the corporation's fiscal year. As with the personal income tax system, deferrals are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures that provide for the carry-forward and carry-back of losses to other years would be tax expenditures. However, these provisions improve the tax system by recognizing the cyclical nature of business and investment income by essentially allowing such income to be measured over a number of years. Consequently, the estimated costs associated with carry-overs of losses are presented in the Memorandum Items sections.

(6) Avoidance of Double Taxation

Measures that provide relief from double taxation are considered part of the benchmark income tax system. For example, the non-taxation of intercorporate dividends is designed to ensure that income is taxed only once at the corporate level and that the corporate income tax system is neutral across organizational structures. Consider a single corporation that currently operates as a number of divisions. Now suppose the corporation reorganizes into a holding company with wholly owned subsidiaries instead of divisions. The profits from the subsidiaries are taxed as earned and the after-tax profits flow to the holding company through intercorporate dividends. If these dividends were subject to taxation at the holding company level, double taxation would occur. Consequently, the exemption of intercorporate dividends is not considered to be a tax expenditure.

Similarly, the dividend gross-up and tax credit mechanism serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation when earned and again at the personal level when the after-tax income is distributed through dividends.

Finally, measures that recognize income taxes paid in foreign countries are part of the benchmark.

(7) Recognition of Expenses Incurred to Earn Income

Tax provisions that provide for the deduction of current costs incurred to earn business income are treated as part of the benchmark system. Capital costs, which contribute to earnings beyond the fiscal year in which the cost is incurred, are deductible in the benchmark system at a rate that allocates the cost over the period during which the capital contributes to earnings—generally, the useful life of the asset to which the cost relates.

Personal income tax measures allowing the deduction of work-related expenses from employment income are included as tax expenditures.

(8) Government Immunity From Taxation

Section 125 of the Constitution Act, 1867, provides that “no land or property belonging to Canada or any province shall be liable to taxation.” This means that neither the federal nor the provincial governments (nor their Crown agents) are liable to taxation by the other. Accordingly, constitutional immunity from taxation is recognized as part of the benchmark system for income taxation.

(9) Other Taxes in the Income Tax Act

The Income Tax Act includes certain taxing provisions that do not clearly relate to income tax, such as non-resident withholding tax. The approach taken in this publication is to treat the statutory rates of these taxes as the benchmark. Further discussion of this issue and other conceptual issues can be found in Chapter 3.

The Benchmark for the Income Tax System

The definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. A broadly based system is used as the benchmark for income taxes in this report. The essential features are:

Personal Income Tax

- Current tax rates and income brackets, as adjusted for inflation, are taken as given;
- The tax unit is the individual;
- Taxation is imposed on a calendar year basis;
- Income is defined in nominal rather than inflation-adjusted terms; and
- Structural measures that reduce or eliminate double taxation and improve the fairness of imposing taxes on a calendar-year basis are included.

Corporate Income Tax

- The current general tax rate is taken as given;
- The tax unit is the corporation;
- Taxation is imposed on a fiscal year basis;
- Income is defined in nominal rather than inflation-adjusted terms;
- Structural measures that reduce or eliminate double taxation, recognize expenses incurred to earn income and improve the fairness of imposing taxes on a fiscal-year basis are included; and
- The constitutional immunity of Canada and the provinces from taxation is recognized.

Features of the GST Benchmark[2]

The benchmark for the GST is a broadly based, multi-stage value-added tax collected according to the destination principle and using a tax credit mechanism to relieve the tax in the case of business inputs. A more detailed discussion of the features of the GST benchmark follows.

(1) Multi-Stage System

The main structural elements of a multi-stage consumption tax are taken to be part of the benchmark. Under the multi-stage system, tax is applied to the sales of goods and services at all stages of the production and marketing chain. At each stage, however, businesses are generally able to claim tax credits to recover the tax they paid on their business inputs. In this way, the tax system has the effect of applying the tax only to the value added by each business. Since the only tax that is not refunded is the tax collected on sales to final consumers, the tax is imposed on final consumption.

(2) Destination-Based

The benchmark system applies tax only to goods and services consumed in Canada. Accordingly, the tax applies to imports as well as domestically produced goods and services. Exports are not subject to the tax.

(3) Single Tax Rate

The benchmark system has only one tax rate, which is 5 per cent in 2010.[3] As a result, GST provisions that depart from this single rate are considered to be tax expenditures.

(4) Taxation Period

The benchmark taxation period is the calendar year.

(5) Government Immunity From Taxation

As with the income tax benchmark, constitutional immunity from taxation is recognized as part of the benchmark system for the GST.

The benchmark also recognizes that the federal and provincial governments have taken steps to simplify the operation of the tax for transactions involving governments and their agents.

- The federal government decided to apply the GST to purchases by federal departments and Crown corporations in order to keep the tax as simple as possible for vendors. As a result, the GST and the benchmark system treat federal Crown corporations in the same manner as any other business entity.

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[2] The federal government and a number of participating provinces have replaced the GST and these provinces' retail sales taxes with the Harmonized Sales Tax (HST). The HST is applied in these provinces at a rate equal to the rate of GST plus a provincial component that varies by province. The GST still applies in non-participating provinces. For the purposes of this publication, reference to the GST includes the federal portion of the HST in the participating provinces.

[3] The GST was introduced in 1991 at a rate of 7 per cent. The rate was subsequently reduced to 6 per cent on July 1, 2006 and then again to 5 per cent on January 1, 2008.

- By virtue of section 125 of the Constitution Act, 1867, provincial governments and Crown agents are not liable to pay the GST on their purchases. However, the federal government and most provinces have entered into reciprocal tax agreements. These agreements specify situations in which each level of government agrees to pay the sales taxes of the other, and generally this involves applying tax to purchases made by Crown corporations. As a result, provincial Crown corporations are treated like any other business entity in the GST benchmark.

Unlike provincial governments, most universities, public colleges, schools and public hospitals are required to pay tax. Municipalities are also required to pay tax under the benchmark system but have been eligible for a full rebate since February 2004. The benchmark system distinguishes between two different situations when treating these sectors.

- The first situation is where these sectors provide public services that are completely funded through taxes or government transfers. In this situation, the benchmark system treats these sectors as final consumers—that is, they pay tax on their purchases and may not claim input tax credits (e.g. a public hospital is treated as the final consumer of the medical and other supplies that it purchases to provide health care services covered under provincial health insurance plans).
- The second situation is where these sectors sell goods and services to consumers and businesses. In this situation, the benchmark system treats these sectors just like any other business that applies tax to its sales and claims input tax credits for the tax paid on associated inputs (e.g. a public hospital that charges for certain treatments not covered under provincial health insurance plans is treated as a business for the purpose of these treatments).

The Benchmark for the GST

The essential features are:

- Basic structural features of a broadly based, multi-stage tax system;
- Destination approach;
- Single rate;
- Calendar year basis for the taxation period; and
- Recognition of constitutional immunity of Canada and the provinces from taxation.

Types of GST Tax Expenditures

Comparing the actual structure of the GST to the benchmark system, it is possible to identify four main types of tax expenditure:

- Zero-rated goods and services;
- Tax-exempt goods and services;
- Tax rebates; and
- The GST/HST Credit.

(1) Zero-Rated Goods and Services

Under the GST, certain categories of goods and services are taxed at a “zero” rate, rather than at the general tax rate of 5 per cent. Vendors do not charge GST on their sales of zero-rated goods and services (whether these sales are to other businesses or to final consumers). However, vendors are entitled to claim input tax credits to recover the full amount of GST they paid on inputs used to produce zero-rated products. As a result, zero-rated goods and services are tax-free.

One category of zero-rated sales is basic groceries—i.e. foods intended to be prepared and consumed at home. Other categories of zero-rated goods include prescription drugs, medical devices and most agricultural and fish products.

(2) Tax-Exempt Goods and Services

Some types of goods and services are exempt under the GST. This means that the GST is not applied to these sales. Unlike zero-rated goods and services, however, vendors of exempt goods and services are not entitled to claim input tax credits to recover the GST they paid on their inputs.

Examples of tax-exempt goods and services include long-term residential rents, most health and dental care services, day care services, most sales by charities, most domestic financial services, municipal transit and legal aid services.

(3) Tax Rebates

Certain sectors are eligible for rebates on all or a portion of the GST paid on inputs used in the provision of tax-exempt services. For example, as noted above, there are rebates for public service bodies (PSBs) such as schools, universities, public colleges, public hospitals and municipalities. These rebates were implemented when the GST was introduced to ensure that these institutions would not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax, which the GST replaced. These rebates are treated as tax expenditures because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates treated as tax expenditures include the rebates for charities, substantially government-funded non-profit organizations, newly built housing, new residential rental property and book purchases made by qualifying institutions. PSBs may qualify for more than one type of PSB rebate; for example, a hospital that undertakes charitable activities may be eligible to claim the hospital and the charity rebate for each of these activities. Since the rebate rates are different, it is more appropriate to calculate the tax expenditures for each activity separately rather than for the hospital as a single entity. This method does not affect the total cost of PSB rebates and results in a more accurate allocation among tax expenditure provisions.

(4) GST/HST Credit

To ensure that the GST system is fair, the GST/HST Credit is provided through the personal income tax system to single individuals and families with low and moderate incomes. The credit is paid by cheque four times a year in equal instalments. The total amount of the credit depends on family size and income and is calculated annually based on information provided in personal income tax returns.

Calculation of the Estimates

The majority of the personal income tax estimates are computed using the Department of Finance's personal income tax micro-simulation model. This model simulates changes to the personal income tax system, including for the purpose of calculating tax expenditures, using a stratified sample of individual tax returns collected by the Canada Revenue Agency (CRA). The model estimates the revenue impact of possible tax changes by recomputing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the Moving Expense Deduction would result in a change not only in net income but also in all of the credits, such as the Medical Expense Tax Credit, whose values depend on net income. For those tax expenditures

whose costs could not be estimated using this model alone, supplementary data were acquired from a variety of sources. Details on data sources and the methodologies used for estimating the cost of specific personal income tax measures are provided in Chapter 2.

A corporate income tax model is used to measure most of the corporate income tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by the CRA and is able to recompute taxes payable on the basis of adjusted tax provisions. This recomputation of taxes takes into account the availability of unused tax credits, tax reductions, tax deductions and losses that would be used by corporations to minimize their tax liability. Where costs could not be estimated using this model alone, supplementary data acquired from a variety of sources were used. Details on these sources are provided in Chapter 3.

Deferrals Estimated on Nominal Cash-Flow Basis

Certain tax measures defer income taxes from the current taxation year to a later one—for example, by accelerating deductions or by deferring income inclusions. Estimating the cost of tax deferrals presents a number of methodological difficulties since, even though the tax is not currently received, it may be collected at some point in the future. It is therefore necessary to derive estimates of the cost to the Government of providing such a tax deferral while at the same time ensuring comparability with the other tax expenditure estimates.

Income tax deferrals are estimated on a nominal cash-flow basis—that is, the cost is the extent to which tax revenue is lower in the particular year as a result of deferrals associated with transactions in that year and previous years. The estimates thus computed provide a picture of the ongoing cost of maintaining a particular tax provision in a mature tax system.

On a nominal cash-flow basis, deferred income taxes from current-year activities represent a positive tax expenditure while income taxes on previous-year activities for which the deferral has been completed are a negative tax expenditure. Thus, if the level of activity in question were constant from year to year, in a steady state the two amounts would cancel each other out and the tax expenditure would be zero. An increase over time in the level of activity would tend to produce a positive tax expenditure, while a decrease would tend to produce a negative tax expenditure.

While the cash-flow basis of measurement suggests that, in a steady state, there is no overall cost to the Government from deferrals, there is indeed a cost to the Government and a benefit to the taxpayer. Because of the time value of money, a reduction in tax of a given amount today more than offsets a tax increase of the same nominal amount in a future period. This can be demonstrated with a calculation of the value of the implicit interest-free loan that is provided to the taxpayer when taxes are deferred to a later year. For example, if a taxpayer is able to defer $100 in income tax for one year, and the discount rate is 8 per cent, then the present value of the future obligation is $92.59 and the taxpayer has received a benefit of $7.41 in today's dollars. There is an equivalent implicit interest cost to the Government.

Unlike the cash-flow basis, under this approach, in a steady state, a tax deferral would result in a positive tax expenditure. With the exception of tax-assisted retirement savings plans and an illustration of the impact of accelerated write-offs for capital expenses, this publication does not provide present-value estimates of tax expenditures.

Almost two-thirds of the GST tax expenditures that can be reliably estimated are derived using administrative data obtained from the CRA. Most of the remaining estimates are calculated using the Goods and Services Tax Model, which was developed using data from Statistics Canada's Input-Output Tables and the National Income and Expenditure Accounts. The amount of detail available in these data sets permits identification of the tax status (i.e. zero-rated, exempt, rebated) of finely defined expenditure categories. Where estimates could not be derived using administrative data or the model, supplementary data from a variety of sources were used. Where estimates are not based on CRA data, details on these sources are provided in Chapter 4.

Delays in the availability of data mean that some of the values developed for the historical period are in fact projections based on estimated relationships between tax expenditures and (in most cases) historical data for explanatory economic variables. For personal and corporate income tax expenditures, there is a lag in data availability of two years while for GST tax expenditures (for those based on administrative data) the lag is one year. For GST tax expenditure figures that are estimated using the Goods and Services Tax Model, the lag is three to four years due to the lack of availability of input-output data. The values shown for the publication year of the document are derived from forecasts of explanatory variables, which are taken from either the most recent federal budget or economic and fiscal update forecast (e.g. gross domestic product, population, employment, corporate profits, inflation and consumer spending) or from forecasts from third-party sources.

Where projected tax expenditures are not obtained using these approaches, information on the alternative methodology is provided in Chapter 2 for personal income tax, Chapter 3 for corporate income tax and Chapter 4 for GST tax expenditures.

The projected values shown in the tables are inherently subject to forecast errors as they are based on historical data and assumptions on expected economic outcomes. As a result, the projected values of tax expenditures may be revised substantially as more recent data become available.

Interpretation of the Estimates

The estimates indicate the annual cash-flow impact—not time discounted—of each measure on the Government, and not their long-run or steady-state revenue cost, subject to the following limitations:

- All measures are evaluated independently; and
- All other factors remain unchanged.

These methodological distinctions are important and have implications for the interpretation of the estimates. These concepts are discussed in further detail below.

Independent Estimates

The estimate of the cost of each tax expenditure is undertaken separately, assuming that all other tax provisions remain unchanged. Consequently, aggregating the cost of individual measures often provides a biased estimate of the total cost of a particular group of tax expenditures or of all tax expenditures combined.

As explained in more detail in the following paragraphs, this restriction arises from the fact that:

- The income tax rate structure is progressive; and
- Tax measures interact with one another.

Progressive Income Tax Rates

The combined effect of claiming a number of income tax exemptions and deductions may be to move an individual to a lower tax bracket than would have applied had none of the tax measures existed. To the extent that this occurs, aggregation of the individual estimates may under-represent the "true" cost to the federal government of maintaining all of them. For example, consider a taxpayer whose taxable income was $1,000 below the level at which he or she would move from the 15-per-cent into the 22-per-cent tax bracket. Imagine that this taxpayer arrives at this level of taxable income by using two tax deductions of $1,000 each (e.g. the deductions for home relocation loans and for Registered Retirement Savings Plan contributions). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $150. Eliminating both measures simultaneously, however, would not raise the tax liability by $150 + $150, but rather by $150 + $220. Non-refundable personal income tax credits can have a similar impact: some low-income taxfilers may need to use only one of several credits available to reduce their tax liability to zero. As a result, in some cases, the revenue gain obtained from eliminating such credits one by one would be zero but their combined effect would be positive.

While there is only one statutory tax rate for corporations, the low tax rate for small business creates a de facto progressive tax rate schedule for some corporations. In this way, the above argument is valid for the corporate income tax system as well, although the effect would be substantially smaller than for personal income taxes.

Interaction of Tax Measures

As noted above, the estimates are computed one at a time, assuming all other provisions remain unchanged. Given that tax provisions sometimes interact, the total cost of a group of tax expenditures calculated individually may differ from the total cost of the same group of tax expenditures calculated concurrently. This is because adding the independently estimated costs of the tax provisions could result in double counting and so would not provide an accurate measure of the revenue that would be generated by simultaneously altering a group of measures.

A good example is the interaction of GST exemptions and rebates. As discussed above, a number of services that are provided in a non-commercial context are exempt from GST, and institutions providing the services are eligible for rebates on GST paid on their purchases. Although the exemptions and rebates are presented as two different tax expenditures, they are not independent.

- If one of these exemptions were repealed, an implicated institution would charge GST on its supplies and receive input tax credits. The institution would no longer require rebates since all the tax on its purchases would be relieved by the input tax credits, effectively repealing the related rebate as well.
- Adding the two measures to estimate the total relief would therefore overstate the amount of tax relief by the amount of the rebates.

Aggregation of Estimates

Adding the estimates for individual tax expenditures does not provide an accurate measure of the cost of a group of tax expenditures. There are two reasons for this:

- The simultaneous elimination of more than one personal income tax expenditure would generate larger estimates because of progressive income tax rates; and
- Given the interaction of certain tax measures, the revenue impact of eliminating two or more measures simultaneously would differ from taking the independently estimated numbers published in this document and aggregating them.

Federal-Provincial Interaction

The federal and provincial income tax and sales tax systems interact with each other to various degrees. As a result, changes to tax measures in the federal system may have consequences for provincial tax revenues. In this publication, however, any such provincial effects are not taken into account—that is, the tax expenditure estimates address federal revenue only.

All Other Factors Remain Unchanged

The estimates represent the amount by which federal tax revenues are reduced due to the existence of each preference, assuming that all other factors remain unchanged.

In order to evaluate the extent of the revenue reduction, the approach taken here is to recalculate federal revenues assuming the measure in question has been eliminated. The difference between this recalculated amount and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain unchanged means that no allowance is made for: (1) behavioural responses by taxpayers; (2) consequential government policy changes; or (3) changes in tax collections due to altered levels of aggregate economic activity that might result from the elimination of a particular tax measure (further detail is provided below). Incorporating these factors would add a large subjective element to the calculations.

(1) Absence of Behavioural Responses

In many instances, the removal of a tax expenditure would cause taxpayers to change their behaviour to minimize the amount of extra tax they would have to pay.[4] Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates that may exceed the revenue increases that would result if a particular provision were eliminated.

The effects of this assumption can be illustrated for the GST by considering the housing rebate. Homeowners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate were eliminated, the cost of new houses would increase relative to the cost of used houses. This, in turn, might reduce the demand for new houses while increasing the demand for used houses (which are tax-exempt). Since the dynamics of the housing market are not taken into account, the revenues obtained by eliminating the housing rebate could actually be lower than the indicated estimate.

[4] As discussed above, however, the estimates are calculated assuming that, in response to the elimination of a tax expenditure, taxpayers minimize their tax liabilities for a given level of income by making greater use of available unused tax benefits such as discretionary deductions and credits, loss carry-forwards, etc.

(2) Consequential Government Policy Changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and do not take into account other consequential changes in government policy. For example, if the Government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates do not provide for any such transitional relief.

(3) Impact on Economic Activity

The estimates do not take into account the potential impact of a particular tax provision on the overall level of economic activity and thus aggregate tax revenues. For example, although eliminating a particular tax expenditure could generate revenue for the Government, it could also affect the level of economic activity. This in turn could cause a further change in the amount of tax revenue collected. Furthermore, the estimates do not include assumptions about how the Government might use the additional funds available to it and the possible impacts this could have on other tax revenues.

How to Interpret the Estimates

Each estimate represents the federal tax revenue forgone due to a given tax expenditure, everything else being equal. The estimates do not take into account changes in taxpayer behaviour, consequential government actions or impacts on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full amount of revenues shown in *Tax Expenditures and Evaluations.*

Chapter 2

Description of Personal Income Tax Provisions

Charitable Donations and Political Contributions

Charitable Donations Tax Credit

> ***Objective:*** *This measure is designed to support the important work of the charitable sector in meeting the needs of Canadians. (Report of the Royal Commission on Taxation, Vol. 3, 1966; Tax Reform 1987)*

A tax credit is available for charitable donations. The value of the credit is calculated by applying the lowest personal income tax rate (15 per cent in 2010) to the first $200 of total donations in a year and the highest personal income tax rate (29 per cent in 2010) to donations in excess of $200. In general, the credit may be claimed on donations totalling up to 75 per cent of net income. The percentage of income restriction does not apply to certain gifts of cultural property or ecologically sensitive land and in certain other circumstances, such as a gift made in the taxpayer's year of death. Donations in excess of the limit may be carried forward for up to five years.

Reduced Inclusion Rate for Capital Gains on Donations of Publicity Listed Securities to Registered Charities

> ***Objective:*** *This measure was introduced to facilitate the transfer of certain publicly listed securities to charities to help them respond to the needs of Canadians. (Budget 1997)*

Budget 1997 introduced, on a temporary basis, a 50-per-cent reduction in the ordinary inclusion rate on capital gains arising from certain donations of eligible securities to charities (other than private foundations). Eligible securities qualifying for this treatment are those for which a current value can readily be obtained, generally securities that are traded publicly on a prescribed stock exchange. Budget 2000 provided parallel treatment of gifts of shares acquired through employee stock option plans. The half inclusion rate measure was made permanent in 2001. The inclusion rate was then reduced to zero in Budget 2006, and Budget 2007 extended these provisions to include donations of eligible securities to private foundations. Budget 2008 further extended these provisions to certain exchangeable securities, where the securities acquired on the exchange are themselves eligible for a capital gains exemption and are donated to a registered charity within 30 days of the exchange.

A parallel measure applies to corporations.

Reduced Inclusion Rate for Capital Gains on Donations of Ecologically Sensitive Land to Public Charities

> ***Objective:*** *This measure was introduced to enhance the incentives for the protection of Canada's ecologically sensitive land, including areas containing habitat for species at risk. (Budget 2000)*

Since 2000, donations to approved conservation charities of ecologically sensitive land, or easements, covenants and servitudes on such land, have been eligible for special tax assistance. Under the Ecological Gifts Program, in addition to the Charitable Donations Tax Credit available to a donor of ecologically sensitive land to a conservation charity, there is a reduced inclusion rate for a capital gain that has accrued on the land in calculating the donor's income. The capital gains inclusion rate for

donations of ecologically sensitive land made on or after May 2, 2006, is zero. For donations made before May 2, 2006, the capital gain that accrued on the ecologically sensitive land was included in income at one-half the standard capital gains inclusion rate (i.e. 25 per cent).

A parallel measure applies to corporations.

Non-Taxation of Capital Gains on Donations of Cultural Property

> ***Objective:*** *This provision encourages the donation to designated institutions (such as museums and art galleries) of cultural property determined to be of outstanding significance to Canada's national heritage. (Budget 1998)*

Certain objects certified by the Canadian Cultural Property Export Review Board as being of cultural importance to Canada are exempt from capital gains tax if donated to a designated museum or art gallery. Recipient organizations are required to hold the objects for a minimum of 10 years.

A parallel measure applies to corporations.

Political Contribution Tax Credit

> ***Objective:*** *This provision is intended to ensure that registered political parties have a broad base of financial support. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

A tax credit is available for contributions to registered federal political parties, candidates and registered electoral district associations.

Since 2004, the Political Contribution Tax Credit has been set at 75 per cent of the first $400 contributed, 50 per cent of the next $350 contributed, and 33⅓ per cent of the next $525 contributed. The maximum credit is $650 and is available when the taxpayer has contributed $1,275.

Culture

Assistance for Artists

> ***Objective:*** *The special treatment of costs incurred by artists recognizes artists' problems in valuing their works of art on hand, attributing costs to particular works, and carrying inventories over long periods of time. The special election with respect to a charitable gift from an artist's inventory removes an obstacle to artists donating their works of art to charities, public art galleries and other public institutions. (Budget Papers, 1985)*

Some artists who are self-employed may deduct the costs of creating a work of art in the year the costs are incurred rather than in the year the work of art is sold.

Artists may also elect to value a charitable gift from their inventories at any amount up to its fair market value. This value is included in the artist's income. The percentage of income limit for the Charitable Donations Tax Credit does not apply.

No data are available.

Deduction for Artists and Musicians

> ***Objective:*** *The deductibility of certain expenses incurred by artists and musicians recognizes that these expenses are necessary to carry on employment in those fields. (Musical Instruments: Income Tax Reform, 1987)*

General recognition of employees' work-related expenses in the income tax system is provided on a limited basis through the Canada Employment Credit. In addition, specific recognition is provided for extraordinary work-related expenses incurred by certain occupations.

In this regard, employed musicians are able to claim the cost of maintenance, rental, insurance and capital cost allowance on musical instruments against employment income earned as a musician. Employed artists are also entitled to deduct expenses related to their artistic endeavours up to the lesser of $1,000 or 20 per cent of their income derived from employment in the arts.

No data are available.

Education

Adult Basic Education—Tax Deduction for Tuition Assistance

> ***Objective:*** *This measure provides assistance to adults undertaking basic education courses as part of a government training program. (Budget 2001)*

In computing their taxable income, individuals may deduct the amount of tuition assistance received for adult basic education or other programs that do not qualify for the Tuition Tax Credit, to the extent that this assistance has been included in their income. In order to be eligible, the tuition assistance must be provided under:

- Part II of the Employment Insurance Act (or a similar program provided by a province or territory under a Labour Market Development Agreement); or
- Another training program established under the authority of the Minister of Human Resources and Skills Development, such as the Multilateral Framework for Labour Market Agreements for Persons with Disabilities or the Opportunities Fund for Persons with Disabilities.

This measure was made retroactive to 1997 and subsequent taxation years.

Apprentice Vehicle Mechanics' Tools Deduction

> ***Objective:*** *This measure recognizes that apprentice vehicle mechanics have reduced ability to pay tax relative to other taxpayers with the same income due to the extraordinary portion of the cost of new tools they have to provide as a condition of their employment. (Budget 2001; Budget 2007)*

Since 2002, registered apprentice vehicle mechanics have been able to deduct the extraordinary portion of the cost of new tools they purchase in the taxation year or in the last three months of the previous taxation year if the apprentice is in his or her first year. For 2007 and subsequent taxation years, the extraordinary tool costs are those that exceed either the combined value of the deduction for tradespeople's tool expenses ($500) and the Canada Employment Credit ($1,051 in 2010) or 5 per cent of the taxpayer's income, whichever is greater.

Education Tax Credit

> ***Objective:*** *This measure provides assistance to students by recognizing non-tuition costs associated with full- and part-time education. (Budget Supplementary Information, 1972; Budget Plan, 1998)*

Students who are enrolled in post-secondary education or occupational training certified by the Minister of Human Resources and Skills Development are entitled to claim a tax credit. The value of the credit is calculated by applying the lowest personal income tax rate to the monthly education amount. For full-time students the education amount is $400 per month of study, and for part-time students the amount is $120 per month.

Textbook Tax Credit

> ***Objective:*** *This measure provides better tax recognition for the cost of textbooks for post-secondary students. (Budget 2006)*

Students who are enrolled in post-secondary education or occupational training certified by the Minister of Human Resources and Skills Development are entitled to claim a tax credit in recognition of the costs of post-secondary textbooks. The value of the credit is calculated by applying the lowest personal income tax rate to a monthly amount. For full-time students the amount is $65 per month of study, and for part-time students the amount is $20 per month.

Tuition Tax Credit

> ***Objective:*** *This measure provides tax relief to students by recognizing the costs of enrolling in qualifying programs or courses. (Budget Speech, 1960)*

A tax credit is available for tuition fees for post-secondary education and occupational training certified by the Minister of Human Resources and Skills Development. A credit is available for all tuition fees paid, if the total tuition fees exceed $100. The credit also applies to most mandatory ancillary fees imposed by post-secondary institutions. The applicable credit rate is equal to the lowest personal income tax rate.

Transfer of Education, Textbook and Tuition Tax Credits

> ***Objective:*** *This measure increases the availability of tax assistance for education, and acknowledges the significant contributions made to students by supporting individuals. (Income Tax Reform, 1987)*

The unused amounts from the Education, Textbook and the Tuition Tax Credits may be transferred to a supporting spouse, parent or grandparent. The maximum transfer for the three amounts is $5,000.

Carry-Forward of Education, Textbook and Tuition Tax Credits

> ***Objective:*** *Combined with the provision for transfer of the Education, Textbook and Tuition Tax Credits, this measure ensures that students can use these credits fully, whether they have supporting individuals or not. (Budget 1997; Budget 2006)*

Students are able to carry forward indefinitely, to reduce future tax payable, education, textbook and tuition fee amounts that have not been either already used by the student or transferred to a supporting individual, effective in 1997.

Exemption of Scholarship, Fellowship and Bursary Income

> ***Objective:*** *This measure encourages Canadians to experience exceptional education opportunities by providing additional tax assistance to students. (Summary of 1971 Tax Reform Legislation, 1971; Budget 2006; Budget 2007)*

From 1972 to 1999, the first $500 of scholarship, fellowship and bursary income was exempt from income tax. Budget 2000 provided a $3,000 tax exemption for amounts received in connection with a student's enrolment in post-secondary education or certified occupational training programs eligible for the Education Tax Credit. Budget 2006 removed the $3,000 limit to establish a full exemption for post-secondary scholarships, fellowships and bursaries. Budget 2007 extended this full exemption to scholarships, fellowships and bursaries received by elementary and secondary school students.

Registered Education Savings Plans

> ***Objective:*** *Tax assistance for education savings plans broadens access to higher education by encouraging Canadians to save towards the post-secondary education of children. (Budget 1998)*

A taxpayer may contribute to a Registered Education Savings Plan (RESP) on behalf of a designated beneficiary (usually the taxpayer's child). Contributions to RESPs are not deductible, but the investment return on these funds is not taxable until they are withdrawn for the education of the named beneficiary. They are then taxed in the hands of the student. This tax deferral constitutes the tax expenditure associated with RESPs. The lifetime RESP contribution limit is $50,000 per beneficiary, increased from $42,000 in 2007.

In addition, the Government of Canada supplements RESP savings with a Canada Education Savings Grant (CESG) of 20 per cent on the first $2,500 of contributions annually for each beneficiary, to a lifetime maximum grant of $7,200. Budget 2004 introduced the Canada Learning Bond (CLB) for children in low-income families and an enhanced CESG for low- and middle-income families. While the CLB and the CESG are not tax expenditures, they increase the cost of the tax expenditure to the extent that they encourage increased use of RESPs.

When RESP beneficiaries do not pursue higher education, RESP subscribers can withdraw the investment income from their plan either as a direct payment or as a tax-free transfer to a Registered Retirement Savings Plan (RRSP). The investment income received directly is subject to regular tax plus an additional tax of 20 per cent, while the amount transferred to an RRSP is subject to the availability of RRSP contribution room.

Estimates are based on the data and projections from the CESG program.

Student Loan Interest Credit

> ***Objective:*** *This measure is designed to recognize the costs of investing in higher education, and to help ease the burden of student loans. (Budget 1998)*

A tax credit is available for interest payments on loans approved under the Canada Student Loans Program and similar provincial programs, and may be claimed in the year in which the credit is earned or in any of the subsequent five years, effective for 1998 and subsequent years. The value of the credit is calculated by applying the lowest personal income tax rate to the interest payments.

Employment

Canada Employment Credit

> ***Objective:*** *This credit provides tax recognition of work-related expenses incurred by employees. (Budget 2006)*

The Canada Employment Credit took effect July 1, 2006. The value of the credit is calculated by applying the lowest personal income tax rate to the lesser of $1,051 (in 2010) and the individual's employment income for the year. This maximum amount is indexed to inflation.

Child Care Expense Deduction

> ***Objective:*** *This provision recognizes the child care costs incurred by single parents and two-earner families in the course of earning business or employment income, pursuing education or performing research. (Budget 1992; Budget 1998)*

Child care expenses incurred for the purpose of earning business or employment income, taking an occupational training course, pursuing education or carrying on research for which a grant is received are deductible, up to a limit. The deduction may not exceed the lesser of $10,000 for a child eligible for the Disability Tax Credit, $7,000 per child under age 7, and $4,000 per child between 7 and 16 years of age, or older, if infirm; two-thirds of earned income for the year (not applicable to single-parent students); and the actual amount of child care expenses incurred.

The spouse with the lower income must generally claim the deduction. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or a wheelchair, in prison or attending a designated educational institution on a full-time basis.

Deduction for Income Earned by Military and Police Deployed to High-Risk International Missions

> ***Objective:*** *This measure provides special recognition for Canadian Forces personnel and police serving on high-risk international missions. (Budget 2004)*

For 2004 and later years, members of the Canadian Forces or a Canadian police force who serve on operational missions that are assessed for risk allowance level 3 or higher, or a prescribed mission that is assessed for risk allowance level 2 (risk levels as determined by the Department of National Defence), may claim an offsetting deduction for their income earned while serving on the mission, to

the extent that this employment income is included in income. The deduction is capped at the highest amount of income payable to a non-commissioned member of the Canadian Forces during the time of the mission.

Estimates are based on data from the Department of National Defence and the Royal Canadian Mounted Police on the number of individuals serving on eligible missions and their average income.

Deduction of Home Relocation Loans

Objective: *This deduction is intended to facilitate labour mobility by allowing employers to compensate relocated employees facing higher housing costs at the new location. (Budget 1985)*

An offsetting deduction from taxable income is provided for the benefit received by an employee in respect of a home relocation loan. The amount of the deduction is the deemed interest benefit on the first $25,000 of a low interest loan.

Deduction of Other Employment Expenses

Objective: *This provision provides tax recognition for certain expenses incurred for the purpose of earning employment income.*

Specific employment expenses (e.g. automobile expenses, cost of meals and lodging for certain transport employees, legal expenses paid to collect salary) are deductible in certain circumstances when calculating employment income.

Deduction for Tradespeople's Tool Expenses

Objective: *This measure provides tax recognition for the extraordinary cost of tools that tradespeople must provide as a condition of employment. (Budget 2006)*

This deduction allows tradespeople to deduct up to $500 of the total cost of eligible tools acquired in a taxation year that exceeds the amount of the Canada Employment Credit ($1,051 in 2010). For the cost of tools to qualify for the deduction, the employer must certify that the employee is required to acquire those tools as a condition of, and for use in, the employment. This measure applies to new tools acquired on or after May 2, 2006.

Deduction of Union and Professional Dues

Objective: *This measure provides tax recognition of these mandatory employment-related expenses.*

Union and professional dues are fully deductible from employment income.

Deferral of Salary Through Leave of Absence/Sabbatical Plans

Objective: *This provision recognizes that the main purpose behind these plans is to provide in advance for extended leaves of a sabbatical nature within the employment relationship, and not the deferral of taxes. (Budget 1986)*

Employees may be entitled to defer salaries through a leave of absence/sabbatical plan. Provided certain conditions are met by the plan, these amounts are not subject to tax until received.

No data are available.

Disability Supports Deduction

Objective: *This provision recognizes the costs incurred by taxpayers with disabilities for disability supports required to enable them to earn business or employment income or to attend school. In so doing, the provision increases equity between able-bodied earners and those who incur additional expenses owing to a disability. (Budget 1989; Budget 2000; Budget 2004)*

Prior to 2004, taxpayers eligible for the Disability Tax Credit (DTC) who required attendant care in order to earn business or employment income or, after 2000, to attend a designated educational institution or a secondary school, were able to deduct the cost of that care under the attendant care deduction. Budget 2004 replaced the attendant care deduction with a broader disability supports deduction, which recognizes attendant care as well as other disability supports expenses incurred for education or employment purposes, unless they have been reimbursed by a non-taxable payment (e.g. insurance payment). Individuals do not have to be eligible for the DTC in order to claim the deduction. In the case of an employee, the deduction is generally limited to the lesser of the amounts paid for eligible expenses and the taxpayer's earned income. A similar limit also applies to students, except that they can claim the deduction against non-earned income, subject to the length of their education program.

Expenses claimed under the disability supports deduction are not claimable under the Medical Expense Tax Credit (METC). Persons who purchase disability supports for purposes other than education or employment are still able to claim them under the METC.

Employee Benefit Plans

Objective: *This provision improves access to employee benefit plans. (Budget 1979; Budget 1986)*

In certain circumstances, employers may make contributions to an "employee benefit plan" on behalf of their employees. The employee is not required to include in income the contributions to the plan or the investment income earned within the plan until amounts are received. Employers may not deduct these contributions to the plan until the contributions are distributed to the employees.

The preferential tax treatment under these plans is available only in certain circumstances where an employee's right to income under a plan has not been fully earned, or where the main purpose behind the plan is to provide incentives and not the deferral of tax.

Since contributions to employee benefit plans are deductible by the employer in the year they are included in the taxable income of the employee, only the deferral of tax on the investment income constitutes a tax expenditure.

No data are available.

Employee Stock Option Deduction

Objective: *This measure encourages employee participation in the ownership of the employer's business, and assists businesses in their efforts to attract and retain highly skilled employees. (Budget 1977)*

When individuals acquire company shares under an employee stock option plan, they are deemed to have received a taxable benefit from employment equal to the difference between the fair market value of the shares at the time they are acquired and the amount paid to acquire them.

Provided certain conditions are met, individuals may deduct one-half of the employment benefit earned on employee stock options from income for tax purposes, thereby benefiting from the same effective tax rate that investors receive on capital gains. The deduction is generally available for options on common shares issued to arm's-length employees, where the price at which the option can be exercised is equal to or greater than the fair market value of the underlying share at issuance.

Moving Expense Deduction

Objective: *This provision facilitates labour mobility by allowing taxpayers greater flexibility in pursuing new employment and business opportunities anywhere in Canada. (Budget Speech, 1971; Budget 1998)*

Most reasonable moving expenses incurred to earn employment or self-employment income at a new location (e.g. transportation, meals and temporary accommodation, cost of selling a former residence) are deductible from earnings or business income received after the move if the taxpayer moves at least 40 kilometres closer to the new place of employment or study. The deduction has to be claimed in the year of the move or in the following year if it exceeds earnings at the new location in the year of the move.

Most moving expense reimbursements provided by employers are not included in income; however, to the extent that certain employer-provided reimbursements are included in income, an offsetting deduction is allowed to the same extent as permitted for self-paid expenses. The estimates do not include non-taxable reimbursements received from employers.

Non-Taxation of Certain Non-Monetary Employment Benefits

Objective: *This treatment recognizes the significant administrative and compliance costs that would be incurred in taxing non-monetary employment benefits.*

Fringe benefits provided to employees by their employers are not taxed when it is not administratively feasible to determine the value of the benefit. Examples include merchandise discounts, subsidized recreational facilities offered to all employees and special clothing.

No data are available.

Non-Taxation of Strike Pay

> ***Objective:*** *Strike pay is non-taxable by virtue of the Supreme Court of Canada's determination that it is not income from a source. (Wally Fries v. The Queen, [[1990] 2 CTC 439] (90 DTC 6662)*

Since union dues are deductible from income for tax purposes, non-taxation of strike pay is considered a tax expenditure.

No data are available.

Northern Residents Deductions

> ***Objective:*** *These tax measures assist in drawing skilled labour to northern and isolated communities. (Budget 1986; Budget 2008)*

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions. These consist of a residency deduction of up to $16.50 a day, a deduction for two employer-provided vacation trips per year and unlimited employer-provided medical travel. Residents of the Northern Zone are eligible for the full deductions, while residents of the Intermediate Zone are eligible for 50 per cent of the deductions. In 2008, the maximum daily residency deduction was increased by 10 per cent from $15.00 to $16.50.

Overseas Employment Credit

> ***Objective:*** *This measure promotes the competitive international position of Canadian companies undertaking work outside Canada on specified business activities by offering tax treatment comparable to that provided by other countries. (Budget 1983)*

A tax credit is available to Canadian employees working abroad for more than six months in connection with certain resource, construction, installation, agricultural or engineering projects. The credit is equal to the tax otherwise payable on 80 per cent of the employee's net overseas employment income taxable in Canada, up to a maximum income of $80,000.

Tax-Free Amount for Emergency Service Volunteers

> ***Objective:*** *This measure assists small and rural communities, which are often unable to maintain full-time emergency staffs and depend on the services of volunteers. (Budget 1998)*

An exemption of up to $1,000 is available for amounts received by emergency service volunteers who, in their capacity as volunteers, are called upon to assist in emergencies or disasters.

Working Income Tax Benefit

> ***Objective:*** *This measure improves incentives to work for low-income Canadians and lowers the welfare wall. (Budget 2007; Budget 2009)*

The Working Income Tax Benefit (WITB) is a refundable tax credit that supplements the earnings of low-income workers to encourage labour force participation. It is generally available to individuals 19 years of age and older not attending school full-time.

When introduced in 2007, the WITB provided a refundable tax credit equal to 20 per cent of each dollar of earned income in excess of $3,000 to a maximum credit of $500 for single individuals without dependants and $1,000 for families (couples and single parents). Budget 2009 enhanced the tax relief provided by the WITB for the 2009 and subsequent taxation years, effectively doubling the total tax relief provided by the WITB. The enhanced WITB provides up to $925 per year to single individuals and up to $1,680 per year to couples and single parents. An additional WITB supplement of up to $462 is provided to persons eligible for the Disability Tax Credit.

Provincial and territorial governments can propose specific changes to the design of the WITB, subject to some conditions, including cost-neutrality. These conditions are identified in Budgets 2007 and 2009. As of the 2009 taxation year, Quebec, British Columbia, Alberta and Nunavut have introduced jurisdiction-specific WITB designs.

Family

Adoption Expense Tax Credit

> ***Objective:*** *This provision provides tax recognition to parents for costs that are unique to the decision to adopt a child. (Budget 2005)*

The Adoption Expense Tax Credit provides tax recognition to adoptive parents for the exceptional costs that are unique to the decision to adopt a child. Adoptive parents may claim a range of eligible expenses including, among others, adoption agency fees, legal expenses, and travel and living expenses for themselves and the child. These expenses may be incurred for domestic adoptions or for a child adopted from outside of Canada.

The value of the Adoption Expense Tax Credit is calculated by applying the lowest personal income tax rate to eligible adoption expenses for the completed adoption of a child under the age of 18. For the 2010 taxation year, the maximum eligible adoption expense claimable is $10,975 per child. The maximum amount is indexed to inflation.

Caregiver Credit

> ***Objective:*** *This provision recognizes that individuals providing in-home care for elderly or infirm family members have reduced ability to pay tax compared to other taxpayers with similar income. (Budget 1998)*

The Caregiver Credit provides tax relief to individuals providing in-home care for a parent or grandparent 65 years of age or over, or an infirm adult dependent relative, including a child or grandchild 18 years of age or over, brother, sister, aunt, uncle, niece or nephew. The amount the supporting relative can claim depends on the net income of the dependant.

The value of the Caregiver Credit is calculated by applying the lowest personal income tax rate to the amount per eligible dependant ($4,223 in 2010). The credit is reduced when the dependant's net income exceeds $14,422 (in 2010) and is fully phased out when his/her income reaches $18,645 (in 2010). Both the credit amount and the income threshold at which the credit starts to be reduced are indexed to inflation.

Child Tax Credit

> ***Objective:*** *To reduce the tax burden on families with children. (Budget 2007)*

The Child Tax Credit is a non-refundable tax credit based on an amount ($2,101 in 2010) for each child under the age of 18 years at the end of a taxation year. This amount is indexed to inflation. The value of the Child Tax Credit is calculated by applying the lowest personal income tax rate to the amount, which provides tax relief of up to $315 per child in 2010.

Only one parent may claim the credit in a year for a qualified dependant, but any unused portion of the credit may be transferred to a spouse or common-law partner.

Deferral of Capital Gains Through Transfers to a Spouse, Spousal Trust or Family Trust

> ***Objective:*** *This deferral recognizes that it is not always appropriate to treat a transfer of assets between spouses as a disposition for income tax purposes, and therefore allows families flexibility in structuring their total assets. (Budget Speech, 1971; Budget 1995)*

When a property is transferred to another person, capital gains are generally considered to be realized at the time of the transfer on the basis of the fair market value of the property at that time. However, if an individual transfers capital property to a spouse, spousal trust or family trust, the capital property is deemed to have been disposed of by the individual at its adjusted cost base (or at the undepreciated capital cost in the case of depreciable property), and to have been acquired by the spouse or trust for an amount equal to those deemed amounts. This treatment effectively provides a deferral of the taxable capital gain until the disposition of the property by the spouse or until the transferee spouse dies.

No data are available.

Infirm Dependant Credit

> ***Objective:*** *This measure recognizes that a taxpayer supporting an adult dependant who is physically or mentally infirm has a reduced ability to pay tax relative to a taxpayer with the same income and no such dependant. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

The Infirm Dependant Credit provides tax relief to individuals providing support to an infirm adult relative. More specifically, the credit may be claimed by taxpayers supporting a child or grandchild 18 years of age or over, a parent, grandparent, brother, sister, aunt, uncle, niece or nephew who is dependent due to a mental or physical infirmity.

The amount the supporting relative can claim depends on the net income of the dependant. The value of the Infirm Dependant Credit is calculated by applying the lowest personal income tax rate to the infirm dependant amount ($4,223 in 2010). The credit is reduced when the dependant's net income exceeds $5,992 (in 2010) and is fully phased out when his or her income reaches $10,215 (in 2010). Both the credit amount and income threshold at which the credit starts to be reduced are indexed to inflation.

Spouse or Common-Law Partner Credit

Objective: *This credit recognizes that a taxpayer whose spouse or common-law partner has little or no income has a reduced ability to pay tax relative to a single taxpayer with the same income. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

A taxpayer supporting a spouse or common-law partner is entitled to a non-refundable tax credit, the value of which is calculated by applying the lowest personal income tax rate to the spousal/common-law partner amount. In 2010, this amount is $10,382; this amount is indexed to inflation. The credit is reduced dollar-for-dollar by the dependent spouse's or common-law partner's net income.

Eligible Dependant Credit

Objective: *This credit recognizes that a taxpayer without a spouse or common-law partner who is supporting a dependent young child, parent or grandparent or other dependent relative due to mental or physical infirmity has a reduced ability to pay tax relative to a taxpayer with the same income and no such dependant. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

An "equivalent-to-spouse" tax credit may be claimed in respect of a dependent child under age 18, a parent or grandparent, or a relative who is wholly dependent due to physical or mental infirmity by taxpayers without a spouse or common-law partner. The value of the credit is calculated by applying the lowest personal income tax rate to the eligible dependant amount. In 2010, this amount is $10,382, and the credit is reduced dollar-for-dollar by the dependant's net income. This amount is indexed to inflation.

Inclusion of the Universal Child Care Benefit in the Income of an Eligible Dependant

Objective: *This provision is intended to give single parents comparable tax treatment on the same Universal Child Care Benefit amounts as single-earner two-parent families with the same income. (Budget 2010)*

Introduced in Budget 2006, the Universal Child Care Benefit (UCCB) provides families with $100 a month for each child under the age of six. In two-parent families, the UCCB is included in the income of the lower-income spouse or common-law partner. In the case of a single-parent family, the UCCB is generally included in the single parent's income and taxed at his or her marginal tax rate.

Budget 2010 provided single parents the option of including the aggregate UCCB amount received, in respect of all of his or her children, in their income or in the income of the dependant for whom an Eligible Dependant Credit is claimed. In most cases, the dependant would not be subject to tax. If a single parent is unable to claim an Eligible Dependant Credit, he or she has the option of including the aggregate UCCB amount in the income of one of the children for whom the UCCB is paid.

Farming and Fishing

Lifetime Capital Gains Exemption for Farm and Fishing Property

Objective: *This measure provides an incentive to invest in the development of productive farm and fishing businesses, and helps farm and fishing business owners to accumulate capital for retirement. (Budget Papers, 1985; The Lifetime Capital Gains Exemption: An Evaluation, Department of Finance, 1995; Budget 2006; Budget 2007)*

A $750,000 lifetime capital gains exemption is available for gains from the disposition of qualified farm or fishing property. Qualified farm or fishing property is property that is used in the course of carrying on the business of farming or fishing and includes real property (e.g. land and buildings), fishing vessels, a share of the capital stock of a family farm corporation or a family fishing corporation of an individual or the individual's spouse, an interest in a family farm partnership or a family fishing partnership of an individual or an individual's spouse, and eligible capital property (e.g. milk or fishing quotas).

The $750,000 limit is reduced to the extent that capital gains exemptions, including the basic $100,000 lifetime capital gains exemption that was eliminated in 1994 and the $750,000 lifetime capital gains exemption on small business shares, have been used in previous years. Furthermore, it can be applied only to the extent that the gains exceed cumulative net investment losses incurred after 1987. The lifetime capital gains exemption was extended to include qualified fishing properties (effective May 2, 2006) in Budget 2006, and the limit was increased from $500,000 to $750,000 (effective March 19, 2007) in Budget 2007.

Cash Basis Accounting

Objective: *This provision recognizes that requiring all farmers and fishermen to adopt the accrual method of income reporting could result in accounting and liquidity problems. (Report of the Royal Commission on Taxation, Vol. 4, 1966; Proposals for Tax Reform, 1969)*

Under the benchmark tax system, income is taxable when it accrues, and expenses are deductible in the period when the related revenue is reported. Individuals engaged in farming and fishing, however, may elect to include revenues when received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This measure allows farmers and fishers to better match cash receipts with cash expenses, thereby enabling them to defer paying tax on income realized but not yet received.

No data are available.

A parallel measure applies to farming and fishing corporations.

Deferral of Capital Gains Through Intergenerational Rollovers of Family Farms and Family Fishing Businesses

Objective: *This measure allows for continuity in the management of family farms or family fishing businesses in Canada by permitting property used principally in a family farming or fishing business to pass from generation to generation on a tax-deferred basis. (Budget Supplementary Information, 1973; Budget 2006)*

Sales or gifts of assets to children, grandchildren or great-grandchildren typically give rise to taxable capital gains to the extent that the fair market value exceeds the adjusted cost base of the property. However, capital gains arising on intergenerational transfers of certain types of farm or fishing property (i.e. land, depreciable property including buildings, and eligible capital property such as quotas) and shares in a family farm corporation or family fishing corporation or interests in a family farm partnership or family fishing partnership, may be deferred in certain circumstances until the property is disposed of in an arm's length transaction, if the farm or fishing property continues to be used principally in a farming or fishing business. Budget 2006 extended this measure to include qualified fishing properties effective May 2, 2006.

No data are available.

Deferral of Capital Gains Through Intergenerational Rollovers of Commercial Woodlots

Objective: *This measure is intended to facilitate intergenerational rollovers of commercial woodlot operations that are farming businesses. (Budget 2001)*

Taxable capital gains on an intergenerational transfer of farm property in Canada may be deferred, or rolled over, if the property was principally used in a farming business in which the taxpayer or a family member was actively engaged on a regular and continuous basis.

The operation of a commercial woodlot may, in certain circumstances, constitute a farming business. However, the intergenerational rollover is generally not available for commercial woodlots because, aside from monitoring, the management of a woodlot may not demand regular and continuous activity. As a result, many commercial woodlot owners would be subject to income tax on intergenerational transfers of their woodlots. If woodlots were harvested prematurely to pay the tax, this would be detrimental to the sound management of the resource.

Where the regular and continuous activity test set out in the existing rollover rules cannot be met, an alternate test is implemented strictly for the purpose of applying these rules to commercial woodlot operations. This test allows an intergenerational rollover where the conditions of the existing rollover rules are otherwise met and the transferor or a family member is actively involved in the management of the woodlot to the extent required by a prescribed forest management plan.

No data are available.

Deferral of Income From Destruction of Livestock

> ***Objective:*** *This deferral was introduced to allow farmers operating on a cash basis adequate time to replace their herds, destroyed under statutory authority, without imposing a tax burden in the year of livestock destruction. (Budget 1976)*

A taxpayer may defer to the following taxation year, in part or in full at his or her discretion, the income received in compensation for the forced destruction of livestock under statutory authority.

The estimates are based on data provided by Statistics Canada.

A parallel measure applies to farm corporations.

Deferral of Income From Sale of Livestock During Drought, Flood or Excessive Moisture Years

> ***Objective:*** *This deferral allows farmers adequate time to replenish herds of breeding livestock, where some or all of their livestock has had to be sold due to drought conditions, flood or excessive moisture. (June 30, 1988 Press Release; March 5, 2009 Press Release)*

Taxpayers may defer recognition of a portion of the income received on the sale of breeding livestock in prescribed regions affected by drought, flood or excessive moisture. Such deferred income must be recognized in the first taxation year beginning after the region ceases to be a prescribed region. Prior to 2008, this measure applied only where the farmer carries on business in a prescribed drought region. The Government expanded this measure in March 2009 to apply where the farmer carries on business in a region of flood or excessive moisture. The expansion applies to 2008 and subsequent taxation years.

No data are available.

A parallel measure applies to farm corporations.

Deferral of Income From Grain Sold Through Cash Purchase Tickets

> ***Objective:*** *By permitting the deferred reporting of income on grain sales, this measure facilitates the orderly delivery of grain to elevators, which helps meet Canada's grain export commitments. (Budget Papers, 1974)*

Farmers may make deliveries of grain in a particular year and receive a cash purchase ticket that results in payment for the delivered grain in the following year. Under the benchmark tax system, the value of the cash purchase ticket would be included in income in the year that the ticket was received. This measure, however, allows the farmer to include the value of the cash purchase ticket in income in the year after the ticket is received, when that ticket is exchanged for its cash value. As a result, the farmer is able to defer the taxes payable on the sale of the grain until the year after the cash purchase ticket is received.

Since tax expenditures are estimated on a cash-flow basis, an increase in the balance of uncashed grain tickets represents additional income that is being deferred and results in a positive estimate of the tax expenditure. A decrease in the balance of uncashed grain tickets indicates that less income is being deferred and results in a negative tax expenditure.

The tax expenditure estimates are based on data obtained from Statistics Canada. Projections are calculated using a historical average growth rate.

A parallel measure applies to farm corporations.

Deferral Through 10-Year Capital Gain Reserve

Objective: *This provision, while limiting tax deferral opportunities, recognizes that where proceeds are receivable over time, fully taxing capital gains in the year of sale could result in significant liquidity problems for taxpayers. The extension of the generally available 5-year capital gains reserve period to 10 years for farm or fishing property sold to a child eases the intergenerational transfer of these assets. (Explanatory Notes for Act to Amend the Income Tax Act, December 1982; Budget 2006)*

In general, when an individual sells capital property the full payment is received at the time of the sale. In some cases, however, the individual may receive portions of the payment over a number of years. Under those circumstances, the taxpayer can defer some of the capital gains and the tax payable on them into the future. For most capital property, 20 per cent of the capital gain from the sale must be included in taxable capital gains each year (refer to the "Deferral Through Five-Year Capital Gain Reserve" measure under "General Business and Investment"). However, if the proceeds derive from the sale of a farm or fishing property to a child, grandchild or great-grandchild, only 10 per cent of the capital gain need be included in income each year. This measure was extended to include qualified fishing properties effective May 2, 2006.

A similar measure exists in situations where a taxpayer disposes of small business shares to a child, grandchild or great-grandchild (see "Small Business" section).

Exemption From Making Quarterly Tax Instalments

Objective: *This measure ensures consistency in the tax treatment of farmers reporting income on a cash-flow basis. (Budget Speech, 1943)*

Taxpayers earning business income must normally pay quarterly income tax instalments. However, individuals engaged in farming and fishing pay two-thirds of their estimated tax payable at the end of the taxation year and the remainder on or before April 30 of the following year.

No data are available.

AgriInvest (Farm Savings Account)

> ***Objective:*** *AgriInvest supports farmers by providing an income stabilization mechanism to help manage their business risk due to plant or animal disease, or extreme weather conditions. (Budget 2007)*

AgriInvest is a producer savings account that provides flexible coverage to farmers for small income declines (first 15 per cent of income) and supports investments to mitigate risks and/or improve market income. It replaces the stabilization component of the Canadian Agricultural Income Stabilization program, which had no tax implications and which in turn had replaced the Net Income Stabilization Account (see the 2004 edition of *Tax Expenditures: Notes to the Estimates/Projections* for more information on the Net Income Stabilization Account).

Generally, producers may make a deposit into an AgriInvest account each year, and receive a matching contribution from federal and provincial governments. Interest income earned in AgriInvest accounts and government contributions to them are not taxable until the year of withdrawal. The annual tax expenditure thus has two offsetting components: i) the deferral of federal income taxes on interest income earned in the accounts (on all contributions from governments and producers) and on federal and provincial contributions to the accounts during the year in question, and ii) the inclusion in income of amounts withdrawn during that year. The estimates provided are made on a current cash-flow basis—that is, they measure the net impact on revenues of these two components in each of the years under consideration.

A parallel measure applies to farm corporations.

Flexibility in Inventory Accounting

> ***Objective:*** *This measure ensures that farmers operating on a cash basis are able to avoid creating losses that would be subject to the time limitation if carried forward. (Budget 1973)*

Cash basis accounting may result in non-capital losses that are not reflective of the actual losses that would have been created under an accrual system of accounting. This happens because income and expenses are not necessarily matched under the cash basis system. As a result of loss carry-forward and carry-back limitations (i.e. 20 years forward and 3 years backward), farmers under the cash-based system may not be able to use these losses to reduce taxable income in some instances. A mandatory inventory adjustment and optional inventory adjustment are provided, which act to lessen this outcome.

The value of the tax expenditure is the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

A parallel measure applies to farm corporations.

Federal-Provincial Financing Arrangements

Logging Tax Credit

See description in Chapter 3.

Quebec Abatement

Objective: *This provision reflects the election by the Province of Quebec to receive part of the federal program contribution in the form of a tax abatement. (Federal-Provincial Fiscal Revision Act, 1964; Federal-Provincial Fiscal Arrangements Act, Part VI)*

Under the contracting-out arrangements that were offered to provinces in the mid-1960s for certain federal transfer programs, provinces could elect to receive part of the federal contribution in the form of a tax abatement. Quebec was the only province to elect such an arrangement at the time and this has resulted in a 16.5-percentage-point abatement of basic federal tax for Quebec residents. The 16.5 percentage points are the total of both the 13.5 percentage points of personal income tax abated as an Alternative Payment for Standing Programs and the 3 percentage points abated for the discontinued Youth Allowance Program.

Transfer of Income Tax Points to Provinces

Objective: *The tax point transfer assists provinces in providing services in the areas of health, post-secondary education, social assistance and social services, including early childhood development, and early learning and child care services. (Federal-Provincial Fiscal Arrangements Act, Part V)*

In 1967, the federal government transferred four tax points of personal income tax to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education.

With the 1972 income tax reform, the transferred personal income tax points were equivalent to 4.357 tax points of personal income tax. In 1977, an additional 9.143 percentage points of personal income tax were provided to the provinces in respect of post-secondary education, hospital insurance and medicare programs. The estimates presented are for the transferred personal income tax points only.

General Business and Investment

$200 Capital Gains Exemption on Foreign Exchange Transactions

Objective: *This exemption was introduced to minimize record keeping and simplify administration with respect to modest foreign exchange transactions.*

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

No data are available.

$1,000 Capital Gains Exemption on Personal-Use Property

> ***Objective:*** *This exemption was introduced to minimize record keeping and simplify administration with respect to the purchase and disposal of personal-use items. (Summary of 1971 Tax Reform Legislation, 1971)*

Personal-use property is held primarily for the use and enjoyment of the owner rather than as an investment. In calculating the capital gain on personal-use property, if the proceeds of disposition are less than $1,000, no capital gain needs to be reported. If the proceeds exceed this amount, the adjusted cost base (ACB) will be deemed to be a minimum of $1,000, thus reducing the capital gain in situations where the true ACB is less than $1,000.

Budget 2000 introduced rules that prevent the $1,000 deemed ACB and deemed proceeds of disposition for personal-use property from applying if the property is acquired after February 27, 2000, as part of an arrangement in which the property is donated as a charitable gift.

No data are available.

Accelerated Deduction of Capital Costs

See description in Chapter 3.

No data are available.

Deduction of Carrying Charges Incurred to Earn Income

> ***Objective:*** *This provision recognizes that carrying charges are incurred for the purpose of earning income.*

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

Deferral Through Use of Billed-Basis Accounting by Professionals

> ***Objective:*** *This treatment recognizes the inherent difficulty in valuing unbilled time and work in progress. (Summary of 1971 Tax Reform Legislation, 1971)*

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professionals are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

Deferral Through Five-Year Capital Gain Reserve

> ***Objective:*** *This provision, while limiting tax deferral opportunities, recognizes that where capital gain proceeds are receivable over time, fully taxing gains in the year of sale could result in significant liquidity problems for taxpayers. (Explanatory Notes for Act to Amend the Income Tax Act, December 1982)*

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

Investment Tax Credits

See description in Chapter 3.

The investment tax credit available to investors in corporations engaged in mineral exploration is described below under “Mineral Exploration Tax Credit for Flow-Through Share Investors.”

Flow-Through Share Deductions

> ***Objective:*** *Flow-through shares are a financing mechanism that assists corporations in the oil and gas, mining and renewable energy sectors to raise capital for eligible exploration, development and project start-up expenses. (Improving the Income Taxation of the Resource Sector in Canada, March 3, 2003)*

Flow-through shares are an authorized tax shelter arrangement that allows a corporation to transfer certain unused tax deductions to equity investors. An investor buying a flow-through share, in addition to receiving an equity interest in the issuing corporation, is also entitled to claim deductions on account of Canadian Exploration Expenses, Canadian Development Expenses and Canadian Renewable and Conservation Expenses transferred to the investor by the corporation. Investors are willing to pay more for such shares than for regular equity because of the flow-through tax deductions. Flow-through shares are typically issued by corporations which are not taxable and therefore not able to immediately use the deductions themselves.

The tax expenditure associated with flow-through shares is the net amount of two underlying components: an upfront tax expenditure (normally positive) associated with the transfer of deductible expenses from the issuing corporation to the investor, and a partially offsetting incremental revenue gain to the Government that arises when flow-through shares are sold.

The upfront tax expenditure is equal to the difference between the fiscal cost of the flow-through deductions claimed by the investor and the deductions forgone by the issuing corporation. A tax expenditure arises to the extent that: (i) the deduction is taken by the investor earlier than it would have been taken by the corporation (indeed, in many cases, the corporation may never have been able to use the deduction), or (ii) where the investor is an individual, his or her tax rate is higher than the corporate tax rate.

The reported estimates represent an upper bound on the value of the upfront tax expenditure, since it is effectively assumed that the issuing corporations would never have been able to deduct the transferred expenses. To the extent that they could, the tax expenditure would be smaller than the estimates presented. There is no data, however, to allow determination of when, if ever, the expenses

would otherwise have been deducted by the issuing corporations. The data do indicate, for example, that 97 per cent of corporations that flowed through expenses to investors for the 2007 tax year were not taxable in that year and thus not in a position to immediately deduct the expenses themselves.[5]

The tax expenditure estimates published in the *Tax Expenditures and Evaluations* reports for 2008 and 2009 were also upper-bound estimates in that they did not take into account the partially offsetting tax revenue associated with the incremental gain that arises upon the disposal of a flow-through share as a result of the deemed zero cost base of such shares. The 2010 report provides an estimate that takes this offsetting gain into account.

A flow-through share is deemed to have a zero cost base for tax purposes, based on the fact that the shareholder will have claimed a flow-through deduction as high as the full cost of the share. As a result of the zero cost base, the gain realized on the sale of the share will be equal to the share's full value at that time rather than the change in its value since the time of acquisition. As a result, the shareholder will incur a larger gain on the disposition of a flow-through share than in the case of a regular share. For most taxpayers, the gain will be a capital gain, only one-half of which is taxable. The tax revenue to the Government associated with the incremental portion of this gain[6] partially offsets the tax cost of the flow-through deduction. In terms of timing, however, the gain may not be realized until some years after the flow-through deduction, depending on how long the share is held.

As with most tax expenditures, these estimates are determined on a current cash-flow basis, rather than a net present value basis. That is, for a given year, the tax expenditure is the amount of the estimated tax expenditure associated with flow-through share deductions claimed by investors in that year less the estimated incremental revenue gain associated with the zero cost base for flow-through shares sold by investors in that year.

These estimates relate to the fiscal cost of the deduction by individuals of expenses transferred to them under flow-through shares. A parallel item for flow-through share expenses transferred to corporate investors appears in Chapter 3.

Mineral Exploration Tax Credit for Flow-Through Share Investors

Objective: *This temporary measure helps companies raise capital for mining exploration by providing an incentive to individuals who invest in flow-through shares issued to finance exploration. (Budget 2010)*

Flow-through shares facilitate the financing of exploration by allowing companies to transfer unused income tax deductions to investors. This temporary investment tax credit is available to individuals (other than trusts) who invest in flow-through shares.

The credit was originally introduced in 2000 for a three-year period in response to a downturn in mineral exploration, and has been extended on a number of occasions since then. The credit is equal to 15 per cent of specified surface "grassroots" mineral exploration expenses (i.e. seeking new resources away from an existing mine site) incurred in Canada by a corporation and transferred to an

[5] It may be the case that many junior exploration corporations in Canada, particularly in the mining sector, do not become taxable entities. It is a common business model that once an exploitable resource is found, the resource will be sold to a larger corporation or group with more experience developing and operating extraction projects.

[6] The incremental portion of the gain is the difference between the zero cost base and the price at which the company would have been able to issue regular common shares.

individual investor under a flow-through share agreement. A “look-back” rule allows companies to raise funds by issuing flow-through shares in one calendar year and spend the funds in the following calendar year, while allowing the investor to claim the flow-through deduction and the tax credit in the year the share investment is made.

The credit, which is non-refundable, reduces federal personal income tax otherwise payable by the individual investor. Budget 2010 announced the extension of the credit to March 31, 2011.

Reclassification of Expenses Under Flow-Through Shares

Objective: *This provision was introduced to facilitate financing and promote investment in the junior oil and gas sector. (Economic and Fiscal Statement, 1992; Budget 1996)*

Small corporations in the oil and gas sector are entitled to reclassify as Canadian Exploration Expenses (CEE—100-per-cent deductible in the year incurred) the first $1 million of eligible oil and gas Canadian Development Expenses (CDE—30-per-cent deductible per year) renounced to shareholders under a flow-through share agreement. The reclassified amounts are referred to as “deemed CEE.”

The tax expenditure is estimated by comparing the tax value of the deemed CEE claimed by individuals to a benchmark where the underlying CDE is flowed out as CDE rather than being reclassified as CEE. It is assumed that the issuing corporations would have been able to fully flow out the expenses as CDE, even though CDE is generally less attractive to investors than CEE. To the extent that they could not, the tax expenditure would be higher than this estimate.

Like any measure that accelerates the timing of deductions and defers taxes payable, this measure results in a positive tax expenditure measured in cash-flow terms in the initial year of any particular investment (because deductions are higher than they otherwise would have been), and a negative tax expenditure in the following years (when deductions are lower than they otherwise would have been). If the volume of reclassifications grows year over year, the overall tax expenditure will tend to be positive. By contrast, if the volume declines, it will tend to result in a negative tax expenditure. This is because the positive tax expenditure associated with new spending is more than offset by the negative tax expenditure resulting from the higher volume of reclassifications that occurred in previous years. If activity levels are roughly constant from year to year, the measured tax expenditure in cash-flow terms will tend to zero.

A parallel item for reclassification of expenses transferred to corporate investors in flow-through shares appears in Chapter 3.

Partial Inclusion of Capital Gains

Objective: *The reduced rate of inclusion for capital gains provides incentives to Canadians to save and invest, and ensures that Canada’s treatment of capital gains is broadly comparable to that of other countries. (Proposals for Tax Reform, 1969; Tax Reform 1987: The White Paper, 1987; Budget 2000; Economic Statement and Budget Update, 2000)*

Only a portion of net realized capital gains is included in income. The amount of the tax expenditure is the additional tax that would have been collected had the full amount of the capital gains been included in income.

The capital gains inclusion rate was reduced to two-thirds from three-quarters effective February 28, 2000, and reduced again to one-half from two-thirds, effective October 18, 2000.

A parallel measure applies to corporations.

Taxation of Capital Gains Upon Realization

Objective: *This treatment recognizes that, in many cases, it is difficult to estimate with accuracy the value of unsold assets, and that taxing the accrued gains on assets that have not been sold would be administratively complex and could create significant liquidity problems for taxpayers. (Report of the Royal Commission on Taxation, Vol. 3,1966)*

Under the benchmark tax system, capital gains would be fully included in income as they accrue. Under the current system, however, capital gains are generally taxed upon the disposition of property, which results in a tax deferral.

No data are available.

Tax-Free Savings Account

Objective: *This measure improves incentives for Canadians to save by reducing taxes on savings. (Budget 2008)*

The Tax-Free Savings Account (TFSA) is a general-purpose savings account that allows individuals to earn tax-free investment income. Effective 2009, individuals 18 years of age and older acquire $5,000 of TFSA contribution room each year, with unused room being carried forward. The $5,000 limit is indexed to inflation in $500 increments. TFSA contributions are not deductible, but investment income earned in the account, including capital gains, and amounts withdrawn are not included in income for tax purposes or taken into account in determining eligibility for federal income-tested benefits and credits. Withdrawals also create contribution room in the following year for future savings.

Small Business

Lifetime Capital Gains Exemption for Small Business Shares

Objective: *This measure was introduced to bolster risk taking and investment in small businesses, help small business owners to accumulate funds for retirement and facilitate intergenerational transfers. (Budget Papers, 1985; The Lifetime Capital Gains Exemption: An Evaluation, Department of Finance, 1995; Budget 2007)*

A $750,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares, namely shares of an eligible small business corporation that have been owned by the taxpayer or the taxpayer's spouse or common-law partner throughout the 24 months prior to the sale. The small business must be a Canadian-controlled private corporation, where more than 50 per cent of the fair market value of the assets of the corporation was used mainly in an active business carried on primarily in Canada. Certain shares or debts of connected corporations also qualify for the exemption.

The $750,000 limit is available only to the extent that capital gains exemptions, including the basic $100,000 lifetime capital gains exemption that was eliminated in 1994 and the $750,000 lifetime capital gains exemption on qualified farm and fishing properties, have not been used in previous years. Furthermore, it can be applied only to the extent that the gains exceed cumulative net investment losses incurred after 1987. Budget 2007 increased the lifetime capital gains exemption limit from $500,000 to $750,000 effective March 19, 2007.

Deduction of Allowable Business Investment Losses

Objective: *This measure recognizes that small businesses often have difficulty obtaining adequate financing, and provides special assistance for risky investments in such businesses. (Budget 1985; Budget 2004)*

Capital losses arising from the disposition of shares and debt instruments are generally deductible only against capital gains. However, a portion of capital losses in respect of shares or debts of a small business corporation (allowable business investment losses) may be used to offset other income provided that the capital loss is first applied against lifetime capital gain exemptions. The portion of capital losses that may be so used is the same as the portion of capital gains included in income (i.e. one-half since October 18, 2000). Unused allowable business investment losses may be carried back 3 years and forward 10 years. After 10 years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

Allowable business investment losses must be reduced by the sum of lifetime capital gains exemptions claimed in prior years multiplied by the reciprocal of the inclusion rate of capital gains applicable to the particular year. The amount by which a taxpayer's allowable business investment loss is reduced under this provision is treated as a capital loss for the year in which it arose, and may be carried back 3 years and forward indefinitely to offset capital gains of other years.

The estimated tax expenditure is calculated as the amount of tax relief provided by allowing these losses to be deducted from other income in the year they arise. The tax expenditure is overstated since it does not take into account the reduction in tax revenues that would occur if the losses were instead deducted from prior-year, current-year or future capital gains.

Deferral Through 10-Year Capital Gain Reserve

Objective: *This provision, while limiting tax deferral opportunities, recognizes that where proceeds are receivable over time, fully taxing gains in the year of sale could result in significant liquidity problems for taxpayers. The extension of the generally available 5-year capital gains reserve period to 10 years for small business shares sold to a child eases the intergenerational transfer of these assets. (Explanatory Notes for Act to Amend the Income Tax Act, December 1982)*

If proceeds from the sale of small business shares to children, grandchildren or great-grandchildren are not all receivable in the year of sale, recognition of a portion of the capital gain realized may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum 10-year reserve period. This contrasts with the treatment of most other property, where the maximum reserve period is 5 years.

A similar measure exists in situations where a taxpayer disposes of farm or fishing property to a child, grandchild or great-grandchild (see "Farming and Fishing" section).

Labour-Sponsored Venture Capital Corporations Credit

Objective: This measure was introduced to foster entrepreneurship by encouraging investment by individuals in labour-sponsored venture capital organizations, set up to maintain or create jobs and stimulate the economy. (Budget Papers, 1985)

Labour-Sponsored Venture Capital Corporations (LSVCCs) are investment funds, sponsored by unions or other labour organizations, which make venture capital investments in small and medium-sized businesses. A tax credit is provided to individuals for the acquisition of shares of LSVCCs. For 1998 and subsequent years, the rate of the federal tax credit is 15 per cent, up to a maximum credit of $750.

Non-Taxation of Provincial Assistance for Venture Investments in Small Businesses

Objective: The non-taxation of provincial assistance for venture investments in small businesses assists the successful working of such provincial plans. (Budget 1977)

See description in Chapter 3.

No data are available.

Rollovers of Investments in Small Businesses

Objective: This measure was implemented to improve access to capital for small business corporations. (Economic Statement and Budget Update, October 2000; Budget 2003)

Individuals are permitted to defer the tax on a capital gain arising from the disposition of shares in a qualified small business investment, to the extent the proceeds are reinvested in shares of another qualified small business. When introduced in 2000, this deferral was restricted to $2 million of investment, but this restriction was eliminated in Budget 2003. An eligible small business investment consists of shares issued from treasury in an active Canadian-controlled private corporation with assets not exceeding $50 million. The reinvestment must be made at any time in the year of disposition or within 120 days after the end of that year.

Health

Children's Fitness Tax Credit

Objective: This measure was implemented to promote physical fitness among children. (Budget 2006)

The Children's Fitness Tax Credit (CFTC) allows parents to claim a tax credit at the lowest personal income tax rate on up to $500 in eligible fees, for the enrolment of a child under the age of 16 years in an eligible program of physical activity, effective January 1, 2007. The credit may be claimed by either parent.

If a child qualifies for the Disability Tax Credit (DTC), the age limit for the purposes of the CFTC is raised to under 18 years of age. As well, the requirements for an eligible activity are relaxed to cover a broader range of programs more suited to the challenges experienced by these children. Parents of DTC-eligible children may also qualify for a separate $500 amount, subject to spending a minimum of $100 on registration or membership fees for an eligible program of physical activity.

Disability Tax Credit

> ***Objective:*** *This provision improves tax fairness by recognizing the effect of a severe and prolonged disability on an individual's ability to pay tax. (Budget 1997; Budget 2005)*

The Disability Tax Credit (DTC) recognizes the impact of non-itemizable disability-related costs on an individual's ability to pay tax. The DTC improves tax fairness by providing tax relief to individuals who, as certified by a qualified health practitioner:

- Are markedly restricted in their ability to perform a basic activity of daily living, due to the effects of one or more severe and prolonged impairments in mental or physical functions;
- Are significantly restricted in their ability to perform more than one basic activity of daily living if the cumulative effect of their restrictions is equivalent to having a single marked restriction in the ability to perform a basic activity of daily living; or
- Would be markedly restricted were it not for extensive therapy to sustain a vital function.

Budget 2005 introduced a number of changes to the DTC, including extending eligibility to individuals who face multiple restrictions that together have a substantial impact on their everyday lives and amending the provision to ensure that more individuals requiring extensive life-sustaining therapy on an ongoing basis are eligible.

The value of the credit is calculated by applying the lowest personal income tax rate to the disability amount ($7,239 in 2010). The credit amount is indexed to inflation. This credit can be transferred to a supporting spouse, parent, grandparent, child, grandchild, brother, sister, aunt, uncle, nephew or niece of the individual.

Beginning with the 2000 taxation year, families caring for children with severe and prolonged impairments may receive additional tax relief through a supplement to the DTC. The amount of the supplement depends on the amount of child care expenses or attendant care expenses claimed for tax purposes.

For the 2010 taxation year, the value of the supplement is calculated by applying the lowest personal income tax rate to the supplement amount ($4,223 in 2010) and is reduced dollar-for-dollar by the amount of child care or attendant care expenses in excess of $2,473 claimed for tax purposes. Both the expense threshold and the supplement amount are indexed to inflation.

The tax expenditure estimates reflect both the DTC and the DTC supplement for children.

Medical Expense Tax Credit

> ***Objective:*** *This provision recognizes the effect of above-average medical expenses on the ability of an individual to pay tax. (Budget Speech, 1942; Budget 1997; Budget 2005)*

The Medical Expense Tax Credit (METC) provides tax relief for qualifying above-average medical- or disability-related expenses incurred by taxpayers on behalf of themselves, a spouse, a common-law partner or a dependent relative. For the purposes of the METC, a dependant is defined as a child, grandchild, parent, grandparent, brother, sister, uncle, aunt, niece or nephew who is dependent on the taxpayer for support.

The value of the credit is calculated by applying the lowest personal income tax rate to the amount of qualifying medical expenses in excess of the lesser of $2,024 (in 2010) or 3 per cent of net income. The dollar threshold (i.e. $2,024) is indexed to inflation.

Medical expense claims made on behalf of a spouse or common-law partner or minor children may be pooled with the medical expenses of the taxpayer, subject to the minimum expense threshold. For these expenses, there is no upper limit on the amount that can be claimed.

For medical expenses paid on behalf of dependent relatives other than minor children, taxpayers are able to claim qualifying medical expenses that exceed the lesser of 3 per cent of the dependant's net income and $2,024 (in 2010, indexed to inflation). The maximum eligible amount that can be claimed on behalf of dependent relatives other than minor children was set at $5,000 in 2004, and was doubled to $10,000 for the 2005 and subsequent taxation years.

Non-Taxation of Business-Paid Health and Dental Benefits

Objective: *This provision improves access to supplementary health and dental benefits. (Budget 1998)*

Employer-paid benefits for private health and dental plans are deductible business expenses but are not a taxable employee benefit. In addition, self-employed individuals may deduct from business income premiums paid for their coverage, subject to certain restrictions. The tax expenditure estimates are based on data from Statistics Canada and from an annual survey, *Health Insurance Benefits in Canada*, conducted by the Canadian Life and Health Insurance Association.

Refundable Medical Expense Supplement

Objective: *This provision improves incentives for Canadians with disabilities to participate in the labour force by providing an alternative to disability-related supports under provincial social assistance arrangements. (Budget 1997; Budget 2005; Budget 2006)*

Budget 1997 introduced the Refundable Medical Expense Supplement (RMES), which provides assistance for above-average disability and medical expenses to low-income working Canadians. Individuals claiming the RMES may also claim the non-refundable Medical Expense Tax Credit (METC). The maximum annual amount of the RMES was increased to $750 in Budget 2005 (from $562 in 2004) and to $1,000 in Budget 2006.

For 2010, the maximum supplement is the lesser of $1,074, and 25 per cent of the allowable portion of expenses that can be claimed under the METC plus the Disability Supports Deduction. The minimum earnings requirement is $3,135 and the family net income threshold at which the supplement begins to be reduced is $23,775. The supplement amount, the minimum earnings threshold and the family net income threshold are indexed to inflation.

Income Maintenance and Retirement

Age Credit

Objective: *This provision was introduced to reduce the tax burden borne by elderly Canadians. (Budget Highlights, 1972; Budget 2009)*

The Age Credit is provided to individuals aged 65 and over. The value of the credit is calculated by applying the lowest personal income tax rate to the Age Credit amount ($6,446 in 2010). The amount eligible for the Age Credit was increased by $1,000 to $6,408, effective January 1, 2009 (indexed to inflation thereafter). The credit is income-tested: the Age Credit amount is reduced by 15 per cent of net income in excess of $32,506 for 2010; this threshold is also indexed to inflation. Any unused portion of the credit may be transferred to a spouse or common-law partner.

Deferred Profit-Sharing Plans

Objective: *The tax treatment of these plans encourages additional retirement savings, and fosters co-operation between employers and their workers by encouraging employees to participate in their employer's business. (Budget Speech, 1960)*

Consistent with the tax treatment of Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs), a deferral of tax is provided on savings in Deferred Profit-Sharing Plans (DPSPs). Employers may make tax-deductible contributions to a DPSP on behalf of their employees; these contributions are not immediately taxed in the hands of the employee, and the investment income is not taxed as it is earned. Withdrawals are taxable in the hands of the employee. Employer contributions are limited to 18 per cent of the employee's earned income up to one-half of the money purchase RPP dollar limit for the year ($11,225 for 2010). Savings limits for DPSPs are integrated with RRSP/RPP limits, so that employer contributions are included in an employee's pension adjustment, thereby reducing his or her annual RRSP contribution limit. Total contributions to a DPSP and money purchase RPP are limited to 18 per cent of the employee's earned income up to the money purchase RPP dollar limit for the year ($22,450 for 2010).

No data are available.

Non-Taxation of Certain Amounts Received as Damages in Respect of Personal Injury or Death

> ***Objective:*** *This measure provides assistance to young persons receiving personal injury awards.*

Amounts received in respect of damages for personal injury or death, as well as awards paid pursuant to the authority of criminal injury compensation laws, are not taxable. In addition, investment income earned on personal injury awards is excluded from income until the end of the year in which the person reaches the age of 21.

While the benchmark definition of income excludes amounts received as damages (since they compensate taxpayers for a personal loss), it includes investment income earned on these amounts as part of this benchmark tax base. Thus, the non-taxation of investment income earned on these awards for those under age 22 is considered to be a tax expenditure.

No data are available regarding the investment income earned on awards by individuals under age 22.

Non-Taxation of Guaranteed Income Supplement and Allowance Benefits

> ***Objective:*** *This provision recognizes that these income-tested payments provide a basic level of support to elderly Canadians with little income other than the Old Age Security pension. (Budget Speech, 1971)*

The Guaranteed Income Supplement (GIS) is an income-tested benefit payable to Old Age Security pensioners. There is also an income-tested Allowance that is provided to an eligible spouse, common-law partner, widow or widower aged 60 to 64. The GIS and Allowance benefits are non-taxable. Although these benefits must be included in income, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while ensuring that they are taken into account in determining other income-tested credits and benefits.

Non-Taxation of Investment Income From Life Insurance Policies

> ***Objective:*** *For administrative convenience, insurance companies rather than policy holders are taxed on investment income earned on certain life insurance policies.*

The investment income earned on some life insurance policies is not taxed as income to the policyholder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings. The tax expenditure associated with this measure is described in Chapter 3.

Non-Taxation of RCMP Pensions/Compensation in Respect of Injury, Disability or Death

> ***Objective:*** *This provision recognizes that these benefits represent, to a large extent, compensation to members of Canada's national police force and their families for a loss suffered by members in the course of their duties.*

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

No data are available.

Non-Taxation of Social Assistance Benefits

> ***Objective:*** *This provision recognizes the nature of social assistance as a payment of last resort. (Budget 1981)*

Social assistance payments generally must be included in income for tax purposes, but an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation, while ensuring that they are taken into account in determining income-tested credits and benefits.

The tax expenditure estimate for this measure does not include the non-taxation of benefits that are not included in income (e.g. payments to foster parents, benefits in kind).

Non-Taxation of Up to $10,000 of Death Benefits

> ***Objective:*** *This provision was introduced to alleviate the hardship faced by dependants upon the death of a supporting individual. (Budget Speech, 1959)*

Up to $10,000 of death benefits paid by an employer to the spouse or common-law partner of a deceased employee is non-taxable.

No data are available.

Non-Taxation of Veterans' Allowances, Income Support Benefits, Civilian War Pensions and Allowances, and Other Service Pensions (Including Those From Allied Countries)

> ***Objective:*** *This provision recognizes that these benefits provide a basic level of support to veterans of Canada's military engagements and their families. (Budget Speech, 1942; New Veterans Charter, 2006)*

These amounts are not included in income for tax purposes. This includes the Canadian Forces Income Support Benefit that was established as a tax-free amount for eligible low-income veterans under the New Veterans Charter introduced in 2006.

The estimates are based on data received from Veterans Affairs Canada.

Non-Taxation of Veterans' Disability Pensions and Support for Dependants

> ***Objective:*** *This provision recognizes that these benefits provide a basic level of support to veterans of Canada's military engagements and their families. (Budget Speech, 1942; New Veterans Charter, 2006)*

These amounts are not included in income for tax purposes. For applications made after April 1, 2006, the Veterans' Disability Pension has been replaced by the Disability Award (current pensioners have been grandfathered).

The estimates for this item are based on data received from Veterans Affairs Canada.

Non-Taxation of Veterans' Disability Awards

Objective: *This provision recognizes that these benefits provide a basic level of support to veterans of Canada's military engagements and their families. (Budget Speech, 1942; New Veterans Charter, 2006)*

These amounts are not included in income for tax purposes. For applications made after April 1, 2006, the Veterans' Disability Pension has been replaced by the Disability Award (current pensioners have been grandfathered).

The estimates for this item are based on data received from Veterans Affairs Canada.

Non-Taxation of Workers' Compensation Benefits

Objective: *This measure provides assistance to workers suffering on-the-job injuries.*

Workers' compensation benefits have been non-taxable since the first Workers' Compensation Boards were established in 1915. Prior to 1982, workers' compensation payments were excluded from income. Since 1981, workers' compensation benefits must be included in income. However, an offsetting deduction from net income is provided. This approach effectively exempts such benefits from taxation while ensuring that they are taken into account in determining income-tested credits and benefits.

Workers' compensation contributions are deductible as a business expense. As such, the non-taxation of workers' compensation benefits is considered a tax expenditure.

Registered Disability Savings Plans

Objective: *This provision helps parents and others save for the long-term financial security of a child with a severe disability. (Budget 2007)*

A Registered Disability Savings Plan (RDSP) may be established for the benefit of an individual eligible for the Disability Tax Credit. Contributions to an RDSP are limited to a lifetime maximum of $200,000, and are permitted up until the end of the year in which a beneficiary attains 59 years of age.

Annual RDSP contributions attract Canada Disability Savings Grants (CDSGs) at matching rates of 100, 200 or 300 per cent, depending on family income and the amount contributed, up to a maximum lifetime CDSG limit of $70,000 (the family income thresholds are indexed to inflation). Upon establishing an RDSP, low- and modest-income beneficiaries may also receive Canada Disability Savings Bonds (CDSBs) of up to $1,000 per year, to a maximum lifetime CDSB limit of $20,000, irrespective of whether contributions are made to their plan. An RDSP is eligible to receive CDSGs and CDSBs up until the end of the year in which the plan beneficiary attains 49 years of age.

Contributions to an RDSP are not deductible and are not included in income when paid out of an RDSP. The investment income earned in the plan is not taxed as it accrues. CDSGs, CDSBs and investment income earned in the plan are included in the beneficiary's income for tax purposes when paid out of an RDSP. Only the plan beneficiary, or the beneficiary's legal representative, is permitted to receive payments from an RDSP. Payments from an RDSP are required to commence by the end of the year in which the beneficiary attains 60 years of age.

The tax expenditure estimates reflect the tax revenue forgone on the tax-sheltered investment income earned on RDSP assets, minus the revenue from taxing withdrawals of CDSGs, CDSBs and investment income from RDSPs.

Pension Income Credit

Objective: *This provision was introduced to provide additional protection against inflation for the retirement income of elderly Canadians. (Budget Speech, November 1974)*

Budget 2006 doubled the Pension Income Credit amount, from $1,000 to $2,000, for 2006 and subsequent years. The value of the credit is calculated by applying the lowest personal income tax rate to the first $2,000 of qualifying pension income. Any unused portion of the credit may be transferred to a spouse or common-law partner.

Pension Income Splitting

Objective: *This measure recognizes the special challenges of planning and managing retirement income, and provides targeted assistance to pensioners. (Tax Fairness Plan, 2006)*

Canadian residents receiving income that qualifies for the existing Pension Income Credit can allocate up to one-half of that income to their resident spouse or common-law partner for tax purposes. Income that is eligible for pension income splitting and the Pension Income Credit is generally limited to certain types of income from registered plans, such as a lifetime pension from a Registered Pension Plan and, as of age 65, income from a Registered Retirement Savings Plan annuity or a Registered Retirement Income Fund.

Registered Pension Plans and Registered Retirement Savings Plans

Objective: *These plans were introduced to encourage Canadians to save throughout their working lives in order to avoid a serious disruption of their living standards upon retirement. (Pension Reform: Improvements in Tax Assistance for Retirement Saving, Department of Finance, 1989)*

A deferral of tax is provided on contributions to Registered Pension Plans (RPPs) and Registered Retirement Savings Plans (RRSPs) in order to encourage and assist Canadians to save for retirement. Contributions to these plans are deductible from income, the investment income is not taxed as it accrues, and all withdrawals and benefit payments are included in income and taxed at regular rates.

Annual contributions to RRSPs and money purchase (or defined contribution) RPPs are limited to 18 per cent of earned income up to a dollar maximum of $22,000 and $22,450 respectively for 2010. For defined benefit plans, the maximum annual pension limit per year of service is 2 per cent of earnings up to $2,494 for 2010. The RPP dollar limits are indexed to average wage growth for 2010 and subsequent years. The RRSP dollar limit will be indexed to average wage growth beginning in 2011.

The 18 per cent of earnings limit is comprehensive and applies to all tax-deferred saving, whether in RPPs, RRSPs or both. This is achieved through the pension adjustment, which reduces an RPP member's RRSP limit by an estimate of the amount of annual saving in the RPP. Unused RRSP room may be carried forward to future years.

Table 1 in *Tax Expenditures and Evaluations* provides cash-flow estimates of the tax expenditure for RPPs and RRSPs, and supplements those estimates with a present-value estimate. The cash-flow tax expenditure is a measure of the net revenue forgone by the Government in a given year, taking into account the tax forgone on the contributions and investment income and the tax collected on withdrawals in that year. The present-value tax expenditure is a measure of the net revenue forgone in today's dollars due to the contributions made in a given year, taking into account the fact that the deferred tax will be collected in the future when the contributions and investment income earned on them are withdrawn. The methodology underlying the present-value tax expenditure estimates is set out in detail in the 2001 *Tax Expenditures and Evaluations* report. As data on Tax-Free Savings Accounts become available, this methodology will be reviewed to ensure that it takes proper account of Canadians' ability to save in different tax-assisted savings vehicles.

The cash-flow estimates are based on actual levels of RPP and RRSP contributions and withdrawals reported for individuals in the tax data and on information on RPP contributions and investment income reported in various Statistics Canada publications.

The projected values of RPP and RRSP contributions used for the cash-flow tax expenditure projections are also used for the projections of the present-value tax expenditure.

For the cash-flow estimates, the tax expenditure associated with investment income is estimated for each component separately based on observed amounts of interest, dividends and capital gain realizations for trusteed RPPs as reported by Statistics Canada. This information is also used to estimate the tax expenditure on investment income for RRSPs. A growth factor is applied to the investment income components to determine projected tax expenditures associated with investment income.

Subject to specified limits and repayment periods, the Home Buyers' Plan (HBP) and the Lifelong Learning Plan (LLP) allow tax-exempt withdrawals from RRSPs to promote home ownership and skills enhancement respectively. The HBP allows first-time homebuyers to withdraw up to $25,000 to purchase a home. The limit was increased to $25,000 from $20,000 in Budget 2009. Participants are required to repay the amount withdrawn from their RRSPs in equal instalments over a maximum of 15 years. Any amount not repaid for a year is included in the participant's income for tax purposes. The LLP allows individuals to withdraw up to $20,000 over four years to finance full-time training or education. Amounts withdrawn must be repaid in equal instalments over a maximum of 10 years. As under the HBP, any amount not repaid for a year is included in the participant's income for tax purposes. The tax expenditure costs of both the HBP and the LLP are reflected in the overall RRSP tax expenditure, since it would be difficult to attribute specific portions of aggregate RRSP contributions to the existence of these two programs.

Saskatchewan Pension Plan

Objective: *This measure was introduced to ensure consistency in the tax treatment of Canadians saving for their retirement, whether they save through a private or a provincially sponsored registered plan. (Budget 1987)*

Contributions to the Saskatchewan Pension Plan (SPP) are deductible up to the lesser of $600 or the amount of unused Registered Retirement Savings Plan (RRSP) room in a particular year. As for Registered Pension Plans and RRSPs, SPP investment income is not taxed as it is earned in the plan and payments from the SPP are included in income and taxed at regular rates.

Treatment of Alimony and Maintenance Payments

Objective: *These measures provide tax assistance for spousal support payments.*

Spousal support payments (also called "alimony and maintenance payments") are deductible by the payer and included in taxable income for the recipient. Since spousal support payments are made by the spouse with the higher income, the deduction/inclusion rule provides tax assistance for spousal support payments.

The estimates for this item are computed as the value of the deduction to the payer, less the tax collected from the recipient.

U.S. Social Security Benefits

Objective: *This measure restores the tax treatment that applied to Canadian residents in receipt of U.S. Social Security benefits before 1996. (Budget 2010)*

Prior to 1996, pursuant to the Canada-United States Tax Convention (1980), Canadian residents receiving benefits under the Social Security legislation in the United States were required to include only 50 per cent of those benefits in computing income. Changes to the Canada-U.S. Tax Convention effective 1996 increased the inclusion rate for U.S. Social Security benefits to 85 per cent from 50 per cent. Budget 2010 reinstated the 50-per-cent inclusion rate for Canadian residents who have been in receipt of U.S. Social Security benefits since before January 1, 1996 and for their spouses and common-law partners who are eligible to receive survivor benefits. This measure applies to U.S. Social Security benefits received on or after January 1, 2010.

Other Items

Deduction for Certain Contributions by Individuals Who Have Taken Vows of Perpetual Poverty

Objective: *This measure recognizes the special situation of members of religious orders.*

Where, during a taxation year, an individual is a member of a religious order and has taken a vow of perpetual poverty, the individual may deduct in computing taxable income an amount equal to the total of their superannuation or pension benefits and earned income for the year, if that amount is paid in the year to the order. These amounts do not qualify for the Charitable Donations Tax Credit.

Deduction for Clergy Residence

Objective: *The treatment of clergy housing expenses recognizes the special nature of the contributions and circumstances of members of the clergy. (Budget Speech, March 1949)*

Where a member of the clergy is supplied living accommodation by his/her employer or receives housing allowances, an offsetting deduction may be claimed to the extent that this benefit is included in income. When no allowance is received nor living accommodation provided, a calculated deduction for rent and utilities is provided. The taxpayer must be a member of the clergy or of a religious order or a regular minister of a religious denomination.

First-Time Home Buyers' Tax Credit

> ***Objective:*** *This measure assists first-time home buyers with the cost associated with the purchase of a home. (Budget 2009)*

The First-Time Home Buyers' Tax Credit (HBTC) is a non-refundable tax credit based on an amount of $5,000 for first-time home buyers who acquire a qualifying home after January 27, 2009. The value of the credit is calculated using the lowest personal income tax rate. At a 15-per-cent credit rate, the HBTC provides up to $750 in tax relief. Any unused portion of the HBTC may be claimed by an individual's spouse or common-law partner.

The HBTC is also available for certain acquisitions of a home by or for the benefit of an individual who is eligible for the Disability Tax Credit.

An individual is considered to be a first-time home buyer if neither the individual nor the individual's spouse or common-law partner owned and lived in another home in the calendar year of the home purchase or in any of the four preceding calendar years. A qualifying home is one that is generally considered to be a housing unit that an individual or an individual's spouse or common-law partner intends to occupy as a principal residence no later than one year after its acquisition.

Home Renovation Tax Credit

> ***Objective:*** *This measure provided a temporary incentive for homeowners to invest in improvements to their homes and to stimulate economic growth. (Budget 2009)*

The Home Renovation Tax Credit was a temporary 15-per-cent non-refundable tax credit for the 2009 taxation year on the portion of eligible home renovation expenditures exceeding $1,000, but not more than $10,000, providing up to $1,350 in tax relief per family. Expenditures claimed were for work performed, or goods acquired, after January 27, 2009 and before February 1, 2010.

Non-Taxation of Capital Gains on Principal Residences

> ***Objective:*** *This exemption recognizes that principal homes are generally purchased to provide basic shelter and not as an investment. The exemption also increases flexibility in the housing market by allowing families to move more easily from one principal residence to another in response to their changing circumstances. (Summary of 1971 Tax Reform Legislation, 1971; 1981 Budget Information Kit)*

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

The estimates are based on data from the Multiple Listing Service and Statistics Canada.

Non-Taxation of Income From the Office of the Governor General

> ***Objective:*** *This exemption ensures that the income from the Office of the Governor General, who is a direct representative of the Crown, is not subject to tax. (Income War Tax Act, 1917)*

The estimates are based on Public Accounts data.

Non-Taxation of Income of Status Indians and Indian Bands on Reserve

Objective: *The exemption reflects provisions under section 87 of the Indian Act.*

Section 87 of the Indian Act exempts the personal property of status Indians and Indian bands from taxation if such personal property is situated on a reserve. Courts have held that the term "personal property" includes income. Determining whether income is situated on a reserve requires an examination of the factors that connect it to a reserve. With respect to employment income, for example, a key factor is the location (on or off a reserve) at which the employment duties were performed.

No data are available.

Special Tax Computation for Certain Retroactive Lump-Sum Payments

Objective: *This provision is intended to ensure that governments do not unduly benefit as a result of amounts being received in a lump sum. (Budget 1999)*

Taxpayers receiving qualifying retroactive lump-sum payments may use a special mechanism to compute the tax on those payments. To be eligible for the special tax calculation, the right to receive the income must have existed in a prior year. In addition, the principal portion of the lump-sum payment must be at least $3,000, and must have been received in any year after 1994.

The tax expenditure under this item is equal to the difference between the tax that would be owed on the principal portion of eligible retroactive lump-sum payments if they were taxed in the year received, and the tax computed under the special mechanism. The tax under the special mechanism is the federal tax that would have been payable if the principal portion of the retroactive lump-sum payment had been taxed in the year to which it relates, plus interest to reflect the delay in receiving the tax. There is no tax expenditure associated with the interest element of any lump-sum payment because it is fully included in income for the year in which it is received.

Public Transit Tax Credit

Objective: *This measure is intended to provide assistance to Canadians by making transit more affordable and to encourage individuals to use public transit to reduce traffic congestion in urban areas and to improve the environment. (Budget 2006)*

The Public Transit Tax Credit came into effect July 1, 2006. The value of the credit is calculated by applying the lowest personal income tax rate to the cost of monthly public transit passes, or those passes of a longer duration. Effective for the 2007 taxation year, the Public Transit Tax Credit was extended to cover the purchase cost of eligible electronic fare cards and weekly passes.

The credit may be claimed by the individual or the individual's spouse or common-law partner in respect of eligible transit costs of the individual, the individual's spouse or common-law partner, and the individual's children who are under 19 years of age.

Memorandum Items

Avoidance of Double Taxation

Dividend Gross-up and Credit

Objective: *These provisions contribute to the integration of the corporate and personal income tax systems. The dividend gross-up and credit mechanism provides recognition to individuals for corporate-level taxes presumed to have been paid on dividend income. (Budget 2006; Budget 2008)*

The integration of the corporate and personal income taxes on dividend income is implemented by a dividend gross-up and tax credit mechanism. First, dividend income is grossed up by a factor that reflects the weighted statutory federal and provincial corporate income tax rate. The purpose of the gross-up is to obtain the notional pre-tax business income from which the dividend was paid. Second, the grossed-up dividend is included in the individual's income and taxed according to the regular personal income tax rate schedule. Finally, a non-refundable personal income tax credit is provided based on the federal corporate income tax rate to compensate the individual for corporate-level taxes presumed to be paid on the business income that generated the dividend.

Dividends paid by Canadian corporations out of business income subject to the general corporate income tax rate are eligible for an enhanced Dividend Tax Credit. A gross-up factor of 45 per cent and an enhanced tax credit rate of 19 per cent were established in 2006 to reflect the general corporate income tax rate applicable at that time. Budget 2008 adjusted the enhanced Dividend Tax Credit and gross-up factor to reflect scheduled corporate income tax rate reductions that were announced in the 2007 Economic Statement. Effective 2012, the gross-up applicable to eligible dividends will be 38 per cent and the enhanced Dividend Tax Credit will be 15 per cent.

Dividends paid by Canadian corporations out of other income not taxable at the general corporate income tax rate, primarily small business income, are grossed up by a factor of 25 per cent and are eligible for a Dividend Tax Credit rate of 13.3 per cent.

Foreign Tax Credit

Objective: *This provision was introduced to avoid the taxation of income that has already been taxed in foreign countries.*

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

Non-Taxation of Capital Dividends

Objective: *This treatment contributes to the integration of the corporate and personal income tax systems.*

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

No data are available.

Loss Offset Provisions

Capital Loss Carry-overs

> ***Objective:*** *These provisions support businesses and investors by reducing the risk associated with investment, and provide tax relief for cyclical businesses. (Budget Papers: Supplementary Information, 1983)*

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years. Notwithstanding these rules, net capital losses realized in the year in which a taxpayer dies may be deductible against all forms of income for that taxation year and the immediately preceding year. Unused net capital losses from prior years carried forward to the year of death may also be deductible against all forms of income for that taxation year and the immediately preceding year.

The only data that are available are prior years' net capital losses carried forward to the current year to reduce taxes payable and net capital losses realized in the year in which a taxpayer dies and used to reduce taxes payable for that year. The estimates do not include current-year losses carried forward or back to other taxation years, nor do they include future losses carried back to the taxation year in question.

Farm and Fishing Loss Carry-overs

> ***Objective:*** *These measures provide increased cash flows and reduced risks to farms and fisheries in recognition of the cyclical nature of these industries. (Budget Papers, 1983; Budget 2006)*

Farm and fishing losses arising in or after 2006 may be carried back 3 years and forward 20 years and deducted against all sources of income. Farm and fishing losses incurred before 2006 may be carried back 3 years and forward 10 years and deducted against all sources of income.

The only data that are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the actual amount of revenue forgone because they do not include current-year losses carried forward or back to other taxation years, nor do they include future losses carried back to the taxation year in question. The estimates do not include losses carried over by part-time farmers.

Non-Capital Loss Carry-overs

> ***Objective:*** *These provisions support businesses and investors by reducing the risk associated with investment, and provide tax relief for cyclical businesses. (Budget Papers: Supplementary Information, 1983; Budget 2004; Budget 2006)*

Non-capital losses arising in or after 2006 may be carried back 3 years and forward 20 years to offset other income. Non-capital losses incurred in a taxation year ending after March 22, 2004 and before 2006 may be carried back 3 years and forward 10 years. Non-capital losses incurred in a taxation year ending before March 23, 2004 may be carried back 3 years and forward 7 years.

The only data that are available are prior years' losses carried forward to the current year to reduce taxes payable. Thus, the cost estimates may understate the actual amount of revenue forgone because they do not include current-year losses carried forward or back to other taxation years, nor do they include future losses carried back to the taxation year in question.

Social and Employment Insurance Programs

Canada Pension Plan and Quebec Pension Plan Contribution Credit/ Non-Taxation of Employer-Paid Premiums

Objective: *These measures promote tax fairness.*

A tax credit is provided for Canada Pension Plan/Quebec Pension Plan (CPP/QPP) contributions by both employees and the self-employed. The value of the credit is calculated by applying the lowest personal income tax rate to the contributions. Employer-paid premiums are not included in the employee's income. Since CPP/QPP benefits are taxable, the credit and non-inclusion promote tax fairness.

Effective January 1, 2001, self-employed individuals may deduct the portion of CPP/QPP contributions that represents the employer's share.

Employment Insurance and Quebec Parental Insurance Plan Contribution Credit/Non-Taxation of Employer-Paid Premiums

Objective: *These measures promote tax fairness.*

A tax credit is provided for Employment Insurance (EI) and Quebec Parental Insurance Plan (QPIP) contributions. The value of the credit is calculated by applying the lowest personal income tax rate to the contributions. The QPIP has been in effect since January 1, 2006. Employer-paid premiums are not included in the employee's income. Since the benefits received under these programs are taxable, the credit and non-inclusion promote tax fairness.

Beginning in 2010, EI special benefits were extended to self-employed individuals on a voluntary basis.

Other

Basic Personal Amount

Objective: *This provision contributes to tax fairness by ensuring that no tax is paid on a basic amount of income. (Report of the Royal Commission on Taxation, Vol. 3, 1966; Budget Speech, 1998)*

All taxpayers qualify for the Basic Personal Amount. The value of the credit is calculated by applying the lowest personal income tax rate to the Basic Personal Amount ($10,382 in 2010). This amount is indexed to inflation.

Deferral Through Capital Gains Rollovers

Objective: *Rollover provisions are provided in some situations in which it would be unfair to collect capital gains tax even though the taxpayer has sold or otherwise disposed of an asset at a profit. (Proposals for Tax Reform, 1969)*

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

Involuntary Dispositions

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

Voluntary Dispositions

Capital gains resulting from the voluntary disposition of land and buildings by businesses may be deferred if replacement properties are purchased within a specified period (e.g. a business changing location). The rollover is generally not available for properties used to generate rental income.

Transfers to a Corporation for Consideration Including Shares

Individuals may transfer an asset to a corporation controlled by them or their spouses or common-law partners and elect to roll over any resulting capital gain or recaptured depreciation into the corporation instead of paying tax in the year of sale.

No data are available.

Non-Taxation of Lottery and Gambling Winnings

Objective: *Proceeds from the sale of lottery tickets are an important source of funds for provincial governments, charities and other not-for-profit organizations. As a result, there is already a considerable element of implicit taxation of lottery and gambling proceeds. The federal government has vacated this area in favour of the provinces.*

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

A number of substantial methodological difficulties call into question the accuracy and utility of estimates of the revenue implications of non-taxation of lottery and gambling winnings. The first methodological difficulty is that the data on payouts/winnings are incomplete. There are reliable administrative data on aggregate payouts only for government-run lotteries and bingos. The administrative data on payouts at casinos, video lottery terminals, horseracing, and racetrack slot machines, which constitute a large share of total spending on gaming, are fragmentary. In addition, only limited data are available on the payouts/winnings from activities sponsored by charities and other non-government organizations. Second, even if complete information on aggregate payouts were available, the revenue implications of non-taxation still could not be determined with precision. For example, if the benchmark tax system were to include taxation of gambling and lottery winnings, consideration would have to be given to including a deduction for expenses incurred in earning this income, i.e. ticket purchases of wagers/losses. This deduction could be allowed either against all income or against only lottery and gambling winnings. A threshold below which winnings would not

be taxable would also be necessary, due to the large administrative cost of taxing very small prizes. In the absence of accurate information on the distribution of prizes and the incomes of winners, the resulting potential tax base is difficult to estimate. Further, it would be impractical to tax some forms of winnings (e.g. slot machines) because of the way in which prizes are paid out.

Another important point to note with respect to the non-taxation of lottery and gambling winnings is that under federal-provincial agreements negotiated in 1979 and 1985, the federal government, in exchange for an ongoing payment, undertook to refrain from re-entering the field of gaming and betting and to ensure that the rights of the provinces in that field are not reduced or restricted.

No estimates are provided.

Non-Taxation of Allowances for Diplomats and Other Government Employees Posted Abroad

Objective: *This provision recognizes the additional costs incurred by diplomats and other government personnel employed outside Canada.*

Diplomats and other government employees posted abroad receive allowances to cover the additional costs associated with living outside Canada. These allowances are not taxable.

Estimates are based on data provided by Foreign Affairs and International Trade Canada and the Department of National Defence.

Partial Deduction of Meals and Entertainment Expenses

Objective: *This measure recognizes that there is a personal consumption element of business expenses for meals and entertainment expenses. (Income Tax Reform, June 18, 1987; Budget 1994; Budget 2007)*

See description in Chapter 3.

Chapter 3

Description of Corporate Income Tax Provisions

Charities, Gifts and Political Contributions

Deductibility of Charitable Donations

> ***Objective:*** *This measure is designed to support the important work of the charitable sector in meeting the needs of Canadians. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

Donations made by corporations to registered charities are deductible in computing taxable income within certain limits. In general, a deduction may be claimed on donations totalling up to 75 per cent of net income. The limit is increased by 25 per cent of the amount of taxable capital gains arising from the donations of appreciated capital property and 25 per cent of any capital cost allowance recapture arising from the donation of depreciable capital property. The percentage of income restriction does not apply to certain gifts of cultural property or ecologically sensitive lands, and in certain other circumstances donations in excess of the limit may be carried forward for up to five years.

Deductibility of Gifts of Cultural Property and Ecologically Sensitive Land

> ***Objective:*** *This measure encourages the donation of cultural property to designated institutions, such as museums and galleries, and encourages the conservation and protection of Canada's environmental heritage. (Budget 1995; Budget 1997; Budget 2000)*

Gifts of cultural property to institutions designated under the Cultural Property Export and Import Act and gifts of ecologically sensitive land to Canada, a province, a Canadian municipality and certain registered charities are deductible to the extent of net income available in the year. Unused deductions may be carried forward for up to five years.

Reduced Inclusion Rate for Capital Gains on Donations of Publicly Listed Securities to Registered Charities

See description in Chapter 2.

Reduced Inclusion Rate for Capital Gains on Donations of Ecologically Sensitive Land to Public Chnrities

See description in Chapter 2.

Non-Taxation of Capital Gains on Donations of Cultural Property

See description in Chapter 2.

Deductibility of Gifts of Medicine

> ***Objective:*** *This measure provides an incentive for corporations to donate medicines for use in international programs by providing a special additional deduction. (Budget 2007; Budget 2008)*

Businesses that donate medicines from their inventory to an eligible charity can claim an additional deduction equal to the lesser of:

- 50 per cent of the amount by which the fair market value of the donated medicine exceeds its cost; and
- The cost of the medicine.

The unused deduction may be carried forward for up to five years.

Deductibility of Gifts to the Crown

> ***Objective:*** *Gifts made to Canada or to a province are deductible, within certain limits, to encourage such contributions.*

Gifts made by corporations to Canada or a province are deductible in computing taxable income, within certain limits. Unused deductions may be carried forward for up to five years.

The maximum amount deductible for gifts to the Crown is harmonized with the restriction on the deductible amount for charitable donations (these limits are described under "Deductibility of Charitable Donations" above).

Non-Taxation of Registered Charities

> ***Objective:*** *This measure provides tax relief for registered charities in recognition of the important role they play in Canadian society. (Discussion Paper: The Tax Treatment of Charities, June 23, 1975)*

Registered charities, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity has income that would otherwise be taxable, such as investment income or profits from certain commercial activities.

Non-Taxation of Other Non-Profit Organizations (Other Than Registered Charities)

> ***Objective:*** *This measure provides tax relief for non-profit organizations in recognition of the important role they play in Canadian society.*

Non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the non-profit organization has income that would otherwise be taxable, such as investment income or profits from certain commercial activities.

Political Contribution Tax Credit

Objective: *This provision is intended to ensure that registered political parties have a broad base of financial support. (Report of the Royal Commission on Taxation, Vol. 3, 1966) The credit was effectively eliminated under the Federal Accountability Act, which came into force on January 1, 2007.*

A non-refundable tax credit for corporate contributions to registered federal political parties, candidates and registered electoral district associations was implemented in 1974.

From 2004 to 2006, the Political Contribution Tax Credit was 75 per cent of the first $400 contributed, 50 per cent of the next $350 contributed and 33⅓ per cent of the next $525 contributed. The maximum credit was $650, and was available when the corporation contributed $1,275.

Culture

Canadian Film or Video Production Tax Credit

Objective: *The primary objective of the credit is the encouragement of Canadian programming and the development of an active domestic independent production sector. (Canadian Heritage News Release, December 12, 1995)*

The Canadian Film or Video Production Tax Credit was introduced in Budget 1995 for certified Canadian film productions produced by qualified corporations. It provides a refundable investment tax credit of 25 per cent of the cost of eligible salaries and wages. Since 2003, the maximum amount of Canadian labour cost qualifying for a tax credit has been 60 per cent of the total cost of a film or video production, so that the credit provides assistance of up to 15 per cent of the cost of the production. Canadian film or video productions are certified by the Canadian Audio-Visual Certification Office of the Department of Canadian Heritage.

Non-Deductibility of Advertising Expenses in Foreign Media

Objective: *This measure is intended to ensure that control of periodicals and newspapers remains in the hands of Canadians and supports the continued existence of a viable and original Canadian magazine industry. (House of Commons Debates, Vol. 3, 1965; Department of Finance News Release 95-050, June 19, 1995)*

Expenses for advertising in non-Canadian newspapers or periodicals or on non-Canadian broadcast media cannot generally be deducted for income tax purposes if the advertising is directed primarily to a market in Canada. This treatment results in a negative tax expenditure. Deducting the cost of advertising in foreign media is not restricted if the advertising is to promote sales in foreign markets.

Federal-Provincial Financing Arrangements

Income Tax Exemption for Provincial and Municipal Corporations

Objective: *Provinces have constitutional immunity from taxation by the federal government. The Income Tax Act provides an exemption from taxation to certain entities that do not benefit from constitutional immunity including municipalities, certain municipal corporations and corporations, commissions or associations the shares of which are owned by the federal or provincial Crown. The exemption dates back to the Income War Tax Act, 1917.*

The Income Tax Act provides an exemption for certain provincial Crown corporations and municipal corporations.

No data are available.

Transfer of Income Tax Points to Provinces

Objective: *The tax point transfer assists provinces in providing services in the areas of health, post-secondary education, social assistance and social services, including early childhood development and early learning and child care services. (Federal-Provincial Fiscal Arrangements Act, Part V)*

In 1967, the federal government transferred four tax points of personal income tax and one tax point of corporate tax to all provinces in place of certain direct cash transfers under the cost-shared program for post-secondary education. The corporate income tax change involved an increase in the corporate income tax abatement rate from 9 to 10 percentage points, effectively reducing the federal corporate income tax rate at that time from 37 to 36 per cent (the rate before the abatement was 46 per cent).

Logging Tax Credit

Objective: *The Logging Tax Credit was introduced as a means of relieving the high tax burden on the forest industry relative to other industries. (Budget Speech, 1962)*

Budget 1962 noted that as a result of provincial taxes on logging profits (then existing in British Columbia and Ontario), corporations and unincorporated businesses in the forestry industry bore a higher burden of taxation than other industries. The budget proposed a federal tax credit equal to two-thirds of the amount of provincial logging tax paid and expressed the hope that provinces imposing a logging tax would provide a provincial tax credit equal to one-third of the logging tax.

The Logging Tax Credit reduces federal taxes payable by the lesser of two-thirds of any tax on income from logging operations paid to a province and 6⅔ per cent of income from logging operations in that province. Two provinces currently impose logging taxes that are prescribed by regulation for the purpose of this credit—British Columbia and Quebec. Both provinces provide a partial credit against provincial income tax in respect of their logging tax.

A parallel measure applies to individuals with unincorporated businesses.

General Business and Investment

Accelerated Deduction of Capital Costs

> ***Objective:*** *By deferring taxation, these measures improve financial returns, and thus encourage capital investment in particular sectors. (Proposals for Tax Reform, 1969; The Corporate Income Tax System: A Direction for Change, May 1985; Budget 1994; Budget 1996; Budget 2007)*

Where a tax deduction is allowed for the cost of capital investments, the deduction is normally required to be spread over a number of years. This is based on the principle that capital assets are not consumed in the period in which they are acquired, but instead contribute to earnings over several years. Therefore, the deduction is normally allowed at a rate which allocates the cost of the asset over the period that the asset contributes to earnings—the asset's useful life. Allocating the deduction for capital costs over the useful life of assets ensures that the tax system is neutral in its treatment of assets with different useful lives.

The determination of the useful life of an asset involves the assessment of a variety of factors, including statistical estimates of the rate of economic depreciation applying to the asset, industry data on the engineering life of the asset and the repairs needed to keep it operating, and the treatment accorded to the asset for financial accounting purposes.

For tax purposes, firms calculate their deductions for depreciable capital assets under the rules set out in the Income Tax Act and Regulations. The allowable deduction rates for most tangible capital assets are set out in the capital cost allowance (CCA) system. This system generally allows a fixed percentage of the original capital cost of an asset or group of assets to be deducted each year. In most cases, each successive year the fixed percentage is applied to the declining balance of undeducted costs remaining. A similar system applies to deductions for intangible expenses in the natural resource sectors that are capital in nature, such as the costs of exploration and development.

The rate at which certain capital costs can be deducted for tax purposes is, in some cases, more rapid than would be permitted under the useful life benchmark. Examples are the provision of accelerated CCA for certain tangible capital assets and of accelerated deductions for certain intangible expenses that are capital in nature. Such provisions are available, for example, in respect of investments related to research and development, clean energy generation, vessels, manufacturing, advertising and resource exploration.

These provisions result in tax deductions that are higher (as compared with the useful life benchmark) in the initial years of the life of an asset and lower in later years. While the total amount deducted over the life of the asset (equal to the original cost) is not affected, the acceleration in the deduction results in a deferral of tax. Given the time value of money, this can be an important financial benefit to firms. Changes in the timing of tax receipts can also have an important impact on the Government's fiscal position in the short term.

The availability of faster deductions through accelerated CCA was reduced significantly under tax reform in 1988. The most notable accelerated capital deduction provisions in place today are described later in this section.

Parallel measures apply to individuals with unincorporated businesses.

Calculation of the Tax Expenditure

General issues relating to the calculation of the tax expenditure associated with tax deferrals such as accelerated write-offs are discussed in Chapter 1 in the box entitled “Deferrals Estimated on Nominal Cash-Flow Basis.” As noted in the box, there are two general approaches to measuring the tax expenditure associated with accelerated deductions—the cash-flow approach and the present-value approach.

The cash-flow approach to calculating the tax expenditure for an accelerated deduction focuses on deductions taken in a given year. It measures the extent to which tax revenues in that year are lower as a result of that provision than they would be under the benchmark system. It focuses on the short-run impact of the ongoing provision on tax revenues, which is important for fiscal-planning purposes. However, since the cash-flow tax expenditure takes into account the impact in the particular year of CCA claims with respect to assets acquired in various previous years, it is not necessarily equal to the amount of revenue that would be gained in the short run if the provision were to be eliminated for new investments.

The cash-flow approach does not fully capture the benefit to individual taxpayers of timing-related measures like accelerated CCA, which defer taxes without reducing their ultimate amount. For this reason, an alternative approach—the present-value method—is sometimes used to calculate the impact of timing-related measures.

In contrast to the cash-flow approach, which focuses on the impact on revenues in a particular year of investments made in that year and prior years, the present-value approach looks at the expected stream of deductions in the future in respect of an investment or a group of investments made at a particular time. This approach explicitly recognizes the time value of money by reducing the value of future amounts by a discount rate. In this case, the tax expenditure is estimated by comparing the discounted present value of tax payments associated with a given investment or series of investments made at a particular point in time over the life of those investments with and without the accelerated deduction in place.

Notwithstanding the different methodologies available, annual tax expenditure estimates are not provided for accelerated deductions because adequate data are not generally available to calculate them with a reasonable degree of accuracy. In many cases, this is due to differences in categorization of assets and recording of related expenses between the tax system and possible benchmarks such as financial statements and studies of economic depreciation. In some cases, the accelerated category encompasses a range of assets or expenses, but tax filings do not provide any detail on the particular type of assets in which companies invest. The calculations would also be complicated by other differences between the tax system and the benchmark, including the following factors:

- CCA and other capital deductions for tax purposes are generally discretionary—a firm can claim any amount up to the maximum permitted, and the undepreciated balance continues to be available for deductions in future years. Firms typically choose to claim such deductions only to the extent necessary to reduce their taxable income for the year to zero rather than claiming larger amounts and triggering a loss. As a result, even where the legislated CCA rate is aligned with the benchmark, if a firm chooses to deduct less than the maximum permitted, this would appear from data based on actual claims as a negative tax expenditure for the year.
- The asset cost may differ for economic depreciation and tax purposes because interest costs are often capitalized for economic depreciation purposes, while for tax purposes such costs are generally expensed in the year incurred. For accounting purposes in Canada, there is no standard practice as regards capitalization of interest.

- For tax purposes, assets are generally grouped in pools with gains or losses on disposition generally adjusting the undepreciated balance, while gains and losses for accounting and economic depreciation purposes are recognized on an asset-by-asset basis.

Despite these limitations, the Department of Finance has occasionally undertaken special studies to estimate tax expenditures associated with particular accelerated provisions. An example is the estimates made with respect to accelerated CCA for oil sands projects, discussed later in this section.

Apart from the overall tax expenditure or fiscal cost to government associated with accelerated deductions, some indication of the magnitude of the financial support for a particular investment provided by an accelerated deduction can be calculated under the present-value approach. As an illustration, assume a taxable corporation invests $100,000 in 2010 in electrical generating equipment using solar energy that has a useful life of 25 years. This equipment is eligible for a 50-per-cent CCA rate under Class 43.2 (discussed below), whereas electrical generating equipment generally is classified under Class 17 with a CCA rate of 8 per cent. Assume that the corporation makes full use of its CCA deductions each year and is not eligible for any other preferences, and that the discount rate is 8 per cent. In this case, the accelerated CCA deductions under Class 43.2 reduce the tax payable by the corporation over the life of the investment by roughly $6,800 in discounted present-value terms compared with the CCA deductions that would otherwise be available under Class 17. This is equivalent in value to an upfront grant of $6,800—about 6.8 per cent of the total investment cost of $100,000.

Accelerated Deductions for Tangible Capital Costs

Capital Equipment Used for Scientific Research and Experimental Development

Eligible capital expenditures for the provision of premises, facilities or equipment used for scientific research and experimental development in Canada may be fully deducted in the year they are incurred. In the absence of this provision, these amounts would be depreciable over several years.

Clean Energy Generation Assets

Accelerated CCA is provided for specified clean energy generation equipment that generates electricity and/or heat from renewable energy sources (e.g. wind, solar, small hydro) and from waste sources (e.g. wood waste, landfill gas, manure) or by making efficient use of fossil fuels (e.g. high efficiency cogeneration). This provision supports investment in equipment that contributes to a reduction in greenhouse gas emissions, improves air quality and promotes diversification of energy supplies.

This incentive is provided under CCA Class 43.2, which was introduced in 2005 and is currently available for assets acquired after February 22, 2005 and before 2020. Class 43.2 provides an accelerated CCA rate of 50 per cent per year (on a declining-balance basis). For assets acquired before February 23, 2005, CCA is provided under Class 43.1 at an accelerated rate of 30 per cent. The eligibility criteria for these two classes are generally the same, except that cogeneration systems that use fossil fuels must meet a higher efficiency standard for Class 43.2 than for Class 43.1. Without Classes 43.1 or 43.2, many of these assets would be depreciated at annual rates of 4, 8 or 20 per cent. Budget 2007 extended the eligibility for class 43.2 to assets acquired before 2020. Detailed eligibility requirements are set out in the Income Tax Regulations.

Where the majority of the tangible capital in a project is eligible for Class 43.1 or Class 43.2, certain project start-up expenses (e.g. feasibility studies, engineering and design work) qualify as Canadian Renewable and Conservation Expenses (described below).

Computer Equipment

In general, computers acquired on or after March 19, 2007, are included in Class 50 and are eligible for a 55-per-cent declining-balance CCA rate. Budget 2009 announced a temporary 100-per-cent CCA rate for eligible computers and systems software acquired after January 27, 2009 and before February 2011. This 100-per-cent CCA rate is not subject to the half-year rule, which generally allows half the CCA deduction otherwise available in the year the asset is first available for use by the taxpayer. As a result, a business is able to deduct the full cost of an eligible computer (including the systems software for that computer) in the first year of use for purchases in the eligible period.

Manufacturing or Processing Machinery and Equipment

In general, machinery and equipment used primarily in Canada for manufacturing or processing goods for sale or lease are included in Class 43 and are eligible for a 30-per-cent declining-balance CCA rate. Budget 2007 implemented a temporary incentive for eligible machinery and equipment acquired on or after March 19, 2007 and before 2009 that are used primarily in such manufacturing or processing activity. Machinery and equipment eligible for the temporary incentive are included in Class 29 and are eligible for a 50-per-cent straight-line CCA rate. Taking into account the half-year rule, maximum depreciation available over a three-year period is 25 per cent written off in the first year, 75 per cent less the first-year write-off in the second year, and the balance in the third year. Budget 2009 announced that the accelerated depreciation rate would be available on eligible assets acquired before 2012.

Mining and Oil Sands Assets

Currently, most machinery, equipment and structures used to produce income from a mine or an oil sands project, including buildings and community infrastructure related to worker accommodations, are eligible for a CCA rate of 25 per cent under Class 41. This rate also applies to assets owned by a mineral resource owner that are used in the initial processing of ore from the mineral resource or in the upgrading of bitumen (the oil sands product) from the mineral resource into synthetic crude oil.

In addition to the regular CCA deduction, an accelerated CCA has been provided since 1972 for assets acquired for use in new mines, including oil sands mines, and major mine expansions (i.e. those that increase the capacity of a mine by at least 25 per cent). In 1996, this accelerated CCA was extended to in-situ oil sands projects (which use oil wells rather than mining techniques to extract bitumen). This change ensured that both types of oil sands projects are accorded the same CCA treatment. The 1996 changes also extended the accelerated CCA to expenditures on eligible assets acquired in a taxation year for use in a mine or oil sands project, to the extent that the cost of those assets exceeds 5 per cent of the gross revenue for the year from the mine or project.

The accelerated CCA takes the form of an additional allowance that supplements the regular CCA claim. Once an asset is available for use, the taxpayer is entitled to deduct CCA at the regular rate. The additional allowance allows the taxpayer to deduct in computing income for a taxation year up to 100 per cent of the remaining cost of the eligible assets, not exceeding the taxpayer's income for the year from the project (calculated after deducting the regular CCA). This accelerated CCA provides a financial benefit by effectively deferring taxation until the cost of capital assets has been recovered out of project earnings.

Budget 2007 announced the phase-out of the accelerated CCA for oil sands projects—leaving in place the regular 25-per-cent CCA rate for these assets—to improve fairness and neutrality among the oil sands and other sectors. To ensure a stable investment climate, the existing accelerated CCA will

be grandfathered for oil sands assets acquired before 2012 in project phases that commenced major construction prior to March 19, 2007. For other assets, companies will maintain the ability to claim accelerated CCA until 2010, with the rate being gradually reduced between 2011 and 2015 according to the following schedule:

Table 3.1
Accelerated CCA Phase-Out Schedule for Oil Sands Projects

	2010	2011	2012	2013	2014	2015
Allowable percentage of additional allowance	100	90	80	60	30	0

The cost of providing accelerated CCA for oil sands projects varies considerably from year to year based on project-specific factors like the timing of investments, the position of projects within their investment cycle and the tax situation of individual firms, as well as broader industry factors like market prices, costs and broad investment trends. Using detailed modelling developed in the context of Budget 2007, the cost of providing the accelerated allowance over the period from 2007 to 2011 was estimated at an average of roughly $300 million per year on a current cash-flow basis.

Mines other than oil sands projects are not affected by the phase-out and remain eligible for accelerated CCA.

Vessels

Vessels are generally included in Class 7 and are subject to a maximum CCA rate of 15 per cent on a declining-balance basis. Accelerated CCA on a straight-line basis at a maximum rate of 33⅓ per cent of the capital cost of the property is available in respect of a vessel, including furniture, fittings, radio communication equipment and other equipment, if it was (a) constructed in Canada, (b) registered in Canada, and (c) not used for any purpose whatever before acquisition by the owner. Taking into account the half-year rule, maximum depreciation available over a four-year period is 16⅔ per cent written off in the first year, 33⅓ per cent written off in the second and third years, and the balance in the fourth year.

Write-off of Capital Assets Before Available for Use

Corporations may claim CCA and investment tax credits (ITCs) on eligible property at the earlier of the time it is put in use or in the second taxation year following the year of acquisition. When CCA and ITCs are claimed before assets are available for use, a tax deferral—i.e. a tax expenditure—results.

Accelerated Deductions for Intangible Capital Costs

Advertising Costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. Under the benchmark tax system, the expenses would be amortized over the benefit period.

Canadian Exploration Expenses

Canadian Exploration Expenses (CEE) are deductible at a rate of 100 per cent in the year incurred. For the oil and gas sector, CEE includes certain intangible costs incurred to determine the "existence, location, extent or quality" of a crude oil or natural gas reservoir not previously known to exist. For the mining sector, CEE has a broader definition and includes not only expenses incurred for the

purposes of determining the existence, location, extent or quality of a mineral resource, but also pre-production development expenses—costs incurred for the purpose of bringing a new mine into production in reasonable commercial quantities.

Generally accepted accounting principles allow companies to depreciate exploration expenses on either a "full cost" or a "successful efforts" basis. The full cost method requires that all exploration costs, whether they result in new production or not, be capitalized and amortized. The successful efforts method requires that only those costs that result in the discovery of reserves and have a direct benefit in terms of future revenues be capitalized; other costs are expensed as incurred.

There is a similar ambiguity about the treatment of exploration expenses under the benchmark tax system. As a general proposition, since exploration expenses are undertaken to create an asset (the reserves discovered), they would be capitalized and amortized over the life of the asset in the benchmark tax system. Since unsuccessful efforts do not result in an exploitable asset, arguably such expenditures would be expensed. On the other hand, some unsuccessful exploration could be considered part of a more general project to find exploitable reserves and may provide valuable information which can assist future exploration efforts. This may suggest that such expenses would also be capitalized. In contrast, development expenses to build a mine would clearly be capitalized over the useful life of the assets created (e.g. the pit or mine shaft), which would typically be the same as the useful life of the underlying reserves. To the extent that the 100-per-cent deduction for CEE is more rapid than the benchmark, it provides a deferral of tax.

Under certain conditions, small oil and gas corporations issuing flow-through shares are entitled to reclassify limited amounts of Canadian Development Expenses flowed out to shareholders as CEE. The tax expenditure associated with this provision is discussed under "Reclassification of Expenses Under Flow-Through Shares" in Chapter 2.

Canadian Renewable and Conservation Expenses

A category of expenses known as Canadian Renewable and Conservation Expenses (CRCE) was introduced in 1996 to make the tax treatment of the renewable and non-renewable energy sectors more similar. CRCE includes certain, generally intangible, start-up costs of renewable energy and energy efficiency projects. Eligible projects are those for which at least 50 per cent of the cost of depreciable assets can reasonably be expected to be property that is eligible for accelerated CCA under Class 43.1 or Class 43.2 (see the section "Clean Energy Generation Assets" above). CRCE includes expenses such as the cost of engineering and feasibility studies, which may be considered analogous to exploration expenses incurred by firms in the non-renewable resource sector. CRCE is formally a subset of CEE and is therefore fully deductible in the year the expense is incurred, and can be transferred to flow-through share investors. Some of these expenses are capital in nature and would arguably be capitalized and amortized over time in the benchmark tax system.

Current Expenditures on Scientific Research and Experimental Development

Eligible current expenditures on scientific research and experimental development (SR&ED) in Canada may be fully deducted in the year they are incurred. However, these expenditures are expected to generate future benefits and income for the SR&ED performer through the creation of knowledge. SR&ED produces technology, a form of knowledge that is used to enhance the productivity of factors of production and economic growth. Like other forms of capital, technology can be stored, sold as a good or service, and also depreciates and becomes obsolete. As such, under the benchmark tax system, these expenditures would be capitalized and depreciated over the time period the knowledge asset created is expected to generate revenues.

Employee Training

Current expenditures that are incurred for employee training are fully deductible by businesses. Expenditures on training improve the quality of human capital and provide benefits to the business in both the current year and future years similar to an acquisition of physical capital. Under the benchmark tax system, these costs would be capitalized and depreciated over the period of time they are expected to generate additional revenues for the firm.

Capital Gains

Deferral Through Five-Year Capital Gain Reserve

See description in Chapter 2.

Partial Inclusion of Capital Gains

See description in Chapter 2.

Taxation of Capital Gains Upon Realization

Objective: *This treatment recognizes that, in many cases, it is difficult to estimate with accuracy the value of unsold assets, and that taxing the accrued gains on assets that have not been sold would be administratively complex and could create significant liquidity problems for taxpayers. (Report of the Royal Commission on Taxation, Vol. 3, 1966)*

Under the benchmark tax system, capital gains would be fully included in income as they accrue. Under the current system, however, capital gains are generally taxed upon the disposition of property, which results in a tax deferral.

Financial institutions and investment dealers are required to report gains and losses on certain properties on an accrual basis (i.e. mark to market).

No data are available.

Investment Tax Credits

The following measures are credits against federal income taxes otherwise payable. They are considered to be tax expenditures because they provide incentives to taxpayers that invest in certain activities, such as scientific research and experimental development (SR&ED), or in certain capital assets in designated regions of the country.

The amount of an investment tax credit (ITC) is calculated as a percentage of the cost of eligible expenditures. ITCs can reduce federal income tax revenues in one of two ways. They may be:

- Used to offset federal income taxes otherwise payable; or
- Fully or partially refunded in the year they are earned in the case of smaller Canadian-controlled private corporations.

All refunds reduce the amount of ITCs for carry-over purposes. Unused ITCs may be carried back 3 years. Unused ITCs may also be carried forward; the 10-year carry-forward period was extended to 20 years in Budget 2006.

ITCs utilized or refunded in a year reduce either the undepreciated capital cost of the asset for capital cost allowance purposes or, in the case of SR&ED ITCs, the SR&ED expenditure pool. In the case of property acquired after 1989 and not immediately available for use, ITCs may not be utilized or refunded until the property is available for use or has been held by the taxpayer for two years.

Parallel measures apply to individuals with unincorporated businesses.

Calculating the Value of ITCs

To maintain consistency with the other tax expenditure estimates, the amounts shown for ITCs estimate the forgone revenue for the year in question. In other words, the estimates show how much additional revenue the Government would have collected in the year if the ITC had been eliminated in that particular year, everything else being equal. The additional revenue would come from three sources: ITCs both earned and used in the year; ITCs earned in the current year but carried back and applied to reduce tax of a previous year; and ITCs earned in prior years but carried forward and used in the current year. The costs of any applicable refunds of ITCs earned are included in the estimates for credits earned and used in the year.

In addition to the credits set out below, other ITCs include the temporary Mineral Exploration Tax Credit for flow-through share investors (discussed in Chapter 2) and the Corporate Mineral Exploration and Development Tax Credit (discussed below under "Sectoral Measures").

Atlantic Investment Tax Credit

Objective: *The objective of this credit is to promote economic development in the Atlantic provinces and the Gaspé region. (Budget 1977)*

The Atlantic Investment Tax Credit (AITC) is available at a rate of 10 per cent in respect of eligible expenditures in the Atlantic region—i.e. Newfoundland and Labrador, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region and their associated offshore areas.

The AITC is earned on eligible expenditures on new buildings and machinery and equipment employed in the following qualifying activities: farming, fishing, logging, mining, oil and gas, and manufacturing and processing.

The AITC is partly refundable for qualifying Canadian-controlled private corporations (CCPCs) and individuals. A qualifying CCPC (or the associated corporate group it belongs to) has taxable income not exceeding the limit on active business income eligible for the small business deduction (see "Low Tax Rate for Small Businesses" below for details).

Scientific Research and Experimental Development Investment Tax Credit

Objective: *This credit is intended to encourage the performance of scientific research and experimental development (SR&ED) in Canada by the private sector through broadly based support, and, in particular, to assist small businesses to perform SR&ED. (Budget 1996)*

The federal income tax incentives for SR&ED provide broadly based support for all types of SR&ED performed in every industrial sector in Canada. The rationale for this tax support is that the benefits of SR&ED extend beyond the performers themselves to other firms and sectors of the economy. The existence of these spillovers or externalities means that, in the absence of government support, firms would perform less SR&ED than desirable for the economy.

The Scientific Research and Experimental Development Investment Tax Credit (SR&ED ITC) is earned on eligible current and capital expenditures in respect of SR&ED in Canada performed by, or on behalf of, a taxpayer and related to a business of the taxpayer.

There are two rates of SR&ED ITCs: a general rate of 20 per cent, and an enhanced rate of 35 per cent for up to $3 million (increased from $2 million in Budget 2008) of expenditures by small and medium-sized Canadian-controlled private corporations (CCPCs)—i.e. with prior-year taxable income of $500,000 or less (increased from $300,000 in Budget 2006, and from $400,000 in Budget 2009) and taxable capital employed in Canada of $10 million or less. The $3-million expenditure limit is reduced to zero on a phased basis as the CCPC's taxable income rises from $500,000 to $800,000 and its taxable capital increases from $10 million to $50 million. (The upper limit on taxable income was increased from $600,000 in Budget 2008 and $700,000 in Budget 2009. The upper limit for taxable capital was increased from $15 million in Budget 2008.)

Unused SR&ED ITCs are partially refundable to unincorporated businesses and either partially or fully refundable for small and medium-sized CCPCs. Details are provided in the table below.

Table 3.2
Federal SR&ED Tax Credit Rates and Rates of Refundability

		Refundability Rates	
Business Type	**Credit Rates**	**Current Expenditures**	**Capital Expenditures**
		(per cent)	
Unincorporated businesses	20	40	40
CCPCs with prior-year taxable income of $500,000 or less and prior-year taxable capital employed in Canada of $10 million or less:			
Expenditures up to expenditure limit[1]	35	100	40
Expenditures over expenditure limit	20	40	40
CCPCs with prior-year taxable income between $500,000 and $800,000 or with prior-year taxable capital employed in Canada between $10 million and $50 million:			
Expenditures up to expenditure limit[2]	35	100	40
Expenditures over expenditure limit	20	0	0
CCPCs with prior-year taxable income of $800,000 or more or with prior-year taxable capital employed in Canada of $50 million or more or non-CCPCs	20	0	0

[1] Expenditure limit is generally $3 million per annum.

[2] Expenditure limit for CCPCs is phased out for prior-year taxable income between $500,000 and $800,000 and for prior-year taxable capital employed in Canada between $10 million and $50 million.

Apprenticeship Job Creation Tax Credit

> ***Objective:*** *This measure encourages employers to hire new apprentices and to support apprentices in their training. (Budget 2006)*

The Apprenticeship Job Creation Tax Credit came into effect May 2, 2006. Eligible employers receive a tax credit equal to 10 per cent of the wages paid to qualifying apprentices in the first two years of their contract, to a maximum credit of $2,000 per apprentice per year.

Investment Tax Credit for Child Care Spaces

> ***Objective:*** *This measure encourages businesses to create licensed child care spaces for the children of their employees and, potentially, for children in the surrounding community. (Budget 2007)*

The Investment Tax Credit for Child Care Spaces came into effect March 19, 2007. Eligible businesses receive a non-refundable investment tax credit equal to 25 per cent of eligible expenditures, to a maximum credit of $10,000 per child care space created. Eligible expenditures include the cost or incremental cost of the building in which the child care facility is located, as well as the cost of furniture, appliances, computer equipment, audio-visual equipment, playground structures and playground equipment. Initial start-up costs such as landscaping costs for the children's playground, architect's fees, building permit costs and costs to acquire children's educational materials are also eligible.

Small Business

Deduction of Allowable Business Investment Losses

> ***Objective:*** *This measure recognizes that small businesses often have difficulty obtaining adequate financing and provides special assistance for risky investments in such businesses. (Budget 1985; Budget 2004)*

Capital losses arising from the disposition of shares and debt instruments generally are deductible only against capital gains. However, a portion of capital losses in respect of shares or debts of a small business corporation (allowable business investment losses) may be used to offset other income. The portion of capital losses that may be so used is the same as the portion of capital gains included in income (i.e. one-half since October 18, 2000). Unused allowable business investment losses may be carried back 3 years and forward 10 years. After 10 years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The estimated tax expenditure is calculated as the amount of tax relief provided by allowing these losses to be deducted from other income in the year they arise. The tax expenditure is overstated since it does not take into account the reduction in tax revenues that would occur if those losses were instead deducted from prior-year, current-year, or future capital gains.

Low Tax Rate for Small Businesses

Objective: *This lower tax rate is intended to provide small corporations with more after-tax income for reinvestment and expansion. (Tax Measures: Supplementary Information, Budget 1994)*

Canadian-controlled private corporations (CCPCs) are eligible for a lower federal tax rate of 11 per cent, effective 2008. From July 1, 1988 to 2007, CCPCs were eligible for a 12 per cent rate.

The annual amount of active business income eligible for the reduced tax rate—generally referred to as the "small business limit"—was $250,000 for 2004; $300,000 for 2005 and 2006; $400,000 for 2007 and 2008; and has been $500,000 since 2009.The full benefit of this measure is available to CCPCs with up to $10 million of taxable capital employed in Canada. For CCPCs with between $10 million and $15 million of taxable capital employed in Canada, the limit on income eligible for the lower tax rate is reduced on a straight-line basis. CCPCs with more than $15 million of taxable capital employed in Canada are not eligible for the low rate.

The tax rate reduction paths for the general corporate income tax rate and the small business tax rate are as follows:

Table 3.3

	2005	2006	2007	2008	2009	2010	2011	2012
				(per cent)				
General corporate income tax rate	21	21	21	19.5	19	18	16.5	15
Small business tax rate	12	12	12	11	11	11	11	11
Difference	9	9	9	8.5	8	7	5.5	4

The tax expenditure is calculated as the difference between tax revenues that would have been collected applying the general rate and the small business rate. This approach assumes that all of the additional cash flow available to the firm is used to finance additional investment. However, some of the additional cash flow may be used for other purposes (e.g. paid out in dividends) and there are measures designed to recover the revenue loss associated with the low rate. For example, in the specific case of paid out dividends, see "Dividend Gross-up and Credit" in Chapter 2.

Non-Taxation of Provincial Assistance for Venture Investments in Small Businesses

Objective: *The non-taxation of provincial assistance for venture investments in small businesses assists the successful working of such provincial plans. (Budget 1977)*

Government assistance received by a corporation is generally either included in the corporation's income or used to reduce the cost base of the assets to which the assistance relates for capital cost allowance purposes. Provincial assistance provided for venture capital investment under specified provincial programs is an exception to this treatment and is therefore considered a tax expenditure.

A parallel measure applies to individuals with unincorporated businesses.

No data are available.

International

Exemption From Canadian Income Tax of Income Earned by Non-Residents From the Operation of a Ship or Aircraft in International Traffic

Objective: *The tax exemption for operating a ship or an aircraft in international traffic is a reciprocal tax exemption provided in order to avoid international double taxation.*

Non-resident persons operating a ship in international traffic are exempt from Canadian income tax, as is the case in other countries. Similarly, non-resident persons operating an aircraft in international traffic are exempt from Canadian income tax. In both cases, the exemption applies only if the non-resident's home country gives Canadian residents substantially similar tax relief. The exemption is considered to be a tax expenditure because the Income Tax Act applies to non-residents who carry on a business in Canada, including potentially (in the absence of an exemption) the operation of a ship or an aircraft in international traffic that involves Canadian territory.

The amount of the tax expenditure is the tax that would otherwise be payable on profits related to the Canadian business of the non-resident persons. This would be at least partially offset by a reduction in the tax payable on the income of Canadian residents who benefit from a reciprocal tax exemption in another country. While the reciprocal exemption exists in both the Income Tax Act and generally in Canada's tax treaties, the tax expenditure would be limited to situations where the exemptions arise solely under the Income Tax Act, as treaty provisions are generally considered to be part of the benchmark tax system.

No data are available.

Exemption From Tax for International Banking Centres

Objective: *In order to broaden our trade and business interests in Europe and the Pacific Rim, this measure exempts international banking centres established in Montréal and Vancouver from tax on their income. This measure is also intended to return to Canada some banking activities previously conducted abroad and to attract business that normally would not be conducted in Canada. (Department of Finance News Release 87-16, January 28, 1987)*

A prescribed financial institution's branch or office carrying on certain business in the cities of Montréal or Vancouver may qualify as an international banking centre (IBC) and therefore be exempt from tax on its income. To qualify as an IBC under the Income Tax Act, the branch's income must be derived from accepting deposits and making loans to non-residents. This measure is considered a tax expenditure because it allows a financial institution to undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

The tax expenditure estimates for IBCs are calculated as the amount of corporate income tax that would have been paid on the income generated from IBCs if they were subject to tax. In addition, any loss from an IBC would be considered a negative tax expenditure, as such a loss does not reduce taxable income in the same way as other non-capital losses.

A review of taxpayer data indicates a small number of taxpayers that benefit from the exemption. As a result, while data are available on the magnitude of this tax expenditure, publication of estimates of this tax expenditure may not be possible in order to preserve taxpayer confidentiality.

Exemptions From Non-Resident Withholding Tax

***Objective:** These exemptions are intended to enhance the competitiveness of Canadian businesses by lowering the cost of accessing capital and other business inputs, such as technology, from abroad.*

Canada, like other countries, imposes a withholding tax on various types of income paid to non-residents. The basis for this tax rests on the internationally accepted principle that a country has the right to tax income that arises or has its source in that country. The types of income subject to non-resident withholding tax include certain interest, dividends, rents, royalties and similar payments; management and administration fees; estate and trust income; alimony and support payments; and certain pension, annuity and other payments.

Non-resident withholding tax is levied under Part XIII of the Income Tax Act. It is imposed on the gross value of the payment to the non-resident, with no deductions allowed for expenses. This tax is separate from the tax on net income levied under Part I of the Income Tax Act. Canada's statutory non-resident withholding tax rate is 25 per cent. However, for certain payments the rate is lowered or exempt through Canada's extensive network of bilateral tax treaties. These rate reductions and exemptions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country. These rate reductions and exemptions are not considered to be tax expenditures; they are considered to be part of the benchmark.

The Income Tax Act also provides for a number of unilateral exemptions from withholding tax. For example, as of January 2008, interest paid to arm's length non-resident persons (other than participating debt interest) is exempt from withholding tax. Unilateral exemptions from withholding tax are considered to be tax expenditures.

The key exemptions which are measured as tax expenditures are as follows:[7]

- Dividends—this tax expenditure reflects exemptions from withholding tax for certain capital gains dividends and certain dividend payments by foreign business corporations.
- Interest—prior to 2008, this tax expenditure principally reflects exemptions from withholding tax for arm's length interest payable on long-term corporate debt, debt issued or guaranteed by the federal, provincial, or municipal governments, foreign currency deposits, and interest on eligible deposits with an international banking centre. As of 2008, it reflects an exemption from withholding tax for payments to non-residents of arm's length interest (other than participating debt interest).
- Rents and royalties—this tax expenditure reflects exemptions from withholding tax for: payments on copyright royalties; certain leasing payments in respect of railway rolling stock, aircraft, and related property, as well as certain other payments such as for motion pictures and films; certain payments related to research and development expenses; natural resource and timber royalties; and payments related to certain leasing arrangements for property used outside Canada.
- Management fees—this tax expenditure reflects exemptions from withholding tax for certain management or administration fees.

[7] As a result of changes effective for 2008 and later years to the legislative provisions associated with non-resident withholding tax and to the Canada Revenue Agency forms used to identify payments to non-residents, the information available to estimate some of these tax expenditures is different for years after 2007 than for years up to that time. Accordingly, the presentation of items beginning with the 2010 tax expenditure reports will differ from previous tax expenditure publications.

The tax expenditure estimates are derived by applying benchmark withholding tax rates (i.e. treaty rates in the case of payments to a country with which Canada had a tax treaty in the year considered) or the statutory 25 per cent withholding tax rate (in the case of payments to non-treaty countries) that would otherwise apply, in the absence of an exemption, to observed payments and comparing this theoretical amount of revenue to the actual withholding tax collections.

The approach taken here is not the only possible way to treat withholding tax in the tax expenditure accounts:

- Non-resident withholding tax could be considered to be a category of tax distinct from income tax—this approach would suggest that withholding tax should not be included in the tax expenditure accounts for corporate income tax.
- Another possible approach would be to consider non-resident withholding tax to be a departure from the benchmark income tax system, implying that any revenues from withholding tax would be a negative tax expenditure.
- Non-resident withholding tax could be compared to income tax, such that the benchmark would be income tax treatment of the payments.
- Alternatively, the entire non-resident withholding tax system could be considered to be part of the benchmark, such that there would be no tax expenditures associated with it.

Non-resident withholding tax is an important source of government revenue. Estimates of these revenues are set out in the table below.

Table 3.4
Withholding Tax Collected on Payments to Non-Residents, 2005–2008

	2005	2006	2007	2008
		($ millions)		
Non-portfolio dividends	1,100	775	830	1,060
Portfolio dividends	915	1,070	1,260	1,555
Interest	735	930	1,150	1,060
Rents and royalties	805	740	755	785
Management fees	45	25	30	35
Other payments[1]	725	940	1,285	990
Total	**4,330**	**4,485**	**5,310**	**5,480**

[1] Includes withholding tax on social security benefits, pension income, and other types of income.

Source: Canada Revenue Agency, NR4 Return. Totals may not add up due to rounding.

Non-Taxation of Life Insurance Companies' World Income

Objective: *To ensure that Canadian multinational life insurance companies are not adversely affected in foreign insurance markets, their foreign income is exempt from tax in Canada. This exemption is provided because other jurisdictions do not necessarily tax life insurance companies on the same basis as Canadian tax rules (e.g. other forms of taxation include taxes on premiums or on net investment revenue). (Supplementary Budget Papers, March 31, 1977)*

All Canadian corporations except Canadian multinational life insurers are taxed on their worldwide income. Canadian multinational life insurers are taxed only on their profits from carrying on a life insurance business in Canada using special rules in the Income Tax Regulations.

Prior to 1993, the cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions. However, information required to estimate this tax expenditure is no longer available.

Tax Treatment of Active Business Income of Foreign Affiliates of Canadian Corporations and Deductibility of Expenses Incurred to Invest in Foreign Affiliates

Objective: *The Canadian system for taxing the income of foreign affiliates is historically based on the objectives of eliminating double taxation, encouraging the international competitiveness of Canadian multinationals, and protecting the tax base. More recently, it has also been associated with Canada's policy on tax information exchange.*

The tax treatment of the active business income of a foreign affiliate of a Canadian corporation depends on several factors:

- Where the active business income is earned by a foreign affiliate that is resident in a country with which Canada has a tax treaty or a tax information exchange agreement (TIEA) in force, any dividend paid out of that income to a Canadian corporation is not subject to Canadian tax.
- Where the active business income is earned in a country with which Canada has no tax treaty or TIEA currently in force, any dividend is taxed in Canada but a tax deduction is provided to the Canadian corporation based on the foreign taxes paid on the underlying income.
- Where the active business income is earned in a country with which Canada has no tax treaty and which has not concluded a TIEA within five years of being asked by Canada to do so, and the foreign affiliate is controlled by the Canadian corporation, that income is taxed to the Canadian corporation as it accrues (i.e. on a current basis rather than when a dividend is paid), with a deduction based on underlying foreign taxes.

Interest and other expenses incurred by a Canadian corporation in respect of an investment in a foreign affiliate can generally be deducted in Canada without any specific limitations that are specific to foreign affiliate investments.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, that is to be associated with Canada's system for taxing the active business income of foreign affiliates of Canadian corporations. Three different benchmarks could be contemplated:

1. Active business income earned by the foreign affiliate of a Canadian corporation could be exempt from tax in Canada, both when that income is earned and at the time it is paid out as a dividend to the Canadian corporation. This is consistent with a "territorial" approach whereby only Canadian source business income is taxed in Canada.
   - If a territorial approach were to be considered as the benchmark, then no preference would be associated with the current exemption of such income, while the taxation of active business income earned by foreign affiliates in countries with which Canada does not have a tax treaty or a TIEA would be viewed as a negative tax expenditure. The unrestricted deductibility of interest and other expenses incurred by Canadian corporations to earn exempt foreign business income would, on the other hand, be considered a positive tax expenditure.

2. Alternatively, the active business income of a foreign affiliate could be taxable in Canada when dividends are paid to the Canadian corporation and double taxation alleviated with a deduction based on foreign taxes. Under this approach, additional taxes are levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign business income out of which the dividend was paid.
   - If this were to be considered the benchmark system, then the current exemption for dividends paid out of active business income earned in treaty and TIEA countries would provide a preference measured as the additional tax, net of the foreign tax deduction, that would have been payable had the dividends been taxable in Canada. The taxation of active business income on an accrual basis from controlled foreign affiliates in countries which have not entered into a tax treaty and which have not concluded a TIEA within five years of being asked by Canada to do so would be a negative tax expenditure, because such income would be taxed earlier than under the benchmark. The current deductibility of interest and other expenses incurred by Canadian corporations to earn foreign business income would be a positive tax expenditure under this benchmark, as the principle that expenses should be recognized in the same period as the associated income implies that such expenses should only be deductible when the associated foreign affiliate income is subject to tax in Canada.
3. Finally, the benchmark system could be defined whereby the active business income of a foreign affiliate would be taxable in Canada as it accrues to the Canadian corporation (i.e. on a current basis), with a deduction based on foreign taxes paid.
   - If this treatment were to be viewed as the benchmark, both the exemption and the taxation-upon-repatriation approaches would represent a positive tax expenditure, measured as the forgone revenue from income that is exempt from tax (net of foreign tax credits) plus the cost of deferring incremental Canadian tax from the time the active business income is earned until the time the income is subject to tax in Canada (if at all), in the case of income that is subject to taxation on a deferred basis. The current deductibility of interest and other expenses incurred by Canadian corporations to earn foreign business income would not be a tax expenditure under this benchmark.

Data required to compute the amount of tax preference associated with any of the possible benchmarks are not available. For example, while the amount of dividends received from foreign affiliates is known, the computation of the tax expenditure under the second and third benchmarks requires that the amount of actual taxes paid in each foreign country on profits out of which dividends are paid also be known. In addition, under the third benchmark, factoring in the impact of deferral would require one to know when, in previous years, the profits underlying the dividend payments were earned (and, thus, would have been taxable). A number of methodological issues would also need to be overcome.

Sectoral Measures

Farming

Cash Basis Accounting

See description in Chapter 2.

Deferral of Income From Destruction of Livestock

See description in Chapter 2.

Deferral of Income From Sale of Livestock During Drought, Flood or Excessive Moisture Years

See description in Chapter 2.

Deferral of Income From Grain Sold Through Cash Purchase Tickets

See description in Chapter 2.

AgriInvest (Farm Savings Account)

See description in Chapter 2.

Flexibility in Inventory Accounting

See description in Chapter 2.

Agricultural Co-operatives—Patronage Dividends Issued as Shares

Objective: *To aid the capitalization of agricultural co-operatives, this measure provides favourable treatment of patronage dividends paid to members in the form of eligible shares rather than as cash distributions. (Budget 2005)*

Patronage dividends received by a member of a co-operative, other than dividends received in respect of consumer goods and services, are included in the recipient's income and are taxable in the year they are received. Members of an agricultural co-operative are permitted to defer paying tax on a patronage dividend received in the form of an eligible share from such a co-operative until the disposition (or deemed disposition) of the share.

Agricultural co-operatives that are eligible for this measure must be resident in Canada and have, as their principal business activity, farming or the provision of goods or services required for farming in Canada. In order to be an eligible share, the share must be issued after 2005 and before 2016, and must not be redeemable or retractable within five years of its issue.

Exemption for Farmers' and Fishers' Insurers

> ***Objective:*** *This exemption encourages insurers to provide much-needed insurance service in all rural districts. (1945 Royal Commission on Co-operatives)*

This measure provides a tax exemption in respect of a portion of the taxable income of a mutual insurance company that insures property used in farming or fishing (including the principal residence of farmers and fishers).

To be entitled to this exemption, at least 20 per cent of the insurer's gross revenue from premium income (net of reinsurance) must be earned in respect of insurance of property used in farming or fishing. This exemption generally applies to the insurer's taxable income relating to the farming and fishing insurance business.

Natural Resources

Corporate Mineral Exploration and Development Tax Credit

> ***Objective:*** *This measure is intended to improve the international competitiveness of the resource sector and promote the efficient development of Canada's natural resource base. (Improving the Income Taxation of the Resource Sector in Canada, March 3, 2003)*

As part of the resource sector tax changes announced in Budget 2003, the Government introduced a 10-per-cent corporate tax credit for qualifying mineral exploration and development expenses. The credit applies to both grass-roots exploration and pre-production mine development expenditures in Canada in respect of diamonds, base and precious metals as well as industrial minerals that become base or precious metals through refining.

The Mineral Exploration and Development Tax Credit applied in respect of eligible expenditures made in 2003 at a rate of 5 per cent. The rate rose to 7 per cent in 2004, and was fully phased in at a 10-per-cent rate as of 2005.

As with other investment tax credits, unused credit amounts may be carried back 3 years and forward 20 years.

Deductibility of Contributions to a Qualifying Environmental Trust

> ***Objective:*** *Contributions to trusts set up for the purpose of funding reclamation of a site used for mining, quarrying or the deposit of waste have been made deductible in order to assist firms that are required to make such contributions. (Budget 1997)*

Certain environmentally sensitive activities such as mining and waste disposal can disturb the natural environment in the area where the activity takes place, and measures may need to be taken to remediate the environmental damage after operations have terminated. In these situations, the regulating government may require companies to set aside funds in advance in an arm's length trust to ensure that adequate amounts are available to conduct restoration activities at the end of operations.

Budget 1994 provided the treatment outlined below for government-mandated contributions to eligible mine reclamation trusts. Budget 1997 extended this treatment to similar trusts established for waste disposal sites and quarries for the extraction of aggregate and similar substances. Eligible trusts, which must meet a number of statutory conditions, are now referred to as “qualifying environmental trusts” (QETs).

General income tax rules do not permit a deduction for contingent expenses, so a deduction for pre-funded reclamation costs paid into a trust would normally only be available when the reclamation costs are actually incurred. Prior to the introduction of the QET rules, these general rules could lead to two problems for companies. First, they could give rise to cash-flow problems since no tax recognition was provided when the contribution to the trust was made. Second, some companies, particularly single-mine companies, may have been unable to fully utilize the deduction for actual reclamation expenses, since the majority of these expenses occur at the end of the life of a mine or after its closure, when it no longer produces taxable income against which to claim the deduction.

In response to these issues, the QET rules provide a deduction for government-mandated contributions to a QET in the year the contribution is made. This reduces current tax and provides cash-flow assistance to companies as they set funds aside.

Income earned in the trust is subject to tax each year under special rules in Part XII.4 of the Income Tax Act. The income taxed in the trust is also considered taxable income of the corporation that established it, but the corporation receives a refundable tax credit equal to its share of the tax paid by the trust. The net result is that trust income is effectively taxed at the marginal tax rate applicable to the corporation, rather than the rate applicable to the trust. Amounts withdrawn from the trust to fund reclamation costs—both the original capital and income earned on it—are included in the corporation’s income for tax purposes, even though the income earned has already been taxed once. As a result, the investment income is included in taxable income twice. Typically, however, the beneficiary will have a deduction for reclamation costs incurred, resulting in no net tax cost at the time of withdrawal.

The inclusion of trust income in taxable income twice—once when earned and a second time when withdrawn—offsets in whole or in part the present-value benefit to the corporation of bringing forward the deduction for reclamation costs to the time when the funds are first set aside. The present value of this benefit will exactly offset the increased tax liability arising from the additional income inclusion for the trust income if the discount rate used to compute the present value of the early deduction is the same as the net rate of return earned by the capital invested in the trust. To the extent that the discount rate (which normally reflects the company’s cost of capital) is higher than the net rate of return, there will be a present-value benefit to the corporation (because the value of the acceleration exceeds the cost of the additional income inclusion).

For purposes of this report, tax expenditures are generally calculated in nominal terms. The nominal value of this tax expenditure over the life of a particular project may be negative as a result of the double inclusion in taxable income of the trust earnings. It will tend to be positive, however, if the company is taxable at the time of the contribution to the trust (so that the upfront deduction is available), but not taxable at the time of withdrawal (which could well be the case for a single-mine operation once the mine ceases to operate). The cash-flow tax expenditure for the measure as a whole in any given year is equal to the amount by which the total tax value of contributions to QETs exceeds the total tax value of deductions for reclamation expenses funded by withdrawals from QETs. This amount could be positive or negative.

Earned Depletion

> ***Objective:*** *The earned depletion incentive was designed to encourage corporations to undertake exploration and development. This measure was phased out as part of the 1987 tax reform, but existing earned depletion balances continue to be available to corporations to deduct against current income. (Proposals for Tax Reform, 1969; Summary of 1971 Tax Reform Legislation; Budget Speech, May 6, 1974; Budget Speech, November 18, 1974; White Paper, Tax Reform, 1987)*

Prior to 1990, corporations in the oil and gas and mining sectors were entitled to earned depletion. This was an extra deduction of up to 33⅓ per cent of certain exploration and development expenses and of the cost of assets related to new mines (including oil sands mines) and major mine expansions. This deduction supplemented the deduction for the actual costs incurred. As in the case of Canadian Exploration Expenses and Canadian Development Expenses, earned depletion could be pooled (i.e. placed in a special account) and any remaining balance could be carried forward indefinitely for use in later years.

Additions to the depletion pools for earned depletion and mining exploration depletion were eliminated as of January 1, 1990. Deductions can still be made on the basis of existing unused depletion pools. The deduction for earned depletion is generally limited to 25 per cent of the corporation's annual resource profits, although mining exploration depletion can be deducted against non-resource income.

The tax expenditure for any given year is the tax value of the portion of the earned depletion pool balances deducted in that year.

Net Impact of the Resource Allowance and the Limited Deductibility of Crown Royalties and Mining Taxes

> ***Objective:*** *In 1974, the deductibility of Crown royalties and mining taxes in respect of the production of oil and gas and minerals was eliminated to ensure that these provincial levies did not unreasonably erode the federal corporate income tax base. The resource allowance was introduced in 1976 to provide recognition in the determination of taxable income, within reasonable limits, of the cost of provincial royalties and mining taxes. (Budget 1974; Budget 1975; Budget 2003; Improving the Income Taxation of the Resource Sector in Canada, March 3, 2003)*

Royalties and mining taxes are essentially the price charged by the owner of a natural resource for the right to exploit the resource. They are generally intended to tax some portion of the supernormal profits ("economic rent") that can be earned by extracting scarce natural resources. In Canada, most natural resources are owned by the provinces, so most royalties are levied by provincial governments. Crown royalties and mining taxes (which function like royalties) have traditionally been deductible for federal income tax purposes under general rules as part of the cost of inputs used in resource production. For tax expenditure purposes, royalty deductibility is considered part of the benchmark tax system.

Crown royalties and mining taxes were made non-deductible as of May 6, 1974 to protect the federal tax base from the effects of what were then rapidly increasing provincial royalties and mining taxes. While oil and gas and mining companies were initially made eligible for a resource tax abatement, the abatement was replaced by the resource allowance deduction in 1976. The resource allowance functioned as a proxy for royalties and mining taxes paid to provinces, yet placed a ceiling on deductions, thereby protecting the federal tax base.

The resource allowance provided a deduction equal to 25 per cent of a corporation's resource profits, computed after operating costs and capital cost allowance, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses.

In Budget 2003, the Government announced tax changes for the resource sector that included extension of the lower general corporate income tax rate of 21 per cent to the sector over a five-year period and improvements to the tax structure. The changes included the phasing out of the resource allowance and the phasing in of a deduction for actual royalties and mining taxes paid.

A discussion of the rationale for the changes was set out in the March 2003 technical paper, *Improving the Income Taxation of the Resource Sector in Canada*. The paper noted that the resource allowance distorted investment decisions by providing a tax deduction that did not reflect the actual cost of provincial resource charges. It also created an arbitrary dividing line between expenses taken into account before the allowance is calculated and those that applied after the calculation, thereby raising the costs of compliance and administration. Finally, changed economic conditions, including greater pressure on provinces to levy royalties and mining taxes at competitive rates, made the original policy rationale of the resource allowance less relevant.

The transition path for the deductible percentage of the 25-per-cent resource allowance and of Crown royalties and mining taxes was as follows:

Table 3.5

	2003	2004	2005	2006	2007
			(per cent)		
Deductible percentage of 25-per-cent resource allowance	90	75	65	35	0
Deductible percentage of Crown royalties and mining taxes	10	25	35	65	100

For years prior to 2007, the tax expenditure in respect of royalties and the resource allowance can be broken down into two components. The overall tax expenditure is calculated by netting:

- The federal tax revenue earned by disallowing royalty deductibility (a negative tax expenditure); and
- The federal tax revenue forgone resulting from the resource allowance deduction (a positive tax expenditure).

As of 2007, the rules reflect the benchmark system, so there is no longer a tax expenditure.

Tax Rate on Resource Income

Objective: *Budget 2003 announced that, over a five-year period, the general corporate income tax rate reduction announced for other sectors in October 2000 would be extended to resource income and improvements made to the tax structure. Establishing a common statutory rate of tax for all sectors was intended to improve the international competitiveness of the Canadian resource sector and treat it more consistently with other sectors. (Improving the Income Taxation of the Resource Sector in Canada, March 3, 2003)*

As part of the Five-Year Tax Reduction Plan set out in the October 2000 *Economic Statement and Budget Update*, the Government legislated a reduction in the general rate of corporate income tax from 28 to 21 per cent over five years. This reduction was intended to bring the effective rate of taxation of the most highly taxed sectors, including services, in line with the effective rate applicable to manufacturing and processing (M&P), which was eligible for a 7-percentage-point M&P allowance.

The announced reduction in the general rate did not apply to the resource sector, which benefited from a number of targeted tax provisions, including the resource allowance, that had the effect of reducing its effective tax rate. In the October 2000 Statement, the Government also announced consultations on options to extend the lower tax rate to the resource sector while at the same time improving the tax structure.

Following an extensive series of consultations, Budget 2003 announced a package of tax changes for the resource sector that included extension of the lower general corporate income tax rate of 21 per cent to resource income and improvements to the tax structure, to be phased in over five years. The changes included the elimination of the resource allowance, the restoration of deductibility for actual royalties and mining taxes paid, and a new 10-per-cent corporate tax credit for qualifying mineral exploration and pre-production development expenditures. Additional details are set out in the March 3, 2003 technical paper, *Improving the Income Taxation of the Resource Sector in Canada*.

The tax rate reduction paths for the general corporate income tax rate and the rate for resource income were as follows:

Table 3.6

	2000	2001	2002	2003	2004	2005	2006	2007
				(per cent)				
General corporate income tax rate	28	27	25	23	21	21	21	21
Resource income tax rate	28	28	28	27	26	25	23	21
Difference	0	1	3	4	5	4	2	0

Given the general corporate tax rate as the benchmark, the difference in the tax rate for resource income effectively constituted a negative tax expenditure (i.e. it resulted in more corporate income tax being paid than would have been the case if the benchmark tax rate had applied, everything else being equal).

The reduction of the resource sector rate to the general rate was fully phased in as of 2007.

Transitional Arrangement for the Alberta Royalty Tax Credit

Objective: *This transitional arrangement for smaller oil and gas producers is part of the changes announced in Budget 2003 to improve the international competitiveness of the resource sector and promote the efficient development of Canada's natural resource base. (Improving the Income Taxation of the Resource Sector in Canada, March 3, 2003)*

Under the resource tax structure introduced in 2003, a deduction is provided for Crown royalties and mining taxes. Prior to 2007, under the Alberta Royalty Tax Credit (ARTC) program, the Province of Alberta refunded a minimum of 25 per cent of the first $2 million in Alberta Crown royalties paid by a corporate group. Under the new structure for resource taxation, a refund provided under the ARTC reduced the deductible amount of Crown royalties, or was included in income if the corporation had already deducted the Crown royalties in respect of which the refund was made.

During a transitional phase-in period, there was a reduction in the portion of the refund that reduced deductible royalties or that was required to be included in income for tax purposes. Specifically, only half of the ARTC reduced royalties or was included in computing income for tax purposes for calendar

years 2003 through 2007. The transitional period was originally expected to continue for years 2008 through 2012, with the rate increasing to 100 per cent in 2012. The Alberta government, however, discontinued the ARTC effective January 1, 2007.

The transitional measure was available, in full, to individuals who received the ARTC, and to taxable Canadian corporations that paid no more than $2 million in Alberta Crown royalties, as defined for ARTC purposes. For corporations that paid more than $2 million in Alberta Crown royalties, the benefit of the transitional arrangement was reduced on a straight-line basis, such that the benefit of the transitional measures was completely removed for corporate groups that paid $5 million or more in Alberta Crown royalties. This transitional measure assisted individuals and smaller corporations in their transition to the new resource tax structure announced in 2003.

Flow-Through Share Deductions

Objective: *Flow-through shares are a financing mechanism that assists oil and gas, mining and renewable energy corporations to raise capital for exploration, development and project start-up expenses.*

This item reflects the fiscal cost of the deduction of expenses transferred to corporate investors in flow-through shares, which is explained in greater detail in the parallel item in Chapter 2. Estimates are made using the same assumptions as for the personal income tax case. They represent an upper bound on the value of the tax expenditure associated with flow-through shares held by corporate investors.

Reclassification of Expenses Under Flow-Through Shares

Objective: *This provision was introduced to facilitate financing and promote investment in the junior oil and gas sector. (Economic and Fiscal Statement, 1992; Budget 1996)*

In the oil and gas sector, small corporations are entitled to reclassify as Canadian Exploration Expenses (100-per-cent deductible in the year incurred) the first $1 million of eligible oil and gas Canadian Development Expenses (30-per-cent deductible per year) renounced to corporate shareholders under a flow-through share agreement. The tax expenditure estimate is discussed in greater detail in the parallel item in Chapter 2.

Other Sectors

Exemption From Branch Tax for Transportation, Communications, and Iron Ore Mining Corporations

Objective: *The exemption from branch tax is in recognition that certain foreign companies sometimes have no real alternative to the branch office form of organization when operating in other jurisdictions. For example, this is often the case for Canadian mining ventures that are jointly financed by Canadian and foreign interests and require large amounts of capital investment. (Budget Speech, April 10, 1962)*

A tax (commonly known as the branch tax) is imposed under Part XIV of the Income Tax Act on that portion of the income of non-resident corporations derived from carrying on business in Canada through a branch. If a Canadian branch has ceased active business operations, non-residents are liable for tax on capital gains on dispositions of taxable Canadian property. Part XIV tax is similar to Part XIII tax—i.e. non-resident withholding tax. Many of the considerations related to the base for the tax expenditure for non-resident withholding tax also apply to Part XIV tax.

The statutory rate of Part XIV tax is 25 per cent, but is frequently reduced by bilateral tax treaties to 15 per cent, 10 per cent or 5 per cent. A corporation is exempt from the branch tax if it is:

- A corporation whose principal business is:
  - The transportation of persons or goods;
  - Communications; or
  - Mining iron ore in Canada; or
- An exempt corporation such as a registered charity.

The tax expenditure estimates are derived by applying treaty tax rates (in the case of payments to a country with which Canada had a tax treaty in the year considered) or the statutory 25-per-cent tax rate (in the case of payments to non-treaty countries) that would otherwise apply, in the absence of an exemption, to the income of the branch.

Because of the similarities between Part XIV tax and Part XIII tax (for which revenue estimates are provided under the "Exemptions From Non-Resident Withholding Tax" heading), estimates of revenues from Part XIV tax are set out in the table below.

Table 3.7
Part XIV Tax Collected, 2005–2008

	2005	2006	2007	2008
		($ millions)		
Part XIV Tax	40	50	45	105

Source: Canada Revenue Agency.

Film or Video Production Services Tax Credit

Objective: *The Film or Video Production Services Tax Credit makes Canada a more attractive place for film production by complementing the existing Canadian Film or Video Production Tax Credit and by allowing a greater range of productions (usually foreign-owned) to qualify for assistance. The tax credit supports film and video productions produced in Canada. (Department of Finance News Release 97-063, July 30, 1997)*

The Film or Video Production Services Tax Credit came into force November 1, 1997, to coincide with the elimination of film production services tax shelters. This tax credit applies to film or video production services that are provided in Canada for films that do not have sufficient Canadian content to qualify for the Canadian Film or Video Production Tax Credit. The measure provides a 16-per-cent tax credit on salaries and wages paid to Canadian residents for services performed in Canada. For expenditures incurred prior to February 18, 2003, the credit was applied at the rate of 11 per cent. The Canadian Audio-Visual Certification Office of the Department of Canadian Heritage provides certificates of eligibility.

The tax credit is designed to re-target government assistance by making the benefit available directly to the production services provider. Previously, this assistance was provided through syndicated tax shelters for such productions.

Low Tax Rate for Credit Unions

> ***Objective:*** *The purpose of the low tax rate for credit unions is to permit a credit union to accumulate capital on a tax-preferred basis up to a maximum of 5 per cent of deposits and capital. (Department of Finance News Release 71-157, December 6, 1971)*

Although not a private corporation for most purposes, a credit union is deemed to be a Canadian-controlled private corporation for purposes of the small business deduction. Furthermore, a credit union with taxable income above the small business limit may be taxed at the small business rate if its total taxable income since 1971 is less than four-thirds of its "maximum cumulative reserve," which is equal to 5 per cent of members' deposits and share capital.

Surtax on the Profits of Tobacco Manufacturers

> ***Objective:*** *The federal surtax on the profits of tobacco manufacturers is one of several tax measures that complement the Government's comprehensive strategy to improve the health of Canadians by discouraging tobacco consumption. (Department of Finance News Release 2001-095, November 1, 2001)*

Tobacco manufacturers are subject to a surtax on their profits. The surtax is levied at a rate of 50 per cent of the Part I corporate income tax levied on the manufacturing profits of tobacco companies. The surtax was originally implemented as part of the National Action Plan to Combat Smuggling in February 1994 for a three-year period, and was extended for another three years from February 1997. In November 1999, the Government announced that, effective February 2000, the surtax would be made permanent. Because the surtax results in more revenues than would otherwise be raised under the benchmark tax system, it is a negative tax expenditure.

Other Items

Deductibility of Countervailing and Anti-Dumping Duties

> ***Objective:*** *Deducting these duties when paid, rather than waiting to deduct the exact amounts upon final resolution of the dispute, assists firms. This assistance recognizes that these firms are required to pay amounts that are not under the control of the taxpayer and that, although these amounts may be subsequently refunded, in whole or in part, this process can take several years. (Budget 1998)*

In accordance with the rules established under the World Trade Organization, countries may impose countervailing and anti-dumping duties to offset the injurious effects of imports that are subsidized or dumped. These actions may result in Canadian taxpayers paying such amounts in order to export their products. Budget 1998 made cash outlays for duties deductible in the year they are paid even though these amounts are effectively only a contingent liability, which may be refunded, in whole or in part, in a subsequent year. Any refunds or additional amounts subsequently received, such as interest, are required to be included in income in the year received.

The value of the tax expenditure on a present-value basis is the present value of the benefit provided by allowing these contingent costs to be deducted from income when paid rather than when the exact amount, if any, of the duty is finally determined. In cash-flow terms, the early deduction results in a positive tax expenditure for the year when the deduction on account of the contingent liability is taken, and an offsetting negative tax expenditure for the year when the liability is finally determined. The overall tax expenditure for any given year is the sum of these amounts.

No data are available.

Deductibility of Earthquake Reserves

Objective: *In 1997, the Office of the Superintendent of Financial Institutions introduced guidelines for federally regulated property and casualty insurance companies relating to earthquake exposures to ensure that they have sufficient financial capacity to pay insured earthquake losses when they occur. This measure helps to ensure that sufficient capacity is achieved in a timely fashion. (Budget 1998)*

Property and casualty insurers are permitted by the Office of the Superintendent of Financial Institutions to deduct reserves for earthquake exposures in computing profits on their financial statements. The earthquake premium reserve is deductible for tax purposes. The maximum that can be added to the reserve in any year is 75 per cent of the earthquake premiums, net of the insurer's cost of earthquake reinsurance. This type of reserve would not be deductible under the benchmark system because it is a contingent liability. The tax expenditure is the tax value of the net change in the reserve from the previous year.

Deferral Through Use of Billed-Basis Accounting by Professional Corporations

Objective: *This treatment recognizes the inherent difficulty in valuing unbilled time and work in progress. (Summary of 1971 Tax Reform Legislation)*

Under accrual accounting, costs must be matched with their associated revenues. In computing their income for tax purposes, however, professional corporations are allowed to elect either an accrual or a billed-basis accounting method. Under the latter method, the costs of work in progress can be written off as incurred even though the associated revenues are not brought into income until the bill is paid or becomes receivable. This treatment gives rise to a deferral of tax.

No data are available.

Holdback on Progress Payments to Contractors

Objective: *This measure is intended to alleviate potential cash-flow difficulties for construction contractors.*

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g. 10 per cent to 15 per cent) is often held back until the entire project is completed satisfactorily. The amount held back need not be brought into the income of the contractor until the project to which it applies is certified as complete, rather than when earned, as would be required in the benchmark tax structure. Where a contractor, in turn, withholds an amount from a subcontractor, the holdback amount is not deductible until paid.

If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax and a positive tax expenditure. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes and a negative tax expenditure.

Investment Income Credited to Life Insurance Policies

Objective: *Investment income earned by life insurance companies with respect to life insurance policies is generally untaxed or benefits from a prolonged tax deferral under the current rules. Life insurance companies pay an Investment Income Tax to reduce this tax preference to the life insurance sector. (Supplementary Information Relating to Tax Reform Measures, December 16, 1987)*

Life insurance policies can generate significant investment income for the policyholder due to the long-term nature of life insurance contracts. A life insurance policyholder is generally not subject to annual taxation on the investment income in the life insurance policy unless the life insurance policy does not qualify as an exempt life insurance policy. However, life insurance companies pay the Investment Income Tax because they are the recipients of the income earned on funds accumulating within life insurance policies. The tax expenditure is measured as the difference between the annual tax that would be payable by policyholders and the Investment Income Tax paid by life insurance companies.

Tax Status of Certain Federal Crown Corporations

Objective: *Constitutional immunity from taxation is overridden for certain federal Crown corporations that carry on significant commercial activities in order to avoid creating a competitive advantage over similar businesses in the private sector. Other Crown corporations that do not benefit from constitutional immunity are exempt from federal income tax in order to reduce compliance and administration costs.*

Under section 125 of the Constitution Act, 1867, Canada and the Provinces are immune from taxation. The Income Tax Act provides an exemption from tax for federal Crown corporations; however, as a result of being prescribed as taxable in the Income Tax Regulations, 14, the exemption does not apply for certain Crown corporations that carry on significant commercial activities. Since some of the Crown corporations on the prescribed list are agents of the Crown, this measure gives rise to a negative tax expenditure—tax revenue is higher than it would be under the benchmark tax system.

In contrast, exempting other Crown corporations that are not agents of the Crown results in a positive tax expenditure. Their exempt status avoids the compliance and administrative costs associated with filing a tax return. Furthermore, the net financial position of the federal government would be unchanged if these Crown corporations were required to pay income taxes—the payment of taxes would merely be a transfer of funds from the Crown corporation to consolidated revenues.

The estimates show only the impact of taxing prescribed Crown corporations—no data are available on the cost of exempting other Crown corporations.

Memorandum Items

Avoidance of Double Taxation—Integration of Personal and Corporate Income Tax

Investment Corporation Deduction

> ***Objective:*** *The purpose of this measure is to induce investment of savings by investment corporations in Canada rather than abroad by achieving a degree of integration between the personal and corporate tax systems, so that investment in Canadian properties is taxed at a lower rate than investment abroad. (Budget Speech, 1960)*

Investment corporations provide an important flow of individual savings available for investment in the ownership of Canadian industry because qualifying investment corporations must invest in Canadian properties. These corporations are Canadian public corporations that have over 80 per cent of their property in shares, bonds, marketable securities or cash and receive over 95 per cent of their investment income from those sources.

Investment corporations make portfolio investments in a manner similar to mutual fund corporations. In order to reduce the combined personal and corporate income tax burden on dividends, the current rules reduce the income tax payable by 20 per cent of the extent that the investment corporation's taxable income exceeds its taxed capital gains in the year.

The tax expenditure associated with this measure is estimated as the additional revenue that would have been collected by the Government if investment income had been subject to Part I tax at the general income tax rate applicable to public corporations.

Refundable Capital Gains for Investment and Mutual Fund Corporations

> ***Objective:*** *This item is part of an integrated system of measures ensuring that the treatment of capital gains earned by investment corporations or mutual fund corporations and subsequently distributed is generally comparable to the treatment of capital gains earned directly by an individual. The rationale for this integrated system is that investments made through these kinds of corporations are comparable to typical investments made by an individual since these special investment corporations must hold only passive investments.*

Capital gains realized by an investment corporation and a mutual fund corporation are taxed at the corporation level, and the tax is accumulated in the "refundable capital gains tax on hand" account. The corporation uses this account to claim a capital gains tax refund when it distributes capital gains to its shareholders or through share redemptions by a mutual fund corporation. Since these distributions are capital gains, they are taxed as capital gains in the hands of the shareholder and not as dividends.

This measure is considered a memorandum item because, although it constitutes a departure from the benchmark system by allowing a public corporation (that qualifies as an investment corporation or a mutual fund corporation) to flow out its capital gains to shareholders, these capital gains are taxed at the individual level.

Refundable Taxes on Investment Income of Private Corporations

Objective: *A refundable Part I tax levied on the investment income of private corporations is intended to reduce the deferral advantage to individuals of earning investment income through these private corporations instead of earning such income directly. The deferral advantage arises when the corporate tax rate applied to this income is lower than the marginal tax rate of the individual shareholder. (Budget 1995)*

Refundable tax provisions of the corporate income tax system provide some integration of the corporate and personal income tax regimes. These provisions include:

- A refundable tax (Part IV tax) of 33⅓ per cent on dividends received by private corporations; and
- An additional Part I tax of 6⅔ per cent on the investment income (excluding deductible dividends) received by Canadian-controlled private corporations (CCPCs).

These additional taxes, as well as 20 percentage points of the Part I tax paid by CCPCs on investment income (excluding deductible dividends), are refundable to the corporation at a rate of one dollar for every three dollars of taxable dividends paid.

The additional Part I tax on the investment income of CCPCs, the Part IV tax on dividends, and the amount of refundable taxes refunded upon the payment of dividends are considered as memorandum items, even though they constitute departures from the benchmark system, because they are part of a mechanism that reduces deferral advantages and allows integration of corporate and personal income taxes on investment income. In addition, because investment income of CCPCs is subject to Part I tax at a rate of 28 per cent rather than at the general corporate income tax rate, this incremental tax also represents a departure from the benchmark system and is included as part of the additional Part I tax along with the additional tax of 6⅔ per cent.

The difference between the general corporate income tax rate and the CCPC investment income tax rate is as follows:

Table 3.8

	2005	2006	2007	2008	2009	2010	2011	2012
				(per cent)				
General corporate income tax rate	21	21	21	19.5	19	18	16.5	15
CCPC investment income tax rate	28	28	28	28	28	28	28	28
Difference	7	7	7	8.5	9	10	11.5	13

Because the additional Part I tax and the Part IV tax result in more revenues than would otherwise be raised under the benchmark system, they are recorded as negative amounts. To the extent that, in a particular year, the amount of refundable taxes refunded upon the payment of dividends exceeds the total of the additional Part I tax on the investment income of CCPCs and the Part IV tax on dividends, there is a net negative impact on government revenues (recorded in these accounts as a positive amount).

Loss Offset Provisions

Capital Loss Carry-overs

> ***Objective:*** *These provisions support businesses and investors by reducing the risk associated with investment, and provide tax relief for cyclical businesses. (Budget 1983)*

Net capital losses may be carried back three years and forward indefinitely to offset capital gains of other years. Estimates are provided for both the revenue impact of allowing net capital losses of previous years to be applied to reduce income tax otherwise payable for the current year (i.e. net capital losses applied to the current year) and the impact of allowing current-year net capital losses to be applied to reduce income tax paid in previous years (i.e. net capital losses carried back).

Farm and Fishing Loss Carry-overs

> ***Objective:*** *These measures provide increased cash flows and reduced risks to farms and fisheries in recognition of the cyclical nature of these industries. (Budget 1983)*

Corporations can carry losses from farm and fishing operations back 3 years. They can also carry the losses forward; the carry-forward period was increased from 7 to 10 years in Budget 2004 and from 10 to 20 years in Budget 2006.

When the corporation's major source of income is not farming, the amount of farming losses deductible in the year is restricted to a maximum of $8,750. The unused losses, defined as the excess of the net farm losses over the farm losses deductible in the year, are considered restricted farm losses. Restricted farm losses may also be carried over to other years, using the same carry-over periods that are permitted for other farm losses, but can only be applied against farm income.

Estimates are provided for both the revenue impact of allowing farm and fishing losses of previous years to be applied to reduce income tax otherwise payable for the current year (i.e. farm and fishing losses applied to the current year) and the impact of allowing current-year farm and fishing losses to be applied to reduce income tax paid in previous years (i.e. farm and fishing losses carried back).

Non-Capital Loss Carry-overs

> ***Objective:*** *These provisions support businesses and investors by reducing the risk associated with investment, and provide tax relief for cyclical businesses. (Budget 1983)*

Non-capital losses may be carried over to other years to offset other income. The carry-back period is 3 years. The carry-forward period was increased from 7 to 10 years in Budget 2004 and from 10 to 20 years in Budget 2006.

Estimates are provided for both the revenue impact of allowing non-capital losses of previous years to be applied to reduce income tax otherwise payable for the current year (i.e. non-capital losses applied to the current year) and the impact of allowing current-year non-capital losses to be applied to reduce income tax paid in previous years (i.e. non-capital losses carried back).

Estimates reflecting the impact of the carry-forward of prior years' losses (i.e. non-capital losses applied to the current year) include the revenue impact of allowing non-capital losses of previous years to be applied to reduce Part I tax and the refundable Part IV tax otherwise payable for the current year. Estimates reflecting the impact of allowing current-year losses to be applied to reduce income tax paid in previous years (i.e. non-capital losses carried back) include the impact on both Part I tax and refundable Part IV tax.

Other

Capital Gains Deferral Through Capital Gains Rollovers

Objective: *Rollover provisions are provided in some situations in which it would be unfair to collect capital gains tax even though the corporation has sold or otherwise disposed of an asset at a profit. (Proposals for Tax Reform, 1969)*

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

Involuntary Dispositions

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

Voluntary Dispositions

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

Reorganizations Involving Corporations

Taxpayers are permitted to defer the realization of capital gains for tax purposes through rollover provisions involving corporations.

Since the benchmark tax structure includes various rollover provisions that permit the deferral of capital gains when a corporate structure is changed, this item is identified separately for information purposes.

No data are available.

Deduction for Intangible Assets

> ***Objective:*** *The deduction for intangible assets, introduced as part of the changes to the tax system in 1971, was implemented to help better match the expense relating to the intangible assets with the revenue it would help generate. (Report of the Royal Commission on Taxation, Vol. 3 and Vol. 4, 1966; Summary of 1971 Tax Reform Legislation)*

Three-quarters of eligible capital expenditures on intangible assets are added to the cumulative eligible capital of a taxpayer. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. Examples of eligible intangible assets include goodwill, customer lists and franchises. Prior to 1972, taxpayers could not deduct such expenditures in the year incurred.

The deduction for intangible assets could give rise to positive or negative tax expenditures depending on the actual rate of depreciation of these assets relative to the amount that is permitted for tax purposes.

No data are available.

Partial Deduction of Meals and Entertainment Expenses

> ***Objective:*** *To reflect the existence of a personal consumption element of meals and entertainment expenses, only 50 per cent of these costs are deductible. The proportion is increased to 80 per cent for long-haul truck drivers in order to provide better recognition of the significant meal expenses they incur while on the road. (Income Tax Reform, June 18, 1987; Budget 2007)*

Meals and entertainment expenses are considered to be a memorandum item because the amount that should be deductible under a benchmark tax system is debatable. While a portion of these expenditures is incurred in order to earn income, there is an element of personal consumption associated with these expenditures.

Generally, the deduction is limited to 50 per cent of the cost of food, beverages and entertainment in order to reflect the personal consumption portion of these costs. Budget 2007 increased to 80 per cent from 50 per cent the share of meal expenses that long-haul truck drivers can deduct for tax purposes. The increase is being phased in over a five-year period, beginning with an increase to 60 per cent for meal expenses incurred after March 18, 2007, and to 65, 70, and 75 per cent for such expenditures incurred during 2008, 2009, and 2010 respectively. The deductible portion will be increased to 80 per cent for such expenditures incurred after 2010.

The estimates reflect the additional tax revenue that would be received if no deduction were allowed (i.e. if it were considered that there is no business purpose to the expenditure).

A parallel measure applies to individuals with unincorporated businesses.

Patronage Dividend Deduction

Objective: *The purpose of this measure is to ensure that income distributed in the form of patronage dividends is considered income of the members or customers, and not of the co-operative association, ordinary corporation, partnership or individual business enterprise, as the case may be.*
(Budget Speech, 1946)

In computing income for a taxation year, a taxpayer is allowed to deduct patronage dividends, which are payments made to customers in proportion to their volume of business. Patronage dividends—other than those from co-operatives and credit unions—may not be deducted if paid to non-arm's length persons.

The appropriate benchmark tax treatment of patronage dividends is uncertain. These dividends could be considered to be analogous to the payment of a volume discount or the return of excess payments. With this view of the benchmark system, there would not be a tax expenditure associated with this measure.

Alternatively, these payments could be perceived as the distribution to members (or shareholders) of earnings that would not be deductible under the benchmark system. The amount shown, reflecting this view of the benchmark system, is the revenue impact of allowing patronage dividends to be deductible from income.

Chapter 4

Description of Goods and Services Tax Provisions[8]

Status Indians and Aboriginal Self-Governments

Non-Taxation of Personal Property of Status Indians and Indian Bands on Reserve

> ***Objective:*** *The exemption reflects provisions under section 87 of Indian Act.*

Section 87 of the Indian Act exempts the personal property of status Indians and Indian bands from taxation if such personal property is situated on a reserve. For GST purposes, this means that GST does not apply to goods acquired on a reserve by status Indians. Goods bought off a reserve are also relieved of tax if the goods are delivered to a reserve by the vendor or vendor's agent. In addition, services performed totally on a reserve that are acquired by a status Indian are relieved of GST.

No data are available.

Refunds for Aboriginal Self-Governments

> ***Objective:*** *This measure relieves from GST the expenditures incurred by Aboriginal self-governments in exercising governmental activities.*

Under side agreements (given force of law) to modern Comprehensive Land Claims and Self-Government Agreements, Aboriginal self-governments are provided with a 100-per-cent refund of the GST for goods and services acquired for use in governmental activities within their lands.

Business

Exemption for Domestic Financial Services

> ***Objective:*** *Although in some cases the price of a financial service may be easily identified, in many others, the price is implicit and difficult to isolate. Therefore, for the sake of consistency and equity, financial services are generally exempt under the GST. (Goods and Services Tax Technical Paper, August 1989)*

In many cases, the price of a financial service is implicit rather than explicit. For example, when banks provide lending and deposit-taking services, the banks' fees for these services include the spread between interest received from borrowers and interest paid to depositors. The exact price associated with each financial transaction is difficult to determine and, therefore, it is difficult to apply the GST to the sale of the service. As a result, most financial services provided to residents of Canada are exempt under the GST.

[8] Estimates of GST tax expenditures represent the GST in provinces without a harmonized sales tax and the federal portion of the HST in provinces that have a harmonized sales tax.

Members of a "closely-related group" (if there is at least 90 per cent cross-ownership of voting shares between them), where one of the members is a "listed financial institution," may jointly elect to treat most supplies between them as tax-exempt financial services. The purpose of this election is to recognize that a closely-related corporate group can be viewed as a single entity with respect to intragroup transactions.

No data are available.

Exemption for Ferry, Road and Bridge Tolls

> ***Objective:*** *This exemption ensures consistency with the treatment of Canada's highway systems and related infrastructure. (Goods and Services Tax Technical Paper, August 1989)*

Ferry, road and bridge tolls are generally exempt from GST. International ferry services are zero-rated, consistent with other international transportation services.

The estimate is derived using the Goods and Services Tax Model.

Exemption and Rebate for Legal Aid Services

> ***Objective:*** *These measures ensure that the introduction of the GST did not result in an increase in tax borne by consumers of legal aid services provided by provincial legal aid plans and they simplify compliance for private lawyers. (Goods and Services Tax Technical Paper, August 1989)*

There are two ways in which the relief of GST is provided in respect of legal aid services:

- Legal aid services provided by private practitioners to a legal aid plan administrator are taxable. However, the person responsible for the legal aid plan is entitled to a rebate of 100 per cent of any tax paid on the supply; and
- Legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland and Labrador, Prince Edward Island, Quebec, Manitoba and Saskatchewan) are exempt.

In provinces where the rebate applies (New Brunswick, Ontario, Alberta and British Columbia), administrative data from the Canada Revenue Agency is used to determine the estimates. For provinces where the service is exempt, the value of the exemption is estimated by multiplying the total legal aid expenditures in the provinces (based on Statistics Canada data) by a proportion, which is the amount of the rebate claimed in provinces with a rebate as a share of their total legal aid expenditures. As a result, the portion of legal aid services that is eligible for the exemption is assumed to be the same as the portion of legal aid services that is eligible for the rebate.

Non-Taxability of Certain Importations

Objective: *These measures are intended to simplify administration, ensure compliance with international convention precedents, and ensure that imports are treated fairly vis-à-vis domestic-sourced goods that are zero-rated. (Department of Finance News Release, September 4, 1990)*

Goods imported into Canada are generally taxable. However, the Excise Tax Act enumerates a list of goods of different classes that, upon importation, do not attract the GST. Furthermore, the GST does not apply to importations of zero-rated goods such as basic groceries and prescription drugs.

In addition to importations of zero-rated goods, other importations that are tax-free under the GST include:

- Goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries;
- Duty-free personal importations such as goods valued at not more than $750 and imported by Canadians who have been outside the country for more than seven days; and
- Goods imported by foreign diplomats.

No data are available.

Rebate for Foreign Conventions and Tour Packages

Objective: *This measure helps maintain and promote the attractiveness of Canada as a destination for foreign groups and conventions. The Foreign Convention and Tour Incentive Program replaced the former Visitors' Rebate Program effective April 1, 2007. (Budget 2007)*

Effective April 1, 2007, the Foreign Convention and Tour Incentive Program was implemented to provide a rebate of the GST paid in respect of:

- Certain property and services used in the course of foreign conventions (generally defined as a convention where at least 75 per cent of participants are non-residents and the sponsor is a non-resident) held in Canada;
- Use of a convention site and related convention supplies acquired by non-resident exhibitors in respect of a foreign or Canadian convention held in Canada; and
- The accommodation portion of tour packages for non-residents.

Some of the supplies acquired by non-residents may be memorabilia. While memorabilia taken home by foreign visitors are effectively exports (i.e. not taxable under the benchmark system), these amounts are relatively small and not distinguishable from other eligible convention-related expenses in the administrative data. They are therefore still included in the tax expenditure estimates.

Under the former Visitors' Rebate Program, non-residents visiting Canada were entitled to a rebate for the GST paid on most goods and short-term accommodation. A rebate was also provided for eligible conference-related expenses for conferences attended by non-residents.

Small Suppliers' Threshold

> ***Objective:*** *This measure ensures that very small businesses do not face an excessive administration burden under the GST. (Goods and Services Tax Technical Paper, August 1989)*

Small suppliers, that is, persons whose total taxable supplies in the preceding year are $30,000 or less ($50,000 or less in the case of public service bodies), are not required to register and collect the GST. Charities and public institutions (for example, a registered charity that is a university, a public college, a school authority, a hospital authority or a designated municipality) can also qualify as a small supplier if their gross annual revenue (as determined for income tax purposes) in either of their previous two fiscal years is $250,000 or less. Those who choose not to register do not have to charge and remit GST, and they are not entitled to input tax credits.

The starting point in deriving the estimate is gross sales data obtained from personal and corporate income tax information. From this data, a ratio is created of the total sales from firms with annual sales of less than $30,000 to the total sales from firms with annual sales of greater than $30,000 with some adjustments for firms not engaged in taxable activities and qualifying public service bodies. This ratio is then applied to the total GST collections to approximate the revenues that would arise from eliminating the small suppliers' threshold.

Zero-Rating of Agricultural and Fish Products and Purchases

> ***Objective:*** *This measure is intended to improve the cash-flow position of farmers and fishers. (Goods and Services Tax Technical Paper, December 1989)*

Instead of taxing sales and providing input tax credits at early stages in the food production-distribution chain, GST legislation zero-rates certain agricultural and fish products throughout the production chain. A prescribed list of zero-rated agricultural and fishing supplies includes farm livestock, poultry, bees, grains and seeds for planting or feed, hops, barley, flax seed, straw, sugar cane or beets. In addition, prescribed sales and purchases of major types of agricultural and fishing equipment are also zero-rated.

This provision improves farmers' and fishers' cash-flow position. For example, in the normal operation of the GST, farmers would pay the GST on taxable purchases and would claim a corresponding input tax credit at the end of their tax period. However, in the case of prescribed zero-rated supplies, the farmer does not pay the GST and so does not have to wait to claim an input tax credit. Consequently, the cash-flow position of the farmer is improved. At the same time, however, the suppliers lose the benefit of holding the GST on these purchases until the end of their tax period.

The impact of this measure on GST revenues is small.

Zero-Rating of Certain Purchases Made by Exporters

> ***Objective:*** *These provisions are designed to improve the cash-flow position of exporters and to ensure that goods and services acquired in Canada for export are totally relieved of tax.*

Exports are destined for consumption outside Canada and consequently, are not part of the benchmark tax system, which is a tax on consumption in Canada.

The GST legislation provides that certain supplies of goods and services delivered in Canada but subsequently exported are also zero-rated.

As with agricultural and fish products, this provision has only cash-flow implications since exporters would in any case be entitled to claim input tax credits for any tax that they paid on these purchases. In other words, the net effect of zero-rating these purchases is to relieve them of tax sooner than otherwise.

The impact of this measure on GST revenues is small.

Charities and Non-Profit Organizations

Exemption for Certain Supplies Made by Charities and Non-Profit Organizations

> ***Objective:*** *The exemption of supplies made by charities and non-profit organizations recognizes the important role they play in Canadian society as well as the non-commercial character of the activities of these organizations. (Goods and Services Tax Technical Paper, December 1989)*

Charities and many non-profit organizations generally perform a public service function, relying heavily on financial support from governments and the voluntary contributions of the general public to pursue their goals. As a result, most supplies made by charities are GST-exempt. Supplies that are exempt when made by non-profit organizations include: supplies made for no consideration; supplies of food and lodging made for the relief of poverty or distress; subsidized homemaker/home-care services; meals on wheels; recreational programs established for children, people with disabilities or disadvantaged individuals; memberships in organizations providing no significant benefit to individual members; and trade union and mandatory professional dues.

The estimate is derived using the Goods and Services Tax Model.

Rebates for Registered Charities and Qualifying Non-Profit Organizations

Objective: *This measure reduces GST costs for registered charities and non-profit organizations, in recognition of the important role they play in Canadian society. (Goods and Services Tax Technical Paper, December 1989)*

Charities registered under the Income Tax Act are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supplies of exempt services. The non-profit organizations eligible for this rebate must receive at least 40 per cent of their funding from governments, municipalities or Indian bands. Registered amateur athletic associations and non-profit organizations operating a facility or part thereof to provide nursing home intermediate care or residential care are also eligible for the rebate.

Education

Exemption for Educational Services (Tuition)

Objective: *This measure recognizes that most educational services are provided by the public sector in a non-commercial context.*

The GST provides an exemption for most educational services. The exemption includes tuition fees paid for: courses provided primarily for elementary or secondary school students; courses leading to credits towards a diploma or degree awarded by a recognized school authority, university or college; and certain other types of training for a trade or vocation. In addition, the exemption covers meals supplied to elementary or secondary students as well as most meal plans at a university or college.

The estimate represents revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases.

The estimate is derived from the Goods and Services Tax Model.

Rebate for Book Purchases Made by Qualifying Public Institutions

Objective: *This rebate recognizes the important role played by public libraries, educational institutions and other groups in improving literacy levels in their communities. (Department of Finance News Release 1996-076, October 23, 1996)*

The 100-per-cent rebate on books is available to public libraries, schools, universities, public colleges, municipalities, and qualifying charities and non-profit organizations.

Rebate for Colleges

> ***Objective:*** *This measure was implemented at the time of inception of the GST to ensure that the sales tax burden did not increase as a result of moving to the GST from the previous federal sales tax. (Goods and Services Tax Technical Paper, August 1989)*

Since colleges provide primarily tax-exempt services, they are unable to claim input tax credits for GST paid on most of their purchases. However, public colleges operating on a not-for-profit basis that are funded by a government or municipality and whose primary purpose is to provide vocational, technical or general education are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

Rebate for Schools

> ***Objective:*** *This measure was implemented at the time of inception of the GST to ensure that the sales tax burden did not increase as a result of moving to the GST from the previous federal sales tax. (Goods and Services Tax Technical Paper, August 1989)*

Since schools provide primarily tax-exempt services, they are unable to claim input tax credits for GST paid on most of their purchases. However, elementary and secondary schools operating on a not-for-profit basis are eligible for a rebate of 68 per cent of the GST paid on purchases related to their supply of exempt services.

Rebate for Universities

> ***Objective:*** *This measure was implemented at the time of inception of the GST to ensure that the sales tax burden did not increase as a result of moving to the GST from the previous federal sales tax. (Goods and Services Tax Technical Paper, August 1989)*

Since universities provide primarily tax-exempt services, they are unable to claim input tax credits for GST paid on most of their purchases. However, recognized degree-granting universities operating on a not-for-profit basis are eligible for a rebate of 67 per cent of the GST paid on purchases related to their supply of exempt services.

Health Care

Exemption for Health Care Services

> ***Objective:*** *This measure recognizes that basic health care services are considered a public service. (Goods and Services Tax Technical Paper, August 1989)*

Health care services are exempt under the GST. These services include the following categories:

- Institutional health care services provided in a health care facility. These include accommodation, meals provided with accommodation, and rentals of medical equipment to patients or residents of the facility.
- Services provided by physicians, dentists and certain health care practitioners whose profession is regulated by the governments of at least five provinces.

- Services covered by a provincial health insurance plan. The previous two provisions already cover most of these services.

Under the Constitution, the GST would not apply in any event to purchases made by provincial governments and provincial health insurance plans. Accordingly, the costs from this provision generally concern health services purchased by final consumers.

The estimates for this provision are derived from the Goods and Services Tax Model.

Rebate for Hospitals

> ***Objective:*** *This measure was implemented at the time of inception of the GST to ensure that the sales tax burden did not increase as a result of moving to the GST from the previous federal sales tax. (Goods and Services Tax Technical Paper, August 1989)*

Since hospitals provide primarily tax-exempt services, they are unable to claim input tax credits for GST paid on most of their purchases. However, public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

Zero-Rating of Medical Devices

> ***Objective:*** *This measure is intended to ensure that a broad range of medical devices that are required to treat or cope with a chronic disease or illness or a physical disability are tax-free. (Goods and Services Tax Technical Paper, August 1989)*

A wide range of medical devices (generally those acquired directly by final consumers) is zero-rated under the GST. This includes wheelchairs, medical and surgical prostheses, hearing and speaking aids, prescription eyeglasses and various diabetic supplies. In some instances, a device qualifies for tax-free status only if prescribed by a recognized health care practitioner.

The estimate is derived using the Goods and Services Tax Model.

Zero-Rating of Prescription Drugs

> ***Objective:*** *This measure recognizes that all drugs which must be sold under prescription under federal law and a number of drugs which do not require prescriptions but that are used to treat life-threatening conditions should be zero-rated. (Report on the Technical Paper on the Goods and Services Tax, November 1989)*

Drugs that are controlled substances for which a prescription is required are zero-rated, as are other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, those items labelled or supplied for veterinary use are not zero-rated as prescription drugs.

The estimate is derived using the Goods and Services Tax Model.

Households

Exemption for Child Care and Personal Services

Objective: *Under the GST, no tax is charged on eligible child care and on personal care services provided to individuals who are underprivileged or suffer from an infirmity or disability in order to preserve the affordability of these services.*

Certain child and personal care services are exempt under the GST. The exemption covers the following:

- Child care services provided for periods of less than 24 hours to children under 14 years of age; and
- Certain personal care services including supplies of care and supervision to residents of an institution, as well as accommodation where it is provided for children, people with disabilities or disadvantaged individuals.

The estimate is derived using the Goods and Services Tax Model.

GST/HST Credit

Objective: *The refundable GST/HST low-income credit was established to improve the fairness of the sales tax system. (Goods and Services Tax Technical Paper, August 1989)*

When the GST was introduced, a refundable income tax credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime than under the former federal sales tax. The amount of the GST/HST Credit depends on family size and income. For the period from July 2010 to June 2011, the basic adult credit is $250 per year. Families with children aged 18 and under receive a basic child credit of $131 per year for each child. However, single parents can claim a full adult credit of $250 per year for one dependent child. In addition to their basic credit, single adults (including single parents) are eligible for an additional credit of up to $131 per year. The value of the credit is reduced for families with annual incomes over $32,506. Both the credit amounts and the income threshold are adjusted annually for increases in the Consumer Price Index.

Zero-Rating of Basic Groceries

Objective: *The zero-rating of basic groceries reflects the widely held view of Canadians that, as a general principle, basic foodstuffs should not be taxed. (Goods and Services Tax Technical Paper, August 1989)*

Basic groceries, which include the majority of foodstuffs for preparation and consumption at home, are zero-rated under the GST. However, the tax is charged on certain goods such as soft drinks, candies and confections, and alcoholic beverages.

The estimate of the tax expenditure is derived using the Goods and Services Tax Model.

Housing

Exemption for Sales of Used Residential Housing and Other Personal-Use Real Property

> ***Objective:*** *This exemption is intended to preserve the affordability of housing while ensuring that the tax regime is not overly complex. (Goods and Services Tax Technical Paper, August 1989)*

Generally, the GST applies to residential real property when it is first sold or leased for residential purposes. Subsequent sales of used residential housing are tax-exempt. In addition, most sales of other personal-use real property, such as vacant land, are tax-exempt when sold by individuals. This exemption is consistent with the tax treatment of personal property and services not supplied in the course of commercial activities. The sale of farmland to a family member who is acquiring the property for personal use is also tax-exempt.

No data are available.

Exemption for Residential Rent (Long-Term)

> ***Objective:*** *This exemption is intended to preserve the affordability of housing while ensuring that the tax regime is not overly complex. (Goods and Services Tax Technical Paper, August 1989)*

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least one month are tax-exempt. Short-term accommodation is also exempt where the charge for the accommodation is not more than $20 per day.

The estimate is derived using the Goods and Services Tax Model.

Rebate for New Housing

> ***Objective:*** *This rebate is designed to ensure that the GST does not pose a barrier to the affordability of new homes. (Goods and Services Tax Consolidated Explanatory Notes, April 1997)*

Purchasers of newly constructed residential dwellings and substantially renovated houses are eligible for a rebate of the GST paid if the purchaser is acquiring the dwelling as a primary place of residence. For houses sold at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $6,300. The rebate is phased out for houses sold for between $350,000 and $450,000.

Before the GST was introduced, the federal sales tax component of the total price of a new home amounted to approximately 4.5 per cent on average. A 36-per-cent rebate was established to leave the sales tax burden unchanged with implementation of the GST. As a result of the GST rate reduction from 7 per cent to 5 per cent and an unchanged rebate, the effective tax rate on new housing has been reduced from 4.5 per cent to 3.2 per cent for housing up to $350,000.

The estimates are based on housing statistics compiled by Statistics Canada for the Canadian System of National Accounts. These data come from a variety of sources including Canada Mortgage and Housing Corporation and the Canada Revenue Agency.

Rebate for New Residential Rental Property

> ***Objective:** This measure ensures that builders and purchasers of new residential rental property face the same effective rate faced by purchasers of new owner-occupied homes. (Budget 2000)*

Effective 2000, builders or purchasers of newly constructed or substantially renovated residential rental property are eligible for a rebate of the GST paid if it can reasonably be expected that the first use of the individual residential units within the property will be for use as a primary place of residence for at least one year. The rebate also applies to the construction of new additions to residential rental property and to the leasing of land that is used for residential purposes.

For residential units valued at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $6,300. The rebate is phased out for residential units valued between $350,000 and $450,000.

The estimates are derived from two sources: data provided by Canada Mortgage and Housing Corporation related to the number of units constructed for rental purposes, and data underlying the measure of residential construction in the National Income and Expenditure Accounts provided by Statistics Canada. The estimates include an allowance for the time lags required for construction.

Municipalities

Exemption for Municipal Transit

> ***Objective:** Municipal transit services provided on a not-for-profit basis are exempt from GST to ensure consistency and equity with other municipal and not-for-profit activities.*
> *(Goods and Services Tax Technical Paper, August 1989)*

Municipal transit services provided on a not-for-profit basis are exempt under the GST. Specifically, no tax applies on fares charged by transit systems operated by, or on behalf of, a local authority or provincial government where all, or substantially all, of its service is to provide transportation within a municipality and surrounding areas. A municipal transit service is defined as a public passenger transportation service provided by a transit authority whose services are at least 90 per cent within a particular municipality and its surrounding areas.

The estimate is derived using the Goods and Services Tax Model.

Exemption for Water and Basic Garbage Collection Services

> ***Objective:** Charges for water and garbage collection services are exempt from GST where the property owner has no option but to receive and pay for the service. (Goods and Services Tax Technical Paper, August 1989)*

Water and basic garbage collection services are exempt under the GST.

The estimates are derived from the Goods and Services Tax Model.

Rebate for Municipalities

> ***Objective:*** *Originally, municipalities were entitled to a partial rebate of 57.14 per cent of the otherwise unrecoverable tax paid on their purchases to ensure that the sales tax burden did not increase as a result of moving to the GST from the previous federal sales tax. (Goods and Services Tax Technical Paper, August 1989)*
>
> *The rebate was increased to 100 per cent to provide municipalities with an increased source of reliable, predictable and long-term funding to address infrastructure priorities. (Department of Finance News Release 2004-007, February 3, 2004)*

Municipalities, including entities determined or designated by the Minister of National Revenue to be a municipality, are entitled to a rebate for the GST paid on their purchases used in the course of supplying exempt municipal services. When the GST was implemented, municipalities were entitled to a 57.14 per cent rebate of the otherwise unrecoverable tax paid on their purchases. The rebate was increased to 100 per cent effective February 1, 2004.

Memorandum Items

Recognition of Expenses Incurred to Earn Income

Rebate to Employees and Partners

> ***Objective:*** *This measure is designed to reduce the possible tax cascading effect that would occur in certain cases when employers and partnerships cannot recover GST paid by employees and partners in the course of their duties. (Goods and Services Tax Technical Paper, August 1989)*

Many employees and partners who are not registrants incur expenses in the course of carrying out their duties that may not be directly reimbursed by their employers and partnerships. Instead, compensation is usually provided through salaries, commissions, profits and other means that would not be subject to GST. Consequently, employers and partnerships cannot recover the GST paid by the employees and partners. As a result, a rebate is available to certain employees of a GST registrant for the GST paid on those expenses that are deductible in computing the employee's income from employment for income tax purposes. For example, an employee is allowed to claim a rebate equal to $5/105^{ths}$ in respect of the GST on the capital cost allowance for an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. The rebate factor for expenses incurred in a harmonized province is slightly different (e.g. $13/113^{ths}$ of the total HST in Ontario where $5/113^{ths}$ represents the GST portion).

This rebate is also available to an individual who is a member of a GST-registered partnership in respect of expenses incurred outside the partnership that are deducted in computing the member's income from the partnership for the purposes of the Income Tax Act.

Other

Partial Input Tax Credits for Meals and Entertainment Expenses

Objective: *This measure recognizes that meals and entertainment expenses involve an element of personal consumption and therefore some part of their cost can properly be characterized as a personal expense that should not result in input tax credits. (Goods and Services Tax Technical Paper, August 1989; Budget 2007)*

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their inputs used in making taxable supplies. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 50 per cent of the GST paid as an input tax credit. As announced in Budget 2007, the portion of input tax credits allowed for the tax paid on meals and beverages consumed by long-haul truck drivers during eligible periods of travel will increase to 80 per cent over a five year period. The allowable portion increased to 60 per cent after March 18, 2007 and before January 1, 2008, and to 65, 70 and 75 per cent for such expenditures incurred during 2008, 2009 and 2010, respectively, and to 80 per cent after 2010. This treatment parallels the treatment of meals and entertainment in the income tax system.

The estimate is based on the meals and entertainment tax expenditures contained in the personal and corporate income tax expenditure tables. This amount is then reduced to account for firms engaged in exempt activities because they are ineligible for input tax credits.