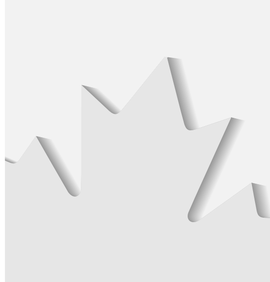
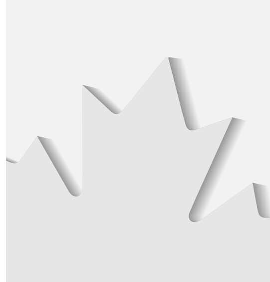


Government of Canada

Tax Expenditures

1995

Canada



Government of Canada

Tax Expenditures

1995

Department of Finance Canada | Ministère des Finances Canada

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INTRODUCTION

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada's federal income tax system and the Goods and Services Tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgements about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.

The principal function of taxes is to raise the revenues necessary to finance government operations. In addition, tax measures are often used to implement government policy objectives by providing assistance or incentives to particular groups of individuals, businesses or to certain types of activities. These measures, which can take the form of tax exemptions, deductions, deferrals or credits, are typically referred to as tax expenditures. This document provides estimates of the cost of these items for the personal income tax system for the years 1992 and 1993, and the corporate income tax system for the years 1991 and 1992. It also provides estimates of the costs of tax expenditures associated with the GST for the years 1992 and 1993.

In order to identify tax expenditures, it is necessary to establish a "benchmark" tax structure which does not contain any preferential tax provisions. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the definition of the benchmark tax system, and hence what constitutes a tax expenditure. For example, child care expenses could be considered to be a cost of earning income and therefore part of the benchmark tax system but, if they are regarded as personal consumption, then tax assistance for child care expenses would be a tax expenditure.

This report takes a broad approach – only the most fundamental structural elements of each tax system are considered to be part of the benchmark. By defining the benchmark in this manner, many tax provisions are treated as tax expenditures. This approach provides information on a full range of measures, and so allows readers who take a different position as to the appropriate benchmark system to construct their own list of tax expenditures.

There are several tax provisions identified in the document that are not generally considered to be tax expenditures even though they reduce the amount of revenue collected. These measures are denoted as "memorandum items" and have been included to provide additional information. Three types of memorandum item are included.

- Measures that are considered to be part of the benchmark system. The dividend tax credit, for example, reduces or eliminates the double taxation of income earned by corporations and distributed to individuals through dividends.

- Measures where there may be some debate over whether the item should be considered to be a tax expenditure. The cost of business-related meals and entertainment, for example, may be considered to be an expense incurred in order to earn income (and therefore part of the benchmark) or may be considered to provide a significant element of personal benefit (and therefore constitute a tax expenditure).
- Measures where the available data do not permit separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. For example, a portion of tax-free allowances for MPs is used to cover legitimate employment expenses (and is therefore part of the benchmark for the income tax system) while the rest may be used for personal consumption (and is therefore an income tax expenditure). Since it is not possible to distinguish between these two elements, the non-taxation of such allowances is included as a memorandum item.

The federal government collects personal income taxes on behalf of the provinces (other than Quebec) which levy their income taxes as a percentage of basic federal tax. It also collects corporate income taxes on behalf of seven provinces (the exceptions are Quebec, Ontario, and Alberta), which use the same taxable income base as the federal government but levy taxes at their own rates. While there are provincial costs associated with the income tax measures examined in this report, the estimates do not incorporate these effects.

Similarly, changes in the GST base can affect provincial revenues. For example, the Atlantic provinces and Quebec levy their sales taxes on a base which includes the GST. In addition, since July 1992, Quebec has substantially harmonized its tax base with the GST. However, changes in the federal tax base would not affect Quebec revenues without a specific change in provincial legislation. As with the income tax measures, the estimates for the GST tax expenditures in this report reflect only federal impacts.

Tax expenditure documents published prior to tax reform provided estimates for personal, corporate and commodity taxes. Phase one of tax reform came into effect in 1988, resulting in a major overhaul of the personal and corporate income tax systems. Many tax expenditures were eliminated, reduced, or, in the case of personal taxes, changed from deductions to credits. Tax reform affected not only the number of tax expenditures, but also their revenue impacts because it changed the rate structure against which they are calculated. The second phase of tax reform replaced the manufacturers' sales tax with the GST, effective January 1, 1991. Because of the significant changes in the tax structure throughout these reforms, no estimates were released during this transitional period.

In December 1992, the first post-reform report, Government of Canada Personal Income Tax Expenditures, was issued. This report covered only personal income tax expenditures for the years 1988 and 1989 because of the lack of statistical information on the newly introduced GST and lags in the

receipt of post-1988 tax reform data for corporations. While preliminary post-reform data for the 1988 taxation year were available for corporations, they did not accurately reflect the impact of tax reform because of the transitional measures in the package and the carry-over of accelerated deductions and credits from previous years.

In December 1993, the second post-reform report was issued. This report covered the personal income tax system for the years 1989, 1990 and 1991, and the corporate income tax system for the years 1989 and 1990. The third post-reform tax expenditure report was published in December 1994. That report provided information on the personal income tax system for the years 1991 and 1992; the corporate income tax system for the years 1990 and 1991; and the GST for the years 1991 and 1992.

The first part of the report 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. The second part of the report presents estimates of the costs of tax expenditures and memorandum items in the personal and corporate income tax systems and the GST.

The report also includes a number of appendices. Descriptions of each tax expenditure as well as information on data sources and methodology used in constructing the estimates are presented in Appendix A (personal), Appendix B (corporate) and Appendix C (GST). Appendix D describes recent changes to personal income tax expenditures.

DEFINING TAX EXPENDITURES

There are several ways for the government to achieve its social and economic objectives. The government can regulate private sector activities. It can spend on programs, grants and subsidies. The government may also pursue these policy objectives through measures contained in the tax system. Methods of providing relief from the payment of taxes include tax exemptions, deductions, tax credits and deferrals. Since in many ways these measures represent an alternative form of government assistance with financial implications similar to those of direct expenditures, they are generally referred to as tax expenditures.

Tax expenditures are used to support a variety of goals ranging from promoting savings and investment, to encouraging research and development, to maintaining international competitiveness, to partially defraying the cost of charitable contributions. Many personal income tax measures, such as the age and disability credits, are based on the specific characteristics of taxpayers. Similarly, several corporate tax measures are tied to the characteristics of the business. For example, the small business deduction is only available to Canadian-controlled private corporations. Other tax expenditures, such as the pension income credit and the manufacturing and processing profits deduction, are linked to the source of income. A third possibility is tax relief linked to the use of funds, such as the Scientific Research and Experimental Development Tax Credit, which is available to businesses making qualified expenditures.

In the case of the GST, a number of measures result in a reduction in tax for particular activities or groups of taxpayers. For example, child care services and municipal transit are exempt from the GST.

What are tax expenditures?

Tax expenditures represent an alternative to direct spending for achieving government policy objectives. They are defined as deviations from a benchmark tax system. Typically, they take the form of exemptions, deductions, credits or deferrals that are available to targeted groups of individuals or businesses.

In order to provide as much information as possible, a broad definition of the benchmark tax system has been adopted.

Given the informational intent of this report, estimates are also provided for some tax measures, such as the dividend tax credit, even though they are usually considered to be part of the benchmark tax system. These tax measures are referred to as memorandum items.

Elements of the Benchmark System

In order to identify tax expenditures, it is necessary to establish a broadly based benchmark tax structure which does not contain tax preferences. Tax expenditures are then defined as deviations from this benchmark. To ensure that the estimates provide meaningful information on the cost of government operations, the benchmark tax systems used in this document are defined as consisting of the basic structural features of the current federal income tax system and the GST.

Personal and corporate income tax systems

The benchmark for the personal and corporate tax systems includes the existing tax rates and brackets, unit of taxation, time-frame of taxation, treatment of inflation for calculating income and those measures designed to reduce or eliminate double taxation.

The definition of income is crucial in determining what is a tax expenditure. Tax provisions which provide for the deduction of current costs incurred to earn income are considered to be part of the benchmark system and therefore not tax expenditures. For example, the deductibility of labour costs or economic depreciation of business assets in determining business income would not be considered a tax expenditure.

It is important to emphasize that the definition of the benchmark tax structure, and hence the identification of tax expenditures, is subjective. Reasonable differences of opinion may exist as to the interpretation and categorization of tax measures. For example, unemployment insurance (UI) premiums paid by an employee could be viewed either as an expense of earning income or as a tax used to finance an income transfer to the unemployed. From the first perspective, the current system of providing employees a tax credit for contributions would not be a tax expenditure. The credit for UI premiums merely recognizes an expense of earning income, and hence, is part of the benchmark tax structure. On the other hand, one could argue that the tax credit for UI contributions represents a tax expenditure because the taxes paid by taxfilers are generally not deductible against personal income taxes. For this reason the tax treatment of UI premiums is reported as a memorandum item. Measures such as these which are subject to debate are discussed on an individual basis in Appendices A and B.

The following provides a more detailed discussion of the features of the benchmark for both the personal and corporate tax systems.

(1) Tax rates and income brackets

For the personal income tax system, the existing rate structure, including surtaxes, is taken to be part of the benchmark system. The basic personal credit is also treated as part of this structure since it is universal in its application and can be viewed as providing a zero rate of tax up to an initial level of income. However, the cost of this credit is included as a memorandum item.

With respect to the corporate income tax system, the basic federal corporate tax rate applicable to non-manufacturing corporations is 28.84 per cent including the surtax but after the provincial abatement. Provisions that reduce this tax rate for certain types of activities or corporations are regarded as tax expenditures. These include the lower tax rates for manufacturing and processing profits, and the rate for small business profits, which is available on the first $200,000 of active business income earned by most Canadian-controlled private corporations (CCPCs). The large corporations tax, levied at the existing rate, is also considered to be part of the benchmark tax system because it serves as a corporate minimum tax.

(2) 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 married credit, as tax expenditures.

The choice of the appropriate unit for the corporate income tax benchmark system raises a number of conceptual issues. There is a wide range of possible tax units, including the establishment or activity unit within a corporation, the single legal corporate entity, and the consolidated group of related corporations. The present income tax system contains elements of all of these approaches. For example, the view that the activity unit is the appropriate unit of taxation is consistent with the "at-risk" rules, which restrict the amount of investment tax credits and business losses that may be flowed out to limited partners. The view that the single legal corporate entity is the relevant tax unit is supported by the fact that income from one part of a business can be offset by other business losses within the same corporation whereas losses by one corporation may not generally be used against the income of another corporation in the group. Other provisions in the current tax system allow corporate groups to reorganize their corporate structures without triggering any capital gains or recaptured depreciation. These rollover provisions lead to a deferral of capital gains and recaptured depreciation, which would be appropriate if the taxation unit is the consolidated group of related corporations. On balance, the view most closely related to the existing system is that of the single legal corporate entity. For this reason, the single corporation is adopted as the benchmark tax unit, together with the availability of various roll-over provisions which permit the deferral of capital gains when a corporate structure is changed.

(3) Taxation period

The benchmark taxation period for the personal income tax system in this document is the calendar year. Accordingly, any measures which 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 fiscal year. As with the personal tax system, deferrals, such as fast write-offs of Canadian exploration and development expenditures, are considered to be tax expenditures.

A strict application of the annual taxation period would imply that measures which provide for the carry-over of losses to other years would be tax expenditures. However, the relatively cyclical nature of business and investment income suggests that it should be viewed over a number of years. Consequently, carry-overs of business and investment losses are treated as part of the benchmark tax system in this report. Estimates of the cost of these provisions are provided in the memorandum items section.

(4) Treatment of inflation

Both the personal and corporate income tax systems are based on nominal income with a number of provisions that account for the impact of inflation. Nominal income is therefore taken as the appropriate basis for the benchmark tax system. Consequently, special measures, such as the partial exclusion of capital gains from taxable income, which may serve to recognize inflation are identified as tax expenditures.

(5) Avoidance of double taxation

Conceptual difficulties arise in deciding whether certain provisions which reduce or eliminate double taxation should be considered as tax expenditures.

For example, regarding the personal and corporate income tax systems as completely separate would suggest that the dividend tax credit is a tax expenditure. However, the credit is an essential feature of the overall (i.e. both corporate and personal) income tax structure and serves to eliminate or reduce double taxation. In its absence, income earned through corporations would be taxed twice, once in the corporation and once at the personal level. For this reason, the dividend tax credit is not considered to be a tax expenditure.

Similarly, the non-taxation of inter-corporate dividends is designed to ensure that income already taxed in one corporation is not taxed again upon receipt of a dividend by another corporation. Without this exemption, double taxation would occur and the corporate income tax system would not be neutral across organizational structures. For example, consider a single corporation that currently operates as a number of divisions. Now suppose it reorganizes into a holding company with wholly owned subsidiaries instead of divisions. The profits from the subsidiaries flow to the holding company through inter-corporate dividends. If these dividends were subject to taxation at both the subsidiary and the holding company levels, double taxation would occur. Consequently, the exemption of inter-corporate dividends is not considered a tax expenditure.

Similar reasoning applies to the tax exemption on income of foreign affiliates of Canadian corporations. Canada either exempts certain dividend income paid by foreign affiliates from Canadian corporate income tax or it provides a foreign tax credit for income taxes paid in the other country. In either case, the intention is to ensure that income is not subject to double taxation (i.e. once in the country of residence of the foreign affiliate and once again in Canada when the dividends are paid out). A further discussion of this topic and the possible benchmarks that could be considered is contained in Appendix B.

Information on some of these measures that provide relief from "double taxation" is provided in the appropriate memorandum sections of this report.

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

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

Corporate income tax

- *the existing general tax rate is taken as given;*
- *the tax unit is the corporation;*
- *taxation is imposed on a fiscal year basis;*
- *nominal income (i.e. no adjustment for inflation) is used in defining income; and*
- *it incorporates structural features of the overall tax system such as the non-taxation of inter-corporate dividends.*

Goods and Services Tax[1]

The benchmark system used to analyze 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. The following provides a more detailed discussion of the features of the GST benchmark.

(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

[1] It should be noted that this analysis deals only with the GST and not with other commodity taxes (e.g., excise taxes).

chain. At each stage, however, businesses are 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 rests ultimately 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. This rate corresponds to the statutory rate of 7 per cent. 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) Constitutional provisions for government sectors

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 (or their Crown agents) are liable to taxation by the other. Accordingly, 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 government sectors.

- 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.
- By virtue of Section 125, 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 (RTAs). 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 benchmark system.

Unlike provincial governments, municipalities are liable to pay the GST. Therefore, the benchmark system considers them as paying tax on their purchases. Universities, colleges, schools and hospitals are also considered to pay tax on their purchases. The GST and the benchmark generally treat

these sectors as final consumers – that is, they pay GST on their purchases, they do not claim input tax credits and they do not collect GST on their sales.

The only exception to this benchmark treatment arises from the fact that municipalities, universities, colleges, schools and hospitals engage in certain commercial activities analogous to those provided in the private sector. For example, some municipalities operate golf courses. Such commercial activities are taxable under the GST and the GST paid on associated inputs can be claimed as input tax credits.

The benchmark for the Goods and Services Tax

The essential features are:

- *basic structural features of a broadly-based, multi-stage tax system,*
- *destination approach,*
- *7-per-cent rate,*
- *calendar year basis for the taxation period, and*
- *recognition of Constitutional provisions for government sectors.*

Defining GST tax expenditures

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

- zero-rated goods and services,
- tax-exempt goods and services,
- tax rebates, and
- tax credits.

(1) Zero-rated goods and services

Under the GST, certain categories of goods and services are considered to be taxed at a "zero" rate, rather than at the general tax rate of 7 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 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 sales 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 products are not entitled to claim input tax credits to recover the GST they paid on their inputs to these products.

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 a portion of the GST paid on inputs. For example, there are rebates for schools, universities, hospitals and municipalities. To the extent that these sectors make taxable sales, they can claim input tax credits to recover the tax they paid on inputs to these sales. Where they provide tax-exempt services, however, they are eligible to receive rebates for only a portion of the GST paid on their inputs to these services. These rebates ensure that these institutions do not bear a greater tax burden on their purchases under the GST than they would have under the manufacturers' sales tax. This treatment constitutes a tax expenditure because, under the benchmark system, these institutions are considered to be final consumers.

Other examples of tax rebates include the rebates for charities, substantially government-funded non-profit organizations and newly built housing. Also, foreign visitors to Canada are able to claim a rebate for the GST they pay on hotel accommodation and on goods they take home. Only the rebate for hotel accommodation is considered to be a tax expenditure, however, because goods taken home by foreign visitors are effectively exports which are not taxable under the benchmark system.

(4) GST credit[2]

To ensure that the GST system is fair, a GST 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 people receive depends on family size and income and is calculated annually based on information provided in the personal income tax return.

[2] It should be noted that there was a small business transitional credit which accompanied the introduction of the GST. This temporary measure provided a one-time credit of up to $1,000 to GST registrants whose taxable sales did not exceed $500,000 in their first full quarter of 1991 or in any three-month period beginning in 1990.

GST tax expenditures:

- *zero-rated goods and services,*
- *tax-exempt goods and services,*
- *tax rebates, and*
- *tax credit.*

Memorandum items for the Goods and Services Tax

As indicated earlier, some tax measures are presented as memorandum items even though they are not generally considered to be tax expenditures. For example, the refund of GST for certain employees' expenses is included as a memorandum item.

Many employees, such as commission salespeople, incur significant expenses in the course of carrying out their duties. Examples include restaurant meals and automobile expenses. Often, such expenses are not reimbursed by employers except indirectly through the salaries and commissions paid to employees. Since employees are not considered to be carrying on a commercial activity, they are not able to claim input tax credits for the GST they paid on these expenses. However, employees can receive a refund of the GST paid on those employment expenses that are deductible for income tax purposes. The refund of GST paid on employees' personal consumption expenses would constitute a tax expenditure. However, it is not possible to determine exactly what portion of these expenses should be considered personal consumption. Therefore, the refunds of GST paid on employees' expenses are reported as memorandum items. The memorandum items for the GST are discussed in more detail in Appendix C.

Calculation and Interpretation of the Estimates

The estimates indicate the cash flow impact to the government of each particular measure. Subject to the limitations described below, the estimates indicate the amount of revenue forgone in each year as a result of the tax expenditure. Accordingly, the estimates covered in this report may not be indicative of the long run or steady state revenue cost associated with each tax expenditure.

The estimates in this document reflect the amount by which federal tax revenues were reduced due to the existence of the various tax measures assuming:

(1) all measures are evaluated independently; and

(2) 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. An important implication of this is that **the estimates cannot be meaningfully aggregated to determine 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:

(1) the income tax rate structure is progressive; and

(2) tax measures interact with one another.

(1) 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 underrepresent 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 17 into the 26-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., home relocation loan and Registered Retirement Savings Plan (RRSP) contribution). Eliminating either deduction by itself would increase taxable income by $1,000 and the taxpayer's federal tax liability by $170. Eliminating both measures simultaneously, however, would not raise the tax liability by $170 + $170, but rather by $170 + $260.

Aggregating the individual estimates for these two items would provide a misleading impression of the revenue impact of eliminating both of them. Therefore, the estimates in this document cannot be meaningfully aggregated to determine the total cost of a particular group of tax expenditures or of all tax expenditures combined.

While there is only one statutory tax rate for corporations, the small business deduction 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 is not as large as for personal income taxes.

(2) 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 dollar value of calculating the cost of the same group of tax expenditures concurrently. This is because adding the independently estimated costs of the tax provisions would result in double counting and so would not provide an accurate measure of the revenue which would be generated by simultaneously altering a group of measures.

For example, consider the non-taxation of veterans' allowances, which reduces the recipient's net income. Many measures, such as the medical expense credit, are calculated on the basis of net income. Thus, the reported estimate for the non-taxation of veterans' allowances represents not only the direct impact on government receipts of not taxing the allowances, but also the indirect impact of the change on the cost of other tax measures (such as the medical expense credit) which depend on net income.

Since estimates for GST tax expenditures are made using the same methodological approach as for income taxes, they too cannot be aggregated because they may interact. The following discussion of hospital rebates and zero-rating of prescription drugs illustrates the differences between independent and concurrent estimates for these two provisions.

- Eliminating hospital rebates: If hospital rebates were eliminated, hospitals would no longer be able to recover 83 per cent of the GST they pay on their purchases[3]. However, they could continue to purchase prescription drugs on a tax-free basis because these drugs are zero-rated. The estimate for hospital rebates recognizes that the rebate would not have been claimed in respect of zero-rated prescription drugs.
- Eliminating the zero-rating of prescription drugs: If prescription drugs were taxed at the GST rate of 7 per cent, then hospitals would pay the tax on their drug purchases but recover 83 per cent of the tax through the rebate system. Therefore, the estimate for the zero-rating of prescription drugs is calculated as net of the expected increase in the payment of hospital rebates.
- Eliminating the two measures concurrently has a revenue impact greater than the sum of the independent estimates because the GST would be payable on prescription drugs and hospitals would be unable to claim a rebate for these purchases.

[3] Most services provided by hospitals are exempt from the GST. This means that no tax is charged on these services but input tax credits cannot be claimed to recover the tax paid on inputs. However, hospital are able to claim a rebate of 83 per cent of the GST paid on the inputs they use to provide exempt services.

Aggregation of estimates

The estimates for individual tax expenditures cannot be added together to determine the total cost of tax expenditures. There are two reasons for this:

- *the simultaneous elimination of more than one income tax expenditure would generate different estimates because of progressive income tax rates;*
- *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 simply aggregating them.*

All other factors remain unchanged

The estimates in this report represent the amount by which federal tax revenues were 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 figure and actual revenues provides the quantitative estimate of the cost of the tax expenditure.

The assumption that all other things remain the same 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 which 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 rearrange their affairs to minimize the amount of extra tax they would have to pay, perhaps by making greater use of other tax measures. Therefore, the omission of behavioural responses in the estimating methodology generates cost estimates which may exceed the revenue increases that would have resulted if a particular provision had been eliminated.

As one example, consider the case of the deduction for RRSP contributions. Eliminating this provision would result in the amount of additional federal revenue indicated in the report only if the contributions were not directed to an alternative tax-preferred form of saving. However, the absence of the RRSP deduction might encourage individuals to place their funds instead in some other tax-favoured instrument, such as a Labour Sponsored Venture Capital Corporation. If such a response did occur, eliminating the RRSP deduction would result in a smaller increase in revenues than that indicated.

The effects of this assumption can also be illustrated for the GST by considering the housing rebate. Home-owners are eligible for a rebate of the GST they pay on the purchase of new houses. If this rebate were eliminated, the price of new houses would increase relative to the price 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.

(2) Consequential government policy changes

The estimates ignore transitional provisions that might accompany the elimination of a particular measure and take no account of other consequential changes in government policy. For example, if the government were to eliminate a particular tax deferral, it could require the deferred amount to be brought into income immediately. Alternatively, it might prohibit new deferrals but allow existing amounts to continue to be deferred, perhaps for a specified period of time. The estimates in this report do not provide for any such transitional relief.

Similarly, the estimates make no allowance for consequential government policy changes. For example, if lottery winnings were made taxable under the personal income tax system, an argument could be made that the cost of tickets should be deductible in the same way as other investment expenses. Furthermore, it may not be possible to track and assess small gambling winnings. This may mean that a threshold under which winnings would be non-taxable would be required. However, in calculating the cost of providing the exemption for lottery winnings, no allowance is made for such hypothetical consequential government policy changes.

(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 the low corporate tax rate for manufacturing and processing could generate a significant amount of revenue for the government, the amount of manufacturing activity could decline, resulting in possible job losses, a reduction in taxable income and hence a reduction in the aggregate amount of tax revenue collected. Furthermore, the derivation of the estimates does not include speculation on 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 in this report represents the amount by which federal tax revenues were reduced due to the tax expenditure assuming that all other factors remain unchanged. ***The estimates do not take into account changes in taxpayer behaviour, consequential government actions or feedbacks on aggregate tax collections through induced changes in economic activity. Accordingly, the elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the following tables****.*

ESTIMATES

The majority of the personal income tax estimates in this report were computed with a personal income tax model. This model simulates changes to the personal income tax system using the statistical sample of tax returns collected by Revenue Canada for its annual publication Taxation Statistics. The model estimates the revenue impact of possible tax changes by re-computing taxes payable on the basis of adjusted values for all relevant income components, deductions and credits. For example, the removal of the moving expense deduction would result not only in a change in net income but also in all of the credits, such as the medical expense tax credit, whose values depend on net income. For those tax expenditures 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 Appendix A.

A corporate income tax model was used to measure most of the corporate tax expenditures. As with the personal income tax model, it is based on a statistical sample of tax returns collected by Revenue Canada, and is able to re-compute taxes payable on the basis of adjusted tax provisions. This re-computation of taxes takes into account the availability of unused tax credits, deductions, and losses that would be used by the corporation to minimize its 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 Appendix B.

The costs of the majority of the GST tax expenditures presented in this report were estimated using the input-output tables and National Accounts data prepared by Statistics Canada. In cases where estimates were not possible using these statistics alone, supplementary data from a variety of sources were used. Details on both the data sources and methodologies are provided in Appendix C.

Calculation of tax deferrals

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 estimates presented here.

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

Comparison with direct expenditures

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

The same conclusions do not always apply to tax expenditures provided to corporate taxpayers. Consider for example an investment tax credit to a corporation with respect to capital equipment acquired to carry out SR&ED in Canada. The cost to the government of providing a 20-per-cent tax credit would, in most circumstances, be the same as it would be if the government had provided a direct grant of 20 per cent. This is because investment tax credits are considered to be assistance and are therefore treated in the same manner as direct government grants or subsidies. The 20-per-cent tax credit, like a direct grant, is either included in income, and subject to corporate income tax, or it reduces the capital or other costs deductible by the taxpayer.

The estimates

Table 1 provides estimates of the cost to the federal government of personal income tax expenditures for 1992 and 1993 grouped according to functional categories. Table 2 provides estimates of the cost of corporate income tax expenditures for 1991 and 1992 for all corporations and by major industrial sector. The 1991 estimates in Table 2 are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data. The grouping into functional categories is not intended as a policy justification for the specific provisions nor is it the case that all tax

measures fall neatly into one of the categories. The categories are provided solely for organizational purposes. Table 3 provides the estimates of the revenue forgone for each of the tax expenditures associated with the GST for the years 1992 and 1993. These departures from the benchmark have been grouped according to the type of tax expenditure.

All estimates are reported in millions of dollars. The letter "S" indicates that the cost is less than $2.5 million while "n.a." signifies that data were not available. The inclusion in the report of items for which estimates are not available is warranted given that the report is designed to provide information on the type of assistance delivered through the tax system even if it is not always possible to provide a quantitative estimate. Work is continuing to replace "n.a."s with quantitative estimates where possible. For example, the corporate income tax entry dealing with exemptions from non-resident withholding tax was an "n.a." in last year's report. In this year's publication a dollar value is reported for these tax expenditures.

As previously noted, the figures and explanations for each measure are for the 1991 and 1992 taxation years in the case of corporate income tax expenditures, and for 1992 and 1993 in the case of personal income tax expenditures and the goods and services tax expenditures. Since that time, some provisions have been altered. Major changes to the tax expenditures since 1992 or 1993 are noted in the explanatory text that describes each measure (Appendices A, B, and C). For the convenience of the reader, a comprehensive list of all the provisions that have been altered since 1992 or 1993 is provided in Appendix D.

Table 1
*Personal income tax expenditures**

	1992	1993
	(millions of dollars)	
Culture and recreation		
Non-taxation of lottery and gambling winnings[1]	905	910
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S
Deduction for clergy residence	50	48
Flow-through of CCA on Canadian films	11	16
Write-off of Canadian art purchased by unincorporated business	n.a.	n.a.
Assistance for artists	n.a.	n.a.
Deduction for artists' employment expenses	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	n.a.	n.a.
Education		
Exemption on first $500 of scholarship, fellowship and bursary income	10	7
Deduction of teachers' exchange fund contributions	S	S
Tuition fee credit	155	175
Education credit	44	43
Education and tuition fee credits transferred	165	190
Registered education savings plans	n.a.	n.a.
Employment		
Deduction of home relocation loans	4	3
Non-taxation of strike pay[2]	9	n.a.
Non-taxation of allowances to volunteer firefighters	4	4
Northern benefits deductions[3]	235	190
Overseas employment credit	27	33
Employee stock options[4]	25	57
Deferral of salary through leave of absence/sabbatical plans	n.a.	n.a.
Employee benefit plans	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Family		
Married credit	1,140	1,205
Equivalent-to-married credit[5]	585	455
Dependant credit[6]	435	12
Refundable child tax credit[7]	2,360	–
Child tax benefit[8]	n.a.	5,275
Deferral of capital gain through spousal roll-over	n.a.	n.a.
Farming and fishing		
$500,000 lifetime capital gains exemption for farm property	250	405
Net Income Stabilization Account (NISA)[9]		
Deferral of tax on government contributions	31	31
Deferral of tax on bonus and interest income	5	9
Taxable withdrawals	-19	-14
Deferral of income from destruction of livestock	S	S
Deferral of income from grain sold through cash purchase tickets[10]	-12	-15
Deferral through 10-year capital gain reserve[11]	-30	-5
Deferral of capital gain through intergenerational roll overs of family farms	n.a	n.a
Exemption from making quarterly tax instalments	n.a	n.a
Cash basis accounting	n.a	n.a
Flexibility in inventory accounting	n.a	n.a
Federal/provincial financing arrangements		
Quebec abatement	2,095	2,140
Transfers of income tax room to provinces	8,700	8,870
General business and investment		
$100,000 lifetime capital gains exemption[12]	735	1,170
Partial inclusion of capital gains[13]	745	1,185
Deduction of research and development expenditures	7	3
Deduction of limited partnership losses	220	215
Investment tax credit[14]	58	125
Deferral through five-year capital gain reserve[15]	-14	-33
Deferral through capital gains roll overs	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.
$1,000 capital gain on personal-use property	n.a.	n.a.

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
$200 capital gain on foreign exchange transactions	n.a.	n.a.
Taxation of capital gains upon realization	n.a.	n.a.
Health		
Non-taxation of employer-paid insurance premiums for private health and welfare plans	1,125	1,200
Disability credit	265	270
Medical expenses credit	225	260
Income maintenance and retirement		
Non-taxation of guaranteed income supplement and spouse's allowance payments[16]	220	225
Non-taxation of social assistance payments[16, 17]	650	705
Non-taxation of workers' compensation payments	610	610
Non-taxation of amounts received as damages in respect of personal injury or death	17	18
Non-taxation of group term insurance of up to $25,000	160	165
Non-taxation of RCMP pension/compensation for injury, disability or death	9	8
Non-taxation of veterans' allowances, civilian war pensions and allowances and other service pensions (including those from allied countries)[18]	7	6
Non-taxation of veterans' disability pension and support for dependants[19]	140	140
Deduction of alimony and maintenance payments	200	220
Age credit	1,355	1,370
Pension income credit	295	305
Saskatchewan pension credit	S	S
Registered retirement savings plans		
Deduction for contributions	3,685	4,490
Non-taxation of investment income	2,760	3,325
Taxation of withdrawals[20]	-1,000	-930
Registered pension plans		
Deduction for contributions	4,990	5,205
Non-taxation of investment income[21]	7,865	8,610
Taxation of withdrawals	-4,580	-4,930
Deferred profit sharing plans	n.a.	n.a.
Non-taxation of up to $10,000 of death benefit	n.a.	n.a.
Non-taxation of investment income on life insurance policies[22]	–	–

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Small business		
$500,000 lifetime capital gains exemption for small business shares	785	1,170
Deduction of allowable business investment losses	89	100
Labour-sponsored venture capital credit[23]	62	58
Deferral through ten-year capital gain reserve[24]	-7	5
Other items		
Non-taxation of War Savings Certificates/Victory Bonds	S	S
Non-taxation of capital gains on principal residences[25]		
Partial inclusion rate	2,375	2,050
Full inclusion rate	3,165	2,735
Non-taxation of income from the Office of Governor General	S	S
Assistance for prospectors and grubstakers	S	S
Charitable donations credit	865	880
Gifts to Crown credit	17	14
Political contribution credit	10	20
Non-taxation of income of Indians on reserves	n.a.	n.a.
Non-taxation of gifts and bequests	n.a.	n.a.
Memorandum items		
Non-taxation of allowances to certain public officials	5	6
Non-taxation of allowances for diplomats and and other government employees posted abroad	10	8
Child care expense deduction	315	305
Attendant care expense deduction	S	S
Moving expense deduction	59	66
Deduction of carrying charges incurred to earn income	585	540
Deduction of meals and entertainment expenses	80	110
Deduction of farm losses for part-time farmers	52	50
Farm and fishing loss carry-overs	11	11
Capital loss carry-overs	50	89
Non-capital loss carry-overs	53	73
Logging tax credit	S	S
Deduction of accelerated tax depreciation[26]	85	95
Deduction of resource-related expenditures[27]	51	78
Deduction of other employment expenses	455	490

Personal income tax expenditures (cont'd)

	1992	1993
	(millions of dollars)	
Deduction of union and professional dues	440	465
Unemployment insurance		
Unemployment insurance contribution credit	1,220	1,230
Non-taxation of employer-paid premiums	2,485	2,510
Canada and Quebec pension plans		
Canada and Quebec pension plan credit	930	985
Non-taxation of employer-paid premiums	1,210	1,270
Foreign tax credit	150	185
Dividend gross-up and credit	640	635
Basic personal credit	17,265	17,130
Non-taxation of capital dividends	n.a.	n.a.

Footnotes

[1] The 1992 estimate ($900 million) published in the previous edition of this report has been revised to reflect the availability of updated data from Statistics Canada concerning total lottery winnings.

[2] The 1993 data were not available as of the date of publication.

[3] The reduction in the tax expenditure reflects the fact that residents of communities no longer eligible for benefits or entitled to reduced benefits following the reform of northern benefits were eligible for full benefits in 1992 but only two-thirds benefits in 1993.

[4] The increase in 1993 for this tax expenditure reflects the improved performance of stock markets in that year.

[5] The decline from 1992 to 1993 reflects the change in the definition of spouse to include common-law spouses.

[6] In 1992, taxpayers could claim a credit in respect of children and other qualified dependent relatives who were either under the age of 19 or mentally or physically infirm. Starting in 1993, with the introduction of the child tax benefit, taxpayers could claim the dependant credit for dependants over 17 years only if they were physically or mentally infirm.

[7] This credit was eliminated with the introduction of the child tax benefit in 1993.

[8] The child tax benefit was introduced in 1993. The estimate corresponds to amounts paid in 1993.

[9] Estimates for the tax expenditures on NISA were not included in previous editions.

[10] Amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to negative estimates in both years.

[11] In 1992 and 1993, the amount of cash tickets outstanding declined, giving rise to negative estimates in both years.

[12] 80 per cent of the increase from 1992 to 1993 for this tax expenditure is attributable to an increase in gains realized on shares, reflecting in part the performance of stock markets in 1993.

[13] The increase in this tax expenditure reflects the performance of stock markets in 1993.

[14] The increase from 1992 to 1993 is largely attributable to the temporary small business investment tax credit. The tax credit was provided for investments in eligible machinery and equipment made after December 2, 1992 and before 1994.

[15] Amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to negative estimates in both years.

[16] The 1992 and 1993 estimates are based on amounts reported for tax purposes. The numbers obtained are then adjusted based on data from Human Resources Development Canada, so that the amount of benefits used to compute the tax expenditure is consistent with program data.

[17] The 1992 estimate ($680 million) published in the previous edition of this report has been revised to reflect the availability of updated social assistance expenditure data from Human Resources Development Canada.

[18] The 1992 estimate ($24 million) published in the previous edition of this report has been revised to reflect the availability of additional sources of information about the average marginal tax rate for taxpayers receiving these benefits.

[19] The 1992 estimate ($170 million) published in the previous edition of this report has been revised to reflect the availability of additional sources of information about the average marginal tax rate for taxpayers receiving these benefits.

[20] The methodology for calculating tax revenues from the taxation of withdrawals has been modified to use distinct income data on RRSP annuity income and to apply different average marginal tax rates to annuity income from RRSPs and to RRSP withdrawals. As a result, the 1992 estimate differs from that in the previous edition (-$940 million). The change in RRSP withdrawals also affects RRSP investment income.

[21] The 1992 estimate ($7,690 million) published in the previous edition of this report has been revised to reflect the availability of updated data concerning assets accumulated in registered pension plans.

[22] Although this measure does provide tax relief for individuals, it is implemented through the corporate tax system. See the corporate income tax expenditure section of this report for an estimate of the value of this tax expenditure.

[23] The implementation of a ceiling by the Québec government, limiting the issuance of shares by the *Fonds de solidarité des travailleurs du Québec* to $97 million for 1993, led to a reduction of this tax expenditure. (The ceiling has since been removed.)

[24] In 1992, amounts brought back into income from reserves exceeded amounts set aside in newly established reserves, giving rise to a negative estimate.

[25] The 1992 estimate has been revised due to improvements in the methodology, in particular, to reflect improved data regarding renovations and additions to houses. This tax expenditure has been declining due to smaller increases and/or declines in the price of houses in recent years.

[26] The 1992 estimate ($100 million) published in the previous edition of this report has been revised to reflect the availability of updated data from Revenue Canada.

[27] Starting on December 2, 1992, the first $2 million of Canadian Development Expenses (CDE) for oil and gas that are renounced by a company to shareholders under a flow-through share agreement can be reclassified as Canadian Exploration Expenses (CEE) and deducted accordingly, i.e. 100 per cent in the first year rather than 30 per cent per year declining balance.

Table 2
*Corporate income tax expenditures**
All corporations

	1991**	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses[1]	2,087	1,934
Low tax rate for manufacturing and processing[2]	349	368
Low tax rate for credit unions and co-operatives	54	60
Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit[3]	578	597
Atlantic Canada Investment Tax Credit	23	34
Special Investment Tax Credit	10	7
Cape Breton Investment Tax Credit	4	3
Exploration Tax Credit[4]	S	–
Small Business Investment Tax Credit	S	5
ITCs claimed in current year but earned in prior years	195	211
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	412	436
Resource allowance[5]		
Non-deductibility of Crown royalties	-317	-358
Resource allowance	232	272
Earned depletion[6]	39	39
Deductibility of charitable donations	74	82
Gifts to the Crown	S	S
Non-deductibility of advertising expenses in foreign media	n.a.	n.a.
Non-taxation of provincial assistance for venture investments in small business	n.a.	n.a.

* The elimination of a tax expenditures would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

** The 1991 figures are based on final data and may differ from the figures in last year's edition of this document which were based on preliminary data.

All corporations (cont'd)

	1991	1992
	(millions of dollars)	
Deferrals[7]		
Fast write-off for capital equipment used for scientific research and experimental development	72	53
Allowable business investment losses	39	45
Holdback on progress payments to contractors	-15	6
Deductibility of carrying charges on land[8]	5	–
Available for use[9]	–	n.a.
Capital gains taxation on realization basis	n.a.	n.a.
Expensing of advertising costs	n.a.	n.a.
Cash basis accounting	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.
Deferral of income		
On grain sales	n.a.	n.a.
On destruction of livestock	n.a.	n.a.
Deferral of tax from use of billed-basis accounting by professionals	n.a.	n.a.
International		
Non-taxation of life insurance companies' world income	85	60
Exemptions from non-resident withholding tax[10]		
Copyright royalties	78	80
Royalties for the use of, or right to use, other property	32	39
Interest on deposits	454	397
Interest on long-term corporate debt	412	450
Dividends	77	80
Management fees	9	10
Exemption of foreign shipping and aircraft companies from Canadian income tax	n.a.	n.a.
Other tax expenditures		
Transfer of income tax room to provinces in respect of shared programs[11]	420	353
Interest credited to life insurance policies	55	60
Non-taxation of registered charities	n.a.	n.a.
Income tax exemption for provincial and municipal corporations	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.
Excise Tax Transportation rebate[12]	–	45

All corporations (cont'd)

	1991	1992
	(millions of dollars)	
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	772	699
Fast write-off for Canadian development expenses and Canadian exploration expenses[13]	575	680
Deductibility of Crown royalties for the Syncrude project (Remission Order)	18	18
Deductibility of royalties paid to Indian bands	n.a.	n.a.
Refundable Part I tax on investment income of private corporations	877	808
Refundable capital gains for special investment corporations[14]	141	41
Loss carry-overs		
Non-capital losses[15]	1,660	1,074
Net capital losses	n.a.	n.a.
Farm losses and restricted farm losses	n.a.	n.a.
Meals and entertainment expenses	392	434
Large corporations tax		
Threshold	500	500
Exempt corporations	n.a.	n.a.
Patronage dividend deduction by credit unions and co-operatives	179	129
Logging tax credit	3	7
Non-resident-owned investment corporation refund[16]	49	16
Investment corporation deduction	S	S
Deferral of capital gains income through various rollover provisions	n.a.	n.a.
Excess deduction for intangible assets	n.a.	n.a.
Tax exemption on income of foreign affiliates of Canadian corporations	n.a.	n.a.

Agriculture, Forestry, Fishing

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	93	105
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	4	4
Atlantic Canada Investment Tax Credit	S	5
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	3
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	3	3
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	6	5
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	S	S
Refundable Part I tax on investment income of private corporations	12	8
Loss carry-overs		
Non-capital losses	7	5
Meals and entertainment expenses	S	S
Logging tax credit	S	S

Manufacturing

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	221	225
Low tax rate for manufacturing and processing	298	325
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	293	284
Atlantic Canada Investment Tax Credit	13	13
Special Investment Tax Credit	10	5
Cape Breton Investment Tax Credit	4	S
ITCs claimed in current year but earned in prior years	115	112
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	32	25
Deductibility of charitable donations	16	18
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	31	20
Allowable business investment losses	5	21
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	96	81
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-18	-124
Refundable Part I tax on investment income of private corporations	19	15
Loss carry-overs		
Non-capital losses	588	267
Meals and entertainment expenses	92	92
Logging tax credit	S	6

Construction

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	289	232
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	3	3
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	11	18
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	6	3
Holdback on progress payments to contractors	-15	6
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	26	22
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	15	6
Refundable Part I tax on investment income of private corporations	34	27
Loss carry-overs		
Non-capital losses	102	83
Meals and entertainment expenses	26	42

Transportation and storage

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	79	64
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	3
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	7	S
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	12	10
Excise Tax Transportation rebate	–	45
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	24	35
Refundable Part I tax on investment income of private corporations	8	5
Loss carry-overs		
Non-capital losses	46	39
Meals and entertainment expenses	17	17
Logging tax credit	S	S

Communications

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	8	4
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	53	59
Atlantic Canada Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	30	35
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	S
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	21	18
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	25	66
Refundable Part I tax on investment income of private corporations	S	S
Loss carry-overs		
Non-capital losses	7	5
Meals and entertainment expenses	12	12

Public utilities

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	5	5
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	10
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	6	5
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	59	44
Refundable Part I tax on investment income of private corporations	S	4
Loss carry-overs		
Non-capital losses	9	4
Meals and entertainment expenses	S	3

Wholesale trade

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	223	240
Low tax rate for manufacturing and processing	25	10
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	52	56
Atlantic Canada Investment Tax Credit	S	3
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	20	10
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	12	6
Deductibility of charitable donations	7	5
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	6	5
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	42	35
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	38	96
Refundable Part I tax on investment income of private corporations	17	17
Loss carry-overs		
Non-capital losses	127	80
Meals and entertainment expenses	58	75
Logging tax credit	S	S

Retail trade

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	345	257
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	S	S
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	3	11
Deductibility of charitable donations	3	3
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	26	22
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	14	S
Refundable Part I tax on investment income of private corporations	33	32
Loss carry-overs		
Non-capital losses	108	94
Meals and entertainment expenses	27	21

Finance

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	272	255
Low tax rate for manufacturing and processing	6	S
Low tax rate for credit unions and co-operatives	54	60
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	32	35
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	11	5
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	324	309
Deductibility of charitable donations	29	34
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	4	4
Allowable business investment losses	11	12
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	124	104
Interest credited to life insurance policies	55	60
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	478	405
Refundable Part I tax on investment income of private corporations	691	653
Refundable capital gains for special investment corporations	141	41
Loss carry-overs		
Non-capital losses	324	186
Meals and entertainment expenses	65	79
Non-resident-owned investment corporation refund	49	16
Investment corporation deduction	S	S

Services

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	511	513
Low tax rate for manufacturing and processing	6	8
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	96	115
Atlantic Canada Investment Tax Credit	S	S
Special Investment Tax Credit	S	S
Cape Breton Investment Tax Credit	S	S
ITCs claimed in current year but earned in prior years	6	11
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	11	17
Deductibility of charitable donations	5	6
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	23	18
Allowable business investment losses	14	6
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	41	35
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	194	238
Refundable Part I tax on investment income of private corporations	51	38
Loss carry-overs		
Non-capital losses	138	121
Meals and entertainment expenses	57	59
Non-resident-owned investment corporation refund	S	S
Investment corporation deduction	S	S

Oil and gas

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	20	12
Low tax rate for manufacturing and processing	10	16
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	13	14
Atlantic Canada Investment Tax Credit	3	11
Exploration Tax Credit	S	–
ITCs claimed in current year but earned in prior years	5	28
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	5	27
Resource allowance		
Non-deductibility of Crown royalties	-307	-342
Resource allowance	194	241
Earned depletion	33	37
Deductibility of charitable donations	5	7
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	6	4
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	16	13
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-39	-60
Fast write-off for Canadian development expenses and Canadian exploration expenses	493	599
Deductibility of Crown royalties for the Syncrude project (Remission Order)	18	18
Refundable Part I tax on investment income of private corporations	5	3
Loss carry-overs		
Non-capital losses	107	44
Meals and entertainment expenses	5	6

Mining

	1991	1992
	(millions of dollars)	
Tax rate reductions		
Low tax rate for small businesses	8	5
Low tax rate for manufacturing and processing	S	S
Tax credits		
Investment tax credits		
SR&ED Investment Tax Credit	12	6
Atlantic Canada Investment Tax Credit	S	S
Cape Breton Investment Tax Credit	S	3
ITCs claimed in current year but earned in prior years	S	S
Political contributions tax credit	S	S
Exemptions and deductions		
Partial inclusion of capital gains	S	3
Resource allowance		
Non-deductibility of Crown royalties	-10	-16
Resource allowance	38	31
Earned depletion	6	S
Deductibility of charitable donations	S	S
Gifts to the Crown	S	S
Deferrals		
Fast write-off for capital equipment used for scientific research and experimental development	S	S
Allowable business investment losses	S	S
Other tax measures		
Transfer of income tax room to provinces in respect of shared programs	4	3
Memorandum items		
Excess of tax depreciation over depreciation for financial statement purposes	-14	-10
Fast write-off for Canadian development expenses and Canadian exploration expenses	82	81
Refundable Part I tax on investment income of private corporations	4	S
Loss carry-overs		
Non-capital losses	96	144
Meals and entertainment expenses	9	6

Footnotes

[1] The decrease in revenue cost for the low tax rate on small businesses was due to the decline in taxable income between 1991 and 1992.

[2] Despite a decline in taxable income between 1991 and 1992, the revenue cost for the preferential tax rate on M&P profits increased due to a one-percentage-point increase in the M&P deduction during 1991.

[3] The numbers reported do not reflect the fact that SR&ED tax credits reduce the SR&ED expenditure pool in the taxation year after the credits are either used to reduce taxes otherwise payable or refunded. This generally increases taxable income in that year because the amount deductible is reduced. It is estimated that the annual revenue from the taxback is about $100 million.

[4] The measure was no longer effective in 1992.

[5] In this publication, tax expenditures are reported separately for the deductibility of Crown royalties and Resource allowance. Also, the tax expenditure items for deductibility of provincial royalties for the Syncrude project (Remission Order) and royalties paid to Indian bands have been moved to the "Memorandum item" section. Changes in tax expenditure reporting reflect changes in the underlying assumptions and methods. See explanation in each corresponding item in Appendix B.

[6] Due to the elimination of the earned depletion allowance, there have been no additions to this expenditure pool since 1989.

[7] Fast write-off for Canadian development expenses and Canadian exploration expenses, which used to be under Deferrals, has been moved to the "Memorandum items" section as a combined item. See explanation in Appendix B.

[8] The measure was no longer effective in 1992.

[9] The measure was not effective until 1992.

[10] These estimates are based on the benchmark assumption that no behavioural response would occur after the hypothetical removal of existing withholding tax exemptions. This assumption is particularly difficult to sustain for this type of tax, as indicated in the text, which means that the amounts shown in the table should not be regarded as estimates of the revenue gain that would be realized from the hypothetical removal of the listed withholding tax exemptions.

[11] The decrease in revenue cost for the transfer of income tax room to provinces in respect of shared programs was due to the decline in taxable income between 1991 and 1992.

[12] The Excise Tax Transportation rebate was introduced in December 1991.

[13] See also Natural Resources Canada's tax expenditure estimates for CDE & CEE in Appendix B, under "Memorandum Items" section.

[14] The decrease between 1991 and 1992 is mainly due to a decrease in dividends distributed to shareholders.

[15] A decline in taxable income between 1991 and 1992 resulted in a decrease in non-capital losses carried over between these two years.

[16] The decrease between 1991 and 1992 is mainly due to a decrease in dividends distributed to shareholders.

Table 3
*GST tax expenditures**

	1992[1]	1993
	(millions of dollars)	
Zero-rated goods and services		
Basic groceries	2,455	2,555
Prescription drugs	160	185
Medical devices	150	165
Agricultural and fish products and purchases	S	S
Certain zero-rated purchases made by exporters	S	S
Non-taxable importations	n.a.	n.a.
Tax exempt goods and services		
Long-term residential rent	1,020	1,065
Health care services	315	335
Education services (tuition)	330	345
Child care and personal services	105	110
Legal aid services	25	25
Ferry, road and bridge tolls	10	10
Municipal transit	60	65
Exemption for small businesses	95	100
Quick method accounting	105	115
Water and basic garbage collection services	100	115
Domestic financial services	n.a.	n.a.
Exempt supplies made by non-profit organizations	n.a.	n.a.
Tax rebates		
Rebates for municipalities	495	505
Rebates for hospitals	280	275
Rebates for schools	290	305
Rebates for universities	115	120
Rebates for colleges	50	50
Rebates for charities	115	120
Rebates for non-profit organizations	70	75
Housing rebate[2]	435	415
Rebate for foreign visitors on accommodation	15	15
Special credit for certified institutions	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See pages 16 to 21 for a discussion of the reasons for this.

GST tax expenditures (cont'd)

	1992[1]	1993
	(millions of dollars)	
Tax credit		
The GST credit	2,490	2,645
Memorandum Items		
Meals and entertainment expenses	190	205
Rebate to employees and partners	55	60
Sales of personal-use real property	n.a.	n.a.

Footnotes

[1] The 1992 estimates might differ from the 1992 estimates shown in the previous Tax Expenditures released in December 1994 because of revisions to Statistics Canada's data.
[2] The decline in the cost in 1993 can be explained by the decline in the value of residential housing in the National Accounts.

APPENDIX A
DESCRIPTION OF PERSONAL INCOME TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1992 and 1993 taxation years. Since that time, some provisions have been altered.

A number of measures which primarily affect corporations, but also have an impact on non-incorporated businesses, are treated under the corporate income tax measures section.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the personal income tax simulation model described in the main text.

Culture and Recreation

Non-taxation of lottery and gambling winnings

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

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

The values do not include amounts from other types of gambling, such as bingo, where no accurate data are available. As a result, the cost of the tax expenditure may be underestimated. On the other hand, no adjustments are made for the possible deductibility of lottery ticket purchases which might accompany the taxation of lottery winnings.

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

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

Deduction for clergy residence

A taxpayer who is a full-time member of the clergy or regular minister of a religious denomination may deduct housing costs from income for tax purposes. 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. The estimate for this item is based on the number of clergy in Canada and Statistics Canada expenditure data on rent.

Flow through of CCA on Canadian films

The capital cost allowance (CCA) rate generally available on films is 30 per cent subject to the half-year rule. On "certified Canadian films", the half-year rule does not apply. The CCA may be flowed through to investors and deducted against their other sources of income. An additional allowance of up to the remaining undepreciated capital cost of the film is deductible against an investor's income from certified Canadian films. Investments in television commercials may be depreciated at a rate of 100 per cent.

Losses arising from CCA claimed at the partnership level and flowed through as limited partnership losses are included in the "Deduction of limited partnership losses" tax expenditure. It is estimated that 15 per cent of limited partnership losses relate to CCA on Canadian films.

(The 1995 budget proposed that the flow-through of the CCA be replaced with a refundable tax credit.)

Write-off of Canadian art purchased by unincorporated businesses

Canadian art acquired by businesses for display in an office may be depreciated on a 20-per-cent declining balance basis even though Canadian art may depreciate at a much slower rate, and may even appreciate.

No data are available.

Assistance for artists

Artists 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 then used to determine the artist's income and the amount that qualifies for the charitable donations credit. The restriction that donations eligible for the charitable donations tax credit cannot exceed 20 per cent of income does not apply.

No data are available.

Deduction for artists and musicians

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.

Since 1991, employed artists have also been 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.

Non-taxation of capital gains on gifts of cultural property

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

Such donations amounted to $51 million in 1992 and $105 million in 1993. However, there is no information on the portion of the value which represents capital gains.

Education

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

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

The values reported in the table are understated since no data are available on individuals receiving scholarship, fellowship or bursary income of less than $500.

Deduction of teachers' exchange fund contributions

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

Tuition fee credit

A 17-per-cent tax credit is available for tuition fees paid by students to a prescribed educational institution. The credit is not available if the total tuition fees paid to institutions are $100 or less.

Education credit

Students who are enrolled at prescribed educational institutions on a full-time basis are entitled to claim a tax credit of 17 per cent of $80 for every month of full-time attendance.

Education and tuition credits transferred

The unused portion of the education and the tuition fee amounts may be transferred to a supporting spouse, parent or grandparent. The maximum transfer for the two credits combined is 17 per cent of $4,000.

Registered education savings plans

A taxpayer may contribute to a registered education savings plan on behalf of a designated beneficiary (usually the taxpayer's child). The contribution cannot exceed $1,500 per beneficiary, with an overall limit of $31,500.

The investment return on these funds is not taxable until it is withdrawn by the beneficiary for educational purposes, and is generally taxable in the hands of the beneficiary rather than the contributor.

No data are available.

Employment

Deduction of home relocation loans

For up to five years, 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 lesser of the amount included in income as a taxable benefit and the amount of the benefit that would arise in respect of an interest-free loan of $25,000.

Non-taxation of strike pay

Strike pay is non-taxable.

The estimates are based on data provided by Statistics Canada's annual report on Corporations and Labour Unions Return Act Part II (CALURA, Catalogue 71-202).

Non-taxation of allowances for volunteer firefighters

Volunteer firefighters may receive up to $500 per year in non-taxable allowances.

The estimates are based on census data.

Northern residents deductions

Individuals living in prescribed areas in Canada for a specified period may claim the northern residents deductions. The benefits consist of a residency deduction of up to $15 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 full benefits, while residents of the Intermediate Zone are eligible for 50 per cent of the benefits.

The current definition of prescribed areas came into force in 1991. However, the implementation of the current system was gradual. Certain communities, which had qualified under the pre-1991 regime but which are no longer eligible under the current system continued to receive full benefits until 1992, and received two-thirds benefits in 1993. Other communities, which had qualified under the pre-1991 regime but are eligible for 50 per cent of the full deductions under the current system continued to receive full benefits until 1992, and received two-thirds benefits in 1993.

Overseas employment credit

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, to a maximum credit of $80,000.

Employee stock options

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

In addition to this general stock option tax treatment, employees of Canadian-controlled private corporations (CCPCs) receive a further deferral advantage since they need not include the calculated benefit in their income until they dispose of the shares. At the time of disposition, a deduction is provided for one-quarter of the difference between the option price and the fair market value at the time the employee exercised the option.

The estimates are computed by assuming the elimination of the deduction, and therefore do not capture the deferral benefit.

Deferral of salary through leave of absence/sabbatical plans

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

No data are available.

Employee benefit plans

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 these contributions are actually distributed to the employees.

No data are available.

Non-taxation of certain non-monetary employment benefits

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

No data are available.

Family

Married credit

A married taxpayer supporting a spouse is entitled to a tax credit of 17 per cent of $5,380. This credit is reduced by 17 per cent of the amount by which the dependent spouse's income exceeded $538.

Effective with the 1993 taxation year, the definition of spouse for tax purposes has been expanded to include common-law spouses, provided that the couple have lived together at least one year or have a common child.

Equivalent-to-married credit

An "equivalent-to-married" tax credit may be claimed in respect of a dependent child under 18 or a parent or grandparent by taxpayers without a spouse. The amount of the credit and the limitation on the dependant's income are the same as for the married credit.

Dependant credit

In 1992, taxpayers could claim a credit in respect of children and other qualified dependent relatives who were either under the age of 19 or mentally or physically infirm. The tax credit was $417 for each of the first two dependants under the age of 19, $834 for each additional dependant under the age of 19 and $1,583 for each infirm dependant. These amounts were reduced by 17 per cent of the amount of the dependant's net income in excess of $2,690. This credit for dependants under the age of 19 was eliminated with the introduction of the child tax benefit in 1993.

Starting in 1993, taxpayers could claim the dependant credit for dependent relations over 17 years who were physically or mentally infirm. A credit of $1,583 applies to any qualified dependant whose income is below $2,690. The credit is exhausted when the dependant earns an income of $4,273 or more.

Refundable child tax credit

In 1992, individuals receiving family allowances were entitled to an income-tested refundable child tax credit. The basic amount was $601 per child. A supplement of $213 was available for each child under the age of seven. This supplement was reduced by 25 per cent of all child care expenses deducted. The combined credit was reduced by 5 per cent of the amount of the parents' net income in excess of $25,921.

This credit for dependants under the age of 18 was eliminated with the introduction of the child tax benefit in 1993.

Child Tax Benefit

The child tax benefit was introduced in 1993, replacing the family allowance, the dependant credit for children under 18 years of age and the refundable child tax credit. The child tax benefit payments are made monthly and are non-taxable.

The child tax benefit provides a basic credit of $1,020 per child annually, plus $75 for the third and each subsequent child. It also includes a supplement of $213 for each child under age 7, the total of which is reduced by 25 per cent of the child care expenses claimed. The total benefit is reduced by 5 per cent (2.5 per cent for one-child families) of family net income over $25,921.

The child tax benefit also includes an earned income supplement for low-income working families equal to 8 per cent of the family earned income in excess of $3,750 (not exceeding a maximum supplement of $500). The supplement is reduced by 10 per cent of the family net income in excess of $20,921.

Deferral of capital gains through transfer to spouse

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

Property transferred to other family members or to unrelated individuals (or to trusts of which they are beneficiaries) is treated differently. The transferor is generally deemed to have disposed of the property at the time of transfer and must include any resulting capital gain in income at that time.

In the case of property transferred to a trust, the tax treatment again differs depending on whether or not the beneficiary of the trust is a spouse. The treatment of spousal trusts is described above. For non-spousal trusts, capital gains are subject to tax not only when property is transferred to the beneficiary, but also periodically while it remains in the trust. These periodic deemed dispositions generally occur every 21 years. However, the period can be extended until the rights of beneficiaries expire, provided those beneficiaries are the children or other qualifying beneficiaries of the individual who created the trust.

(The 1995 budget proposed to eliminate the application of the 21-year rule by January 1, 1999.)

No data are available.

Farming and Fishing

$500,000 lifetime capital gains exemption for farm property

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified farm property. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on small business shares have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Net Income Stabilization Accounts (NISA)

Farmers may deposit up to 22 per cent of a given year's eligible net sales, up to a limit, to their Net Income Stabilization Account (NISA). No tax deduction is given in respect of these deposits. The federal and provincial governments each provide equal matching contributions of up to a combined total of 2 per cent of eligible net sales. They also pay a 3-per-cent interest bonus annually on the farmer's deposits which remain in the account. Governments' contributions and interest accrued in the account are not taxable until withdrawn. All withdrawals from the NISA are taxable except for the contributor's original deposits, which were made with after-tax dollars. Withdrawals from the NISA are triggered if current year gross margin (net sales less eligible expenses) is less than the five-year average gross margin, or if net income is below $10,000 (or $20,000 of family net income if the family held only one account).

The federal tax expenditure is a function of two components: the deferral of tax on the investment income accrued in the account, and on government contributions to the account; and the income inclusion of these amounts when withdrawn from the account. The former has the effect of increasing tax expenditures, while the latter has the opposite effect. The estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on the deficit of the tax measure in each of the years under consideration.

Deferral of income from destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

The estimates are based on data provided by Agriculture Canada.

Deferral of income on grain sold through cash purchase tickets

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

The estimates are based on data provided by the Canadian Wheat Board.

Deferral through 10-year capital gain reserve

If proceeds from a sale of a farm property to a child, grandchild or great-grandchild are not all receivable in the year of sale, realization of a portion of the capital gain may be deferred until the year in which the proceeds become receivable. However, a minimum of 10 per cent of the gain must be brought into income each year, creating a maximum 10-year reserve period. For most other assets, the maximum reserve period is five years.

Deferral of capital gain through intergenerational roll-overs of family farms

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 on intergenerational transfers of farm property are deferred until the property is disposed of outside the immediate family.

No data are available.

Exemption from making quarterly tax instalments

Taxpayers earning business income must normally pay quarterly income tax instalments. 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.

Cash basis accounting

Individuals engaged in farming and fishing may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income inclusion and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues, and expenses are deductible for the period to which they relate.

No data are available.

Flexibility in inventory accounting

Farmers using the cash basis method of accounting are allowed to depart from it with regard to their inventory. Under cash accounting, net additions to inventory are treated as a cost which is deducted in computing income. When inventory is increasing from year to year, such costs could create a loss for tax purposes. However, a discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farmers to avoid creating losses which would be subject to the time limitation if carried forward. The value of the tax expenditure is thus the amount of tax relief associated with the losses that would otherwise have been subject to the time limitations.

No data are available.

Federal/Provincial Financing Arrangements

Quebec abatement

Under the contracting-out arrangements which 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 point transfer. Quebec was the only province to elect this arrangement at the time and this has resulted in a 16.5 percentage-point abatement of federal tax for Quebec residents.

Transfers of income tax room to provinces

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

General Business and Investment

$100,000 lifetime capital gains exemption

The first $100,000 of lifetime capital gains realized by individuals was non-taxable. The exemption was available only to the extent that the gains exceeded cumulative net investment losses incurred after 1987. The costs of tax expenditures associated with capital gains realized on exempt qualified farm property and exempt qualified small business shares are listed separately, even though some of these gains would qualify for the $100,000 lifetime capital gains exemption.

The 1992 budget eliminated the exemption for real estate gains accruing after February 1992 on property not used in an active business.

(The 1994 budget eliminated the $100,000 lifetime capital gains exemption for 1995 and subsequent tax years.)

Partial inclusion of capital gains

Only three-quarters of net realized capital gains are included in income.

Deduction of scientific research and experimental development expenditures

All scientific research and experimental development (SR&ED) expenditures may be deducted immediately, despite the fact that some of these expenditures may be capital in nature.

The estimates are calculated on the basis that 10 per cent of SR&ED expenditures are of a capital nature. In the absence of this SR&ED provision, these amounts would have been depreciated over several years (subject to CCA rules) rather than immediately. The proportion of SR&ED that is of a capital nature is estimated from Revenue Canada data. The estimate is based on the fact that SR&ED expenditures of a capital nature are deductible in the year the expenditures are made rather than subject to CCA rules. However, it does not take into consideration the deduction that would otherwise be available in future years. Accordingly, it overestimates the true cost of the measure to the extent that CCA would otherwise have been deducted over the course of a number of years. A more detailed explanation is provided in Appendix B.

Deduction of limited partnership losses

A limited partner is able to deduct losses against other income up to the amount of investment at risk whereas a shareholder is normally not permitted to deduct corporate losses against personal income. Unused losses may be carried back three years or forward seven years and are deductible up to the amount of investment at risk.

Limited partnership losses arise from a range of investments, from real estate investments to certified film productions. It is estimated that 15 per cent of this tax expenditure is attributable to CCA claimed on Canadian films.

Investment tax credit

A tax credit is available for investments in scientific research and experimental development, exploration activities and certain regions. The tax credits range from 15 per cent to 45 per cent. The estimates treat the full investment tax credit as a tax expenditure even though tax credits reduce the capital cost of assets for CCA purposes and the adjusted cost base for capital gains purposes. A more detailed explanation is provided in Appendix B.

Deferral through five-year reserve

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

Deferral through capital gains roll-overs

In certain circumstances, taxpayers may defer the reporting of capital gains for tax purposes. General business roll-over 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 (for example, a business changing location). The roll-over 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 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.

Deferral through billed-basis accounting by professionals

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.

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

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.

No data are available.

$200 capital gains exemption on foreign exchange transactions

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

No data are available.

Taxation of capital gains upon realization

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

No data are available.

Health

Non-taxation of employer-paid insurance benefits for group private health and dental plans

Employer-paid benefits for private health and dental plans are not taxable.

The 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.

Disability credit

Canadians who are markedly restricted in the basic activities of daily living are entitled to a tax credit. In 1992 and 1993, the credits were 17 per cent of $4,233. Any unused amount of the credit may be transferred to a supporting person.

Medical expenses credit

In 1992 and 1993, taxpayers were entitled to a 17-per-cent credit for eligible medical expenses incurred by the taxpayer, the taxpayer's spouse or by dependants. The credit was available in respect of expenses which exceeded the lesser of 3 per cent of net income or $1,615.

Income maintenance and retirement

The non-taxation of income-tested programs such as the guaranteed income supplement and provincial social assistance presents conceptual difficulties. The problems arise because, in many respects, these programs operate like

an income tax in that eligibility for benefits is phased out after a certain income level. In this regard, excluding such benefits from income tax might not be considered a tax expenditure since they are subject to their own "tax". On the other hand, a broadly based benchmark tax system would include such amounts in income. Given the comprehensive approach taken in this document, these items are considered to be tax expenditures.

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

The guaranteed income supplement (GIS) is an income-tested benefit payable to old age security (OAS) pensioners. Spouses of OAS recipients (or widows/widowers) aged between 60 and 64 may be eligible for the spouse's allowance (SPA). Benefits under both the guaranteed income supplement and spouses' allowance programs are non-taxable. Although GIS and SPA benefits must be included in income, an offsetting deduction from net income is provided. This approach effectively exempts such payments from taxation while continuing to have them affect income-tested credits.

The estimates are based on data from the Human Resources Development Canada publication, *Statistics Related to Income Security Programs* and the personal income tax simulation model.

Non-taxation of social assistance benefits

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

The estimates are based on the personal income tax simulation model and data provided by Human Resources Development Canada.

Non-taxation of workers' compensation benefits

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

Non-taxation of certain amounts received as damages in respect of personal injury or death

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

The values reported in the tables understate the tax expenditure since they are based on awards paid by provinces' Criminal Injuries Compensation Boards only. No data were available for compensation awards paid by other sources, or regarding the investment income earned on awards by individuals under 22.

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

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

(The 1994 budget eliminated the tax exemption for employer-paid premiums for group term life insurance of up to $25,000, effective July 1, 1995.)

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

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

The estimates are based on Public Accounts data.

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

These amounts are not included in income for tax purposes.

The estimates are based on Public Accounts data.

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

These amounts are not included in income for tax purposes.

The estimates for this item are based on Public Accounts data.

Treatment of alimony and maintenance payments

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

This treatment represents a tax expenditure because it departs from the benchmark system established for purposes of this report. Under this benchmark tax system, deductions are permitted only for expenses incurred in order to earn income and transfers from other individuals are not included in income.

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

Age credit

Individual taxpayers aged 65 or over were entitled to claim a tax credit of 17 per cent of $3,482. Unused portions may be transferred between spouses.

(Following the 1994 budget, the age credit is now subject to an income test.)

Pension income credit

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

Saskatchewan pension credit

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

Registered retirement savings plans/registered pension plans

The federal revenue forgone due to the provisions pertaining to registered retirement savings plans (RRSPs), registered pension plans (RPPs) and deferred profit sharing plans (DPSPs) is a function of three components: the deductibility of contributions to such plans; the non-taxation of investment income accrued within such plans, and the income inclusion of RRSP/RPP withdrawals which reduces the cost resulting from the previous two. Individuals benefit from a deferral of tax on amounts contributed and on investment income. Also, there is an absolute tax saving to the extent that the tax rate on withdrawals is below that faced at the time of contributions. As noted in the introduction, the estimates provided in the table are made on a current cash-flow basis. That is, they measure the impact on the deficit of the tax measure in each of the years under consideration.

In 1991, a new system of comprehensive limits on tax-assisted retirement saving took effect. Under this system, saving in RRSPs, RPPs and DPSPs is governed by a comprehensive limit of 18 per cent of earnings up to a dollar amount. In more detail, the limits for 1992 and 1993 were as follows:

- For defined benefit pension plans, the limits were the same as in 1990: that is, there were no fixed limits on employee contributions while employer contributions were restricted to the amounts necessary to fully fund the promised benefits. Annual benefits under these pension plans are limited to the lesser of $1,722 and 2 per cent of best average earnings for each year of pensionable service.
- For RRSPs, contributions were limited to 18 per cent of earned income for the preceding taxation year to a dollar maximum ($12,500 for 1992 and for 1993), minus a Pension Adjustment (PA). The PA was based on RPP or DPSP benefits earned by plan members in the previous taxation year. For a money purchase RPP or a DPSP, the PA is simply the total contribution made by or on behalf of a plan member in the year. For a defined benefit RPP, the PA is a measure of the benefits earned in the year, calculated according to a prescribed formula.

In 1992, the federal government introduced the Home Buyers' Plan as a temporary measure. It allowed all individuals to withdraw up to $20,000 from their RRSPs on a tax-free basis to purchase a home. Amounts withdrawn under the Home Buyers' Plan are to be repaid to the individual's RRSP on an interest-free basis over a period of 15 years. Amounts that are not repaid are included in the individual's income for tax purposes. (In 1994, this measure was made permanent, but restricted to first-time home-buyers only.) The impact of the Home Buyers' plan on the cost of RRSPs is expected to be small.

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

The estimates may not reflect the benefit to a particular individual in any given year because the individual is typically either a contributor or withdrawer at a point in time but not both. In order to estimate the benefit to a particular individual one could calculate the difference in disposable income between a situation in which that individual invests in an RRSP/RPP and one in which that individual invests in a non-sheltered savings instrument.

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

Deferred profit-sharing plans

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

No data are available.

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

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

No data are available.

Non-taxation of investment income on life insurance policies

The investment income earned on some life insurance policies is not taxed as income to the policy holder. Instead, for reasons of administrative convenience, insurance companies are subject to tax on such earnings.

(See Appendix B for a further description of this measure and estimates of the cost of the tax expenditure involved.)

Small Business

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

A $500,000 lifetime capital gains exemption is available for gains in respect of the disposition of qualified small business shares. The $500,000 limit is available only to the extent that the basic $100,000 lifetime capital gain exemption and the $500,000 lifetime capital gain exemption on qualified farm property have not been used, and to the extent that the gains exceed cumulative net investment losses incurred after 1987.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains and this is the approach adopted in the benchmark system. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income. Unused allowable business investment losses may be carried back three years and forward seven years. After seven years, the loss reverts to an ordinary capital loss and may be carried forward indefinitely.

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted from taxable capital gains in future years.

Labour-sponsored venture capital corporations credit

A 20-per-cent tax credit is available on amounts invested in Labour-Sponsored Venture Capital Corporations, to a maximum credit of $1,000.

Deferral through 10-year capital gain reserve

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

Other Items

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

Income earned on these instruments is non-taxable.

The estimates are based on Bank of Canada data.

Non-taxation of capital gains on principal residences

Capital gains realized on the disposition of a taxpayer's principal residence are non-taxable. The capital gains were determined using Multiple Listing Service (MLS) housing prices, adjusted to include expenditures on capital repairs and major additions and renovations, obtained from Statistics Canada's Consumer Expenditure Survey. The holding period for principal residences was derived from 1981 Census data.

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

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

This income is exempt from personal income taxation.

Data were provided by the Office of the Governor General.

Assistance for prospectors and grubstakers

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

Charitable donations credit

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

(The 1994 budget reduced the threshold at which the 29-per-cent rate applies from $250 to $200, starting in the 1994 tax year.)

Gifts to the Crown credit

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

(The 1994 budget reduced the threshold at which the 29-per-cent rate applies from $250 to $200, starting in the 1994 tax year.)

Political contributions credit

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

Non-taxation of income of Indians on reserves

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

No data are available.

Non-taxation of gifts and bequests

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

No data are available.

Memorandum Items

Non-taxation of allowances for certain public officials

Members of Parliament (MPs), MLAs, Senators and some other public officials (such as elected municipal officials and judges) receive flat allowances for expenses incidental to their duties. These amounts are not included in income for tax purposes.

This provision is a memorandum item because it is not possible to distinguish the proportion of these allowances which is used for personal consumption and that which is for work-related expenses.

Data are available only for the non-taxable allowances provided to MPs, MLAs, and Senators. This information is found in the publication *Canadian Legislatures* and *The Canadian Parliamentary Guide*.

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

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

Information on total allowances was obtained from Treasury Board.

Child care expense deduction

A portion of child care expenses is deductible if incurred for the purpose of earning business or employment income, taking an occupational training

course or carrying on research for which a grant is received. For 1992, the deduction could not exceed the lesser of $4,000 per child if the child was under age seven or was disabled, or $2,000 per child between seven and 14 years of age, or two-thirds of earned income for the year. These amounts were raised to $5,000 and $3,000 respectively in 1993. The deduction must generally be claimed by the spouse with the lower income. However, the higher-income parent may claim a deduction if the lower-income parent is infirm, confined to a bed or a wheelchair, in prison, or attending a designated educational institution on a full-time basis.

Attendant care expense deduction

A disabled individual can deduct the cost of unreimbursed care provided by a part-time attendant, if such an expense is required to enable the individual to work. The deduction cannot exceed the lesser of $5,000 or two-thirds of earned income for the year.

Moving expense deduction

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

The estimates do not include non-taxable reimbursements received from employers.

Deduction of carrying charges incurred to earn income

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

Some might consider the deductibility of such expenses to be a tax expenditure because of the tax deferral arising from the up-front deduction of expenses associated with the earning of income which will not be taxed until received possibly in future years. Others would hold that carrying charges are incurred for the purpose of earning income and therefore represent part of the benchmark income tax system.

Deduction of meals and entertainment expenses

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. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

The deduction is limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment is part of

a package price which includes amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer is required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget reduced the deductible portion of meals and entertainment expenses from 80 per cent to 50 per cent, starting in the 1994 tax year.)

Deduction of farm losses for part-time farmers

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

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

Farm and fishing loss carry-overs

Farm and fishing losses may be carried back three years and forward ten years. Most other business losses may be carried forward seven years.

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

Capital loss carry-overs

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

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

Non-capital loss carry-overs

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

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

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of $\frac{2}{3}$ of any logging tax paid to a province and $6\frac{2}{3}$ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

The estimates are based on data from Revenue Canada.

Deduction of accelerated tax depreciation

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

The estimates are based upon a comparison of CCA and book depreciation. Since book depreciation does not necessarily represent the true economic depreciation, it is not possible to calculate the value of this measure with a high degree of accuracy. Consequently, this deduction is reported as a memorandum item. A more detailed explanation is provided in Appendix B.

Deduction of resource-related expenditures

Individuals are entitled to deduct certain expenses associated with the exploration for, and development of, Canadian natural resources. These expenses are deductible if the taxpayer either engages directly in these resource activities or provides financing to a resource company which, in turn, "flows through" the tax deductions to the taxpayer.

A tax expenditure arises when a flow-through share investor is able to use deductions for exploration and development more quickly than would otherwise have been possible by the resource company that actually undertook these expenditures. However, the available data do not permit a separation of expenses which are flowed through to investors and those which are incurred directly by the taxpayers. Accordingly, only some portion of resource-related expenditures deducted represents a true tax expenditure: this explains their treatment as a memorandum item.

Deduction of other employment expenses

Employee expenses are generally not deductible. However, 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 in the computation of income.

This provision is a memorandum item because it is not possible to distinguish the proportion of these expenses which is used for personal consumption and that which is incurred in order to earn income.

Deduction of union and professional dues

Union and professional dues are fully deductible from income.

The mandatory nature of these payments leads to their classification as expenses to earn income.

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

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

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

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

A 17-per-cent tax credit is provided for Canada/Quebec Pension Plan contributions by both employees and the self-employed. Employer-paid premiums are not included in income.

Again, since CPP/QPP contributions are mandatory, they are classified as expenses incurred to earn income.

Foreign tax credit

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

Dividend gross-up and credit

Dividends received from taxable Canadian corporations are "grossed-up" by a factor of one-quarter and included in income. A tax credit equal to 13.33 per cent of the grossed-up amount is then provided, in recognition of taxes paid at the corporate level. These provisions contribute to the integration of the corporate and personal income tax systems.

Basic personal credit

All taxpayers qualify for a basic personal credit equal to 17 per cent of $6,456 in 1992 and 1993.

Non-taxation of capital dividends

Private corporations may distribute the exempt one-quarter 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. This measure is reported as a memorandum item since it contributes to the integration of the taxation of corporate and personal income.

No data are available.

APPENDIX B
DESCRIPTION OF CORPORATE INCOME TAX PROVISIONS

The descriptions of the specific tax measures contained in this appendix are intended as a simplified reference. It should be noted that the explanations refer to the 1991 and 1992 taxation years. Since that time, a number of provisions have been altered. Some of the more significant changes to these provisions made since 1992 are indicated in the text.

Explanations of the methodologies used to produce the estimates are provided where they deviate from the standard approach of using the corporate income tax model, which is maintained by Revenue Canada. For example, certain estimates, such as the deductibility of carrying charges on land, were calculated using other data sources.

Tax Rate Reductions

The following items are measures that reduce the statutory tax rate faced by a corporation. They are tax expenditures because income is taxed at a rate other than the generally applicable tax rate.

Low tax rate for small businesses

Corporations that are Canadian-controlled private corporations (CCPCs) are eligible for a small business tax rate reduction, known as the small business deduction. This deduction lowers the basic federal tax rate on the first $200,000 of active business income of CCPCs by 16 percentage points – from 28 per cent to 12 per cent.

(The 1994 budget announced changes that make some large CCPCs ineligible for the small business benefit.)

Low tax rate for manufacturing and processing

A tax reduction is provided on Canadian manufacturing and processing (M&P) income not subject to the small business deduction. This reduction takes the form of a non-refundable credit on income earned and has the effect of lowering the tax rate on M&P income. In the period under review, the reductions from the general 28-per-cent rate were as follows:

For that portion of a corporation’s taxation year between

July 1, 1990 – June 30, 1991:	4 percentage points
July 1, 1991 – December 31, 1992:	5 percentage points

The amounts reported in the tables estimate the additional revenues that would have been collected by the government if M&P income had been taxed at the general corporate rate.

(Since 1994, Canadian manufacturing and processing income is taxed at a 21-per-cent federal rate, a seven percentage point reduction from the general rate.)

Low tax rate for credit unions

Although not a private corporation for most purposes, a credit union is eligible for the small business deduction (i.e. 16 per cent of its taxable income). A credit union with more than $200,000 of active business income may be eligible for a deduction of 16 per cent of its taxable income where the total income of the corporation since 1971 is less than the corporation's "maximum cumulative reserve", which is equal to 5 per cent of amounts owing to members (including members' deposits and share capital). The purpose of this additional deduction 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.

Exemption from branch tax for transportation, communication, banking, and iron ore mining corporations

The branch tax is imposed on that portion of the income of non-Canadian corporations derived from the carrying on of business in Canada through a branch. The rate is 25 per cent, but this is frequently reduced by reciprocal tax treaties to 15 per cent or 10 per cent.

A corporation is exempt from the branch tax if it is:

(a) a bank;

(b) a corporation whose principal business is:

  (i) the transportation of persons or goods,

  (ii) communications,

  (iii) mining iron ore in Canada, or

(c) an exempt corporation such as a registered charity.

No data are available.

Exemption from tax for international banking centres

A prescribed financial institution's branch or office carrying on certain business in the city of Montreal 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, introduced in 1987, is a tax expenditure because a financial institution can undertake business with non-residents through a Canadian permanent establishment without being subject to Canadian income taxes.

No data are available.

Tax Credits

The following measures are credits against federal taxes otherwise payable. They are considered to be tax expenditures because they provide credits to businesses which engage in a particular activity such as research and development or undertake an investment in a designated region of the country. The federal government forgoes revenue because tax credits can reduce federal revenues in two ways. They may be:

- used to offset federal income taxes otherwise payable, and
- fully or partially refundable for some CCPCs.

Investment tax credits (ITCs)

The Income Tax Act provides an ITC for:

- investment in eligible depreciable property that is used in certain regions of the country, and
- expenditures on Scientific Research and Experimental Development (SR&ED).

An ITC provides beneficial treatment to taxpayers, depending on their size, the region of the country in which they operate and the nature of their investment. The amount of the credit is calculated as a percentage of the cost of eligible expenditures. For taxation years 1991 and 1992, separate estimates are provided for the regional and SR&ED investment tax credits.

Corporations may reduce but, generally, not eliminate federal taxes payable by the amount of ITCs available on certain eligible expenditures. Three-quarters of a taxpayer's federal tax payable in a taxation year may be offset by ITCs. (This latter limitation was removed for taxation years commencing after 1993.) For CCPCs, a special rule permits the full offset of federal tax on their business income eligible for the small business deduction. The carry-forward period for unused credits is 10 years. The surtax still remains subject to the three-quarters limitation. The carry-back period is three years.

Credits utilized or refunded reduce either the undepreciated capital cost of the asset for capital cost allowance (CCA) purposes or, in the case of SR&ED, the SR&ED pool. Credits earned in respect of a property acquired after January 1, 1990 and not immediately available for use may not become claimable until the property is available for use or has been held by the taxpayer for two years.

Refundability of ITCs

A qualifying corporation that cannot use ITCs in the current year because the credits earned exceed the amount that could be used to offset taxes otherwise payable can use the excess to obtain current year cash refunds of either 40 per cent or 100 per cent, depending on the type of eligible expenditure. A qualifying corporation for purposes of the refund is a CCPC

which, together with any associated corporations, had taxable income not exceeding $200,000 in the preceding year. These latter rules were modified in the 1993 and 1994 federal budgets.

For qualifying CCPCs, the refundability rate of ITCs that cannot be used in the year they are earned is generally 40 per cent. A qualifying CCPC may receive a 100-per-cent refund on its share of ITCs earned at the 35-per-cent rate in respect of up to $2 million of annual current SR&ED expenditures. All refunds reduce the amount of ITC for carry-over purposes.

Issues in calculating the value of ITCs

To maintain consistency with the other estimates in this document, the amounts reported in the table estimate the forgone revenue for the year in question from each ITC. In other words, the estimates show how much additional revenue would have been collected by the government in the year if the ITC had been eliminated in that particular year. To do this, the amount of ITCs used in the year had to be separated into two components: ITCs that were both earned and used in the year, and ITCs that were earned in prior years but used in the year. The former represents credits used from current year expenditures. Included in these estimates are the costs of any applicable refunds on ITCs earned. The latter item, ITCs earned in the past but not used until the current year, is itemized separately.

Another perspective on the revenue cost of each ITC is obtained by looking at the amount of ITCs earned in 1991 and 1992. This information is provided in the table below. However, it should be recognized that ITCs earned in the year are not necessarily used in the year – they may be used in a subsequent or previous year, subject to the carry-over rules. As a result, had the ITCs been eliminated, government revenues for the year would not have been higher by the amounts shown in the table below since it may take a number of years for ITCs earned in a year to be used by the taxpayer to reduce federal taxes.

Investment tax credits earned in the year

	1991[1]	**1992**
	(millions of dollars)	
SR&ED ITC[2]	1,093	1,155
Atlantic Canada ITC	100	155
Special ITC	85	28
Cape Breton ITC	4	3
Exploration Tax Credit	2	n.a.
Small Business ITC	n.a.	5

[1] The 1991 figures in this table are based on final data and may differ from the figures in last year's edition of this document, which were based on preliminary data.

[2] Of this amount, about $15 million may be attributed to the regional component in each of the years 1991 and 1992.

Scientific research and experimental development investment tax credit

There are three tax credit rates; a general rate of 20 per cent, a 30-per-cent rate for the Atlantic provinces and the Gaspé, and an enhanced rate of 35 per cent for qualifying CCPCs – those with prior year taxable income less than $200,000. (As a result of a 1994 budget proposal, the 30-per-cent rate will not be available after 1994.) The maximum amount of SR&ED expenditures that can earn ITCs at the 35 per cent in a year is $2 million.

(The rules relating to this expenditure limit were modified in the 1993 and 1994 federal budgets.)

Atlantic Canada investment tax credit (AITC)

The 15-per-cent ITC is available for qualified property in the Atlantic region: Newfoundland, New Brunswick, Nova Scotia, Prince Edward Island, the Gaspé region, and their associated offshore areas. (This rate has been reduced to 10 per cent for tax years ending after 1994.)

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

The AITC is refundable at a 40-per-cent rate for qualifying CCPCs and individuals. It is not refundable for other taxpayers.

Special investment tax credit (SITC)

The ITC rate was 30 per cent in selected prescribed regions. (The February 1994 budget eliminated the 30-per-cent Special ITC, effective as of 1995, subject to some grandfathering provisions.)

Eligible SITC areas are in all provinces including north-eastern British Columbia, north-western Alberta, northern Saskatchewan, most of Manitoba, northern Ontario, northern Quebec and the Gaspé region, and areas of Atlantic Canada.

Qualifying activities are defined under the Regional Development Incentives Act (RDIA) and its regulations, and generally include manufacturing and processing facilities located in a qualifying region with the exception of certain primary processing of natural resources.

Cape Breton investment tax credit (CBITC)

The Cape Breton credit was 45 per cent after 1988 and was applicable to eligible equipment acquired after May 23, 1985 and before 1993.

Exploration tax credit (ETC)

A 25-per-cent ITC was available for qualified Canadian exploration expenditures – these expenditures are incurred in respect of a well costing in excess of $5 million. Credits were earned on costs incurred between December 1, 1985 and December 31, 1990.

Small business investment tax credit (SBITC)

A non-refundable 10-per-cent ITC is available for eligible machinery and equipment acquired after December 2, 1992 and before 1994 by unincorporated businesses, partnerships, and Canadian-controlled private corporations, other than those subject to the Large Corporations Tax.

ITCs claimed in current year but earned in prior years

These are tax credits that were earned by corporations in previous years but not claimed until the current year. There is a revenue cost to the government when the credits are used by corporations to reduce federal taxes payable. While the aggregate amount of these credits is known, there is not enough information available to identify separately the amounts for each credit.

Political contributions tax credit

A non-refundable tax credit is available for contributions to registered federal political parties or candidates. The credit is 75 per cent of the first $100 contributed, 50 per cent on the next $450 contributed and 33⅓ per cent on the next $600 contributed. The maximum credit is $500 and would be available when the taxpayer has contributed $1,150.

This measure constitutes a tax expenditure because political contributions are not incurred to earn income.

Exemptions and Deductions

The following exemptions and deductions are identified as tax expenditures because they deviate from the benchmark tax system.

Partial inclusion of capital gains

Three-quarters of net realized capital gains are included in income. The cost of the tax expenditure is the amount of additional tax that would have been collected had the remaining one-quarter of the capital gains been included in income. However, this amount is likely an overestimate of the true amount of the cost of this tax expenditure. To the extent that the capital gains are from shares that have increased in value due to retained earnings, and which have already been taxed at the corporate level, the partial inclusion of the capital gains provides some relief from double taxation and, therefore, should be part of the benchmark tax system.

Resource allowance

Deductibility of Crown royalties and mining taxes

The current tax system does not permit a deduction for Crown royalties or mining taxes. The deduction has been denied since May 6, 1974. From 1974 to the end of 1975, oil and gas and mining companies were eligible for a resource tax abatement. This tax abatement provided a lower rate of tax on oil and gas and mining income. A resource allowance was introduced in the June 1975 budget to replace the abatement effective 1976.

There is a potential *negative* tax expenditure associated with this item. A *negative* tax expenditure implies that the government is collecting more income taxes than would have occurred in the benchmark system. The issue arises as to whether the benchmark tax system would include a deduction for all Crown royalties and mining charges. Two generic types of non-deductible crown charges levied by governments on the extraction of natural resources can be identified. There are simple royalty systems where the charge is based only on gross revenues. There are also more complex systems of crown levies that are based on net resource profits, i.e. after the deduction of numerous costs, including capital, operating costs and sometimes a return on capital employed.

In the case of the former type of charge, the benchmark system **would** include a deduction because these royalties are analogous to costs of production. However, the benchmark tax system **would not** include a deduction for the latter type of profit-related crown royalties and mining income taxes because they are structured more like income taxes. Provincial income taxes are not considered to be a deductible expense in the benchmark system.

The calculations shown here represent the federal corporate income tax revenues generated by denying deductibility and no attempt has been made to divide the royalties into the two categories described above. This is, in part, due to the fact that many royalty systems include characteristics of both a gross and net calculation.

Resource allowance

Since 1976, the tax system has provided a resource allowance equal to 25 per cent of a taxpayer's annual resource profits, computed after operating costs and capital cost allowances, but before the deduction of exploration expenses, development expenses, earned depletion and interest expenses. The resource allowance is provided in lieu of the deductibility of Crown royalties, mining taxes and other charges related to oil and gas or mining production. The measure allows the provinces room to impose royalties or mining taxes on the production of natural resources while maintaining the integrity of the federal income tax base. The value of the tax expenditure for the resource allowance is the federal tax revenue forgone resulting from allowing 25 per cent of resource profits to be deductible for tax purposes.

Earned depletion

Earned depletion is an additional deduction from taxable income of certain exploration and development expenditures and other resource investments. Taxpayers were entitled to earn an extra deduction of up to 33⅓ per cent of exploration and development expenses or the costs of assets related to new mines or major expansions. Deductions for earned depletion were generally limited to 25 per cent of the taxpayer's annual resource profits. As in the case of Canadian exploration expenses (CEE) or Canadian development expenses

(CDE), earned depletion could be pooled, i.e. placed in a special account, and any remaining balance deducted in a future taxation year with no time limit on carrying forward these amounts.

Earned depletion and mining exploration depletion deductions were eliminated as of January 1, 1990. No additions to the earned depletion pool were permitted after December 31, 1989, but deductions can still be made on the basis of existing depletion pools.

Under the benchmark tax system, a deduction for earned depletion would not be available.

Deductibility of charitable donations

Donations made by corporations to registered charities are deductible in computing taxable income. This deduction is limited to 20 per cent of net income but unused deductions may be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Gifts to the Crown

A corporation may deduct the full amount of any gift it makes to Canada or a province. Unlike charitable donations, the amount deductible is not limited to 20 per cent of net income. However, the deduction may not exceed the amount of income in a particular fiscal year. Amounts not deducted can be carried forward for up to five years.

This deduction would not be permitted under the benchmark tax system because these expenditures are not incurred to earn income.

Non-deductibility of advertising expenses in foreign media

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

This treatment results in a negative estimate since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media that were incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.

No data are available.

Non-taxation of provincial assistance for venture investments in small business

Normally, government assistance received by a corporation is either included in the corporation's income or subtracted in computing the cost basis of the assets to which the assistance relates for capital cost allowance (CCA) purposes. There are a number of exceptions to this rule, including provincial assistance provided for venture capital investment under specified provincial programs. Under the benchmark tax system, this type of assistance would be included in the corporation's income or the cost basis of the assets would be reduced.

No data are available.

Deferrals

The tax expenditures in this section provide for a deferral of income taxes from the current to a later taxation year. They have been valued on a cash-flow basis, i.e. the forgone tax revenue associated with the additional net deferral in the year. The alternative way of valuing deferrals would be to calculate the value of the interest-free loan that is provided to the taxpayer when taxes are deferred to a later year.

Fast write-off for capital equipment used for SR&ED

Capital expenditures for eligible equipment used to carry out SR&ED may be fully deducted in the year of acquisition. In the absence of this provision, these amounts would have been depreciated over several years (subject to CCA rules). The CCA rules represent the benchmark tax system in which expenditures that are capital in nature and designed to produce income in the future are depreciated over the period in which the income is expected. The tax expenditure estimate represents the impact of the fast write-off of SR&ED expenditures of a capital nature in the year they are made.

The current publication includes a revision of the method of estimating the tax expenditures for this item. These new estimates use information now available from Revenue Canada's scientific research and experimental development (T661) database. The industry distribution for 1991 and 1992 (preliminary) is included in Table 2. Tax expenditures for fast write-offs for capital equipment used for SR&ED were $48 million in 1989; $52 million in 1990, $72 million in 1991; and $53 million in 1992.

Deduction of allowable business investment losses

Capital losses arising from the disposition of shares and debts are generally deductible only against capital gains. However, under the allowable business investment loss rules, three-quarters of capital losses in respect of shares or debts of a small business corporation may be used to offset other income.

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

The value of the tax expenditure is the amount of tax relief provided by allowing these losses to be deducted from other income in the year rather than being deducted against uncertain taxable capital gains in the future.

The current publication reflects a revision in the method of estimating tax expenditures for this item. As a result, the tax expenditures associated with this measure are now estimated as $18 million for 1989; $32 million for 1990; $39 million for 1991; and $44 million for 1992. The industry distribution for 1991 and 1992 (preliminary) is included in Table 2.

Deductibility of carrying charges on land

Before 1988, carrying charges on vacant land and "soft costs" were capitalized and amortized over the life of the asset or deducted when related revenue was earned. There were two important exceptions to this rule. First, carrying charges on vacant land were fully deductible if the land was used as part of the business of selling or developing land. Second, land development corporations were not required to capitalize soft costs.

These exceptions were phased out over a five-year period starting in 1988 and ending in 1992. Consequently, in 1991, 20 per cent of these costs remained fully deductible and none were deductible in 1992.

A deduction in respect of land carrying costs up to an amount equal to $1 million times the prescribed interest rate for the year has been available for small developers since 1988. This deduction must be shared by related companies.

Under the benchmark tax system, carrying charges and soft costs would generally be treated as part of the cost of the property and would be deducted when the property was sold.

Data on raw land reported on financial statements were used to estimate the cost of the tax expenditure. However, no data are available to estimate the small developers' deduction.

Available for use

Before 1990, taxpayers were allowed to claim CCA and ITCs in respect of property not yet producing income (i.e. property not in use). In many cases, this resulted in a significant mismatch of revenues and expenses, which gave rise to a tax deferral. This was a tax expenditure because taxpayers were allowed to claim deductions and tax credits on property before it was put in use.

As of 1990, taxpayers may claim CCA and 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. Consequently, for the 1991 taxation year, the value of the tax expenditure was nil because the taxpayer would not be permitted to claim

CCA and ITCs on property that was acquired but not yet available for use. Property that became eligible for CCA and ITCs by virtue of the two-year deferral rule could give rise to a tax deferral (and this would constitute a tax expenditure) in 1992, if the property had been acquired in 1990.

No data are available as assets are pooled into classes and are not accounted for separately. Furthermore, they are not identified as being "available for use" or "not available for use".

Capital gains taxation on realization basis

Capital gains are taxed upon the disposition of property and not on an accrual basis. This treatment results in a tax deferral. Under the benchmark tax system, capital gains would be fully included in income as they accrue.

No data are available.

Expensing of advertising costs

Advertising expenses are deductible on a current basis even though some of these expenditures provide a benefit in the future. This treatment results in a deferral of tax. Under the benchmark tax system, the expenses would be amortized over the benefit period. While the benefits of advertising may extend beyond the current year, determining useful lives in most cases is not feasible.

No data are available.

Cash basis accounting

Farming and fishing corporations may elect to include revenues as received, rather than when earned, and deduct expenses when paid rather than when the related revenue is reported. This treatment allows a deferral of income and a current deduction for prepaid expenses. Under the benchmark tax structure, income is taxable when it accrues.

No data are available.

Flexibility in inventory accounting

Farm corporations using the cash basis method of accounting are allowed to depart from it with regard to their inventory. A discretionary amount, not exceeding the fair market value of farm inventory on hand at year end, may be added back to income each year. This amount must then be deducted from income in the following year. The effect of this provision is to allow farm corporations to avoid creating losses which, if carried forward, would be subject to the time limitation. Thus the tax expenditure provides tax relief to the extent that the losses would otherwise have been subject to the time limitations.

No data are available.

Deferral of income

On grain sales

Farmers may make deliveries of grain before the year end and be paid with a ticket that may be cashed only in the following year. The payment for deliveries of grain is included in income only when the ticket is cashed, thereby providing a deferral of taxes. Under the benchmark tax system, income would be taxed on an accrual basis.

No data are available.

On destruction of livestock

If the taxpayer elects, when there has been a statutory forced destruction of livestock, the income received from the forced destruction can be deemed to be income in the following year. The deferral is also available when the herd has been reduced by at least 15 per cent in a drought year. This provision allows for a deferral of income to the following year when the livestock is replaced. Under the benchmark tax system, income is taxable when it accrues.

No data are available.

Holdback on progress payments to contractors

In the construction industry, contractors are typically given progress payments as construction proceeds. However, a portion of these progress payments (e.g., 10 to 15 per cent) is often held back until the entire project is satisfactorily completed. 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, costs equal to the amount of the holdback are not considered to have been incurred by the contractor and are not deductible until paid. The net impact of these two measures on a given contractor's tax liability depends on the ratio of holdbacks payable to holdbacks receivable. If holdbacks receivable are greater than holdbacks payable, there is a deferral of tax. If holdbacks payable exceed holdbacks receivable, there is a prepayment of taxes.

Increases in net holdbacks receivable or decreases in net holdbacks payable result in a positive estimate of the cost of the tax expenditure. Increases in net holdbacks payable or decreases in net holdbacks receivable result in a negative estimate.

Deferral of tax from use of billed-basis accounting by professionals

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.

International

Non-taxation of life insurance companies' world income

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.

The cost of this tax expenditure was estimated from tax returns and information available from the Office of the Superintendent of Financial Institutions.

Exemptions from non-resident withholding tax

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 fees; estate and trust income, alimony and support payments; as well as certain pension, annuity and other payments.

Over time, as the benefits of freer trade in capital, goods and services have been increasingly recognized, countries including Canada have adjusted their tariff and tax structures to remove impediments to international transactions. Part of this adjustment has been the reduction of non-resident withholding tax on certain payments.

Canada's statutory non-resident withholding tax rate is 25 per cent. However, the rate is lowered and exemptions provided for certain payments through an extensive network of bilateral tax treaties. These rate reductions, which apply on a reciprocal basis, differ depending on the type of income and the tax treaty country.

The Income Tax Act also provides for a number of unilateral exemptions from withholding tax including: exemptions for interest payments on government debt; interest payments to arm's length persons on long-term corporate debt; interest payments to arm's length persons on foreign currency deposits with branches of Schedule I banks; and, royalty payments for the use of copyright.

Lower withholding taxes can reduce the cost to Canadian business of accessing capital and other business inputs from abroad. For example, a lower Canadian withholding tax on interest payments to non-residents can reduce the cost of accessing foreign capital in cases where foreign creditors

raise the interest rate charged to cover payment for withholding tax. The withholding tax exemption for interest on government debt lowers the borrowing costs of all governments in Canada, thereby lowering the tax burden for all Canadians. Similarly, a reduced withholding tax on royalty payments can reduce the cost of accessing foreign technology and other property and services, and thereby enhance the competitiveness of Canadian businesses requiring these inputs.

The cost estimates of the tax expenditures associated with withholding tax exemptions for certain royalties, interest, dividends and management fees paid to non-residents were derived from a detailed survey of payments to non-residents and withholding tax collections on those payments for 1993. The cost estimates were derived by applying treaty withholding tax rates (in the case of payments to a country with which Canada had a tax treaty in 1991/1992) 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 data under the benchmark assumption used throughout this publication of no behavioral response to the hypothetical removal of existing withholding tax exemptions.

This benchmark assumption of no behavioral response is particularly difficult to sustain for this type of tax. Foreign providers of capital, technology, and other property and services in most cases are unwilling to bear withholding tax given that they do not pay such a tax when supplying other markets. If a withholding tax were to be imposed, they would either require that the tax be shifted-back to the Canadian borrower or user of property or services in the form of higher charges (which in many cases could not be absorbed), or they would bypass Canada in favour of other foreign markets where such a tax does not exist, again implying increased financing and other business costs to Canadians. Indeed, these same competitiveness considerations have led to the introduction of a number of withholding tax exemptions both in Canada and in other countries.

Thus, these particular tax expenditure estimates cannot be interpreted as additional revenues that could be collected from non-residents if the withholding tax exemptions were removed, since the removal of the exemptions would generally involve the elimination of the tax base.

Exemption of foreign shipping and aircraft companies from Canadian income tax

Non-resident shipping corporations engaged primarily in international traffic are treated as non-resident under the Income Tax Act. Similarly, by international agreement, non-resident incorporated airlines engaged primarily in international traffic are treated as non-resident. In both cases, the exemption applies only if the non-resident's home country gives Canadians a comparable exemption. The cost of the tax expenditure is then the Canadian tax that would otherwise be payable on profits related to their Canadian business.

No data are available.

Other Tax Expenditures

The following tax measures are not directly related to the corporate business sector in Canada.

Transfer of income tax room to provinces in respect of shared programs

In 1967, federal-provincial fiscal arrangements were altered. The federal government substituted a transfer of corporate income tax points for direct transfers to provinces under the cost-shared program for post-secondary education. The 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 per cent to 36 per cent (the rate before the abatements was 46 per cent). This transfer of tax room has been included as a tax expenditure because it is a substitute for direct spending programs.

Interest credited to life insurance policies

Life insurance companies are taxed under the Investment Income Tax (IIT) at a rate of 15 per cent on net investment earnings attributable to life insurance policies.

The IIT interacts with the taxation of policyholders. The Income Tax Act divides life insurance policies into two categories: savings-oriented policies and protection-oriented policies.

Savings-oriented policies are those where the amount of money invested in the policy is large relative to the death benefit. A holder of a savings-oriented policy is subject to annual accrual taxation in respect of the net investment earnings credited to the policy. Net investment earnings reported by these holders are subtracted from the IIT tax base in order to avoid double taxation of net investment earnings.

In contrast, a holder of a protection-oriented policy is not subject to annual accrual taxation. Net investment earnings are taxed when the policy is surrendered or terminated (other than by death), or when paid out as policy dividends once the cumulative dividends exceed the total premiums paid under the policy. Net investment earnings that are taxable to holders of protection-oriented policies are also deductible from the IIT base.

Most of the cost of the tax expenditure relates to protection-oriented policies. This cost has three basic elements:

- differences between personal and IIT tax rates,
- timing differences (i.e. policies that are eventually taxed in the hands of policyholders), and
- permanent differences (i.e. policies that are held until the death of the insured).

The Excise Tax Transportation Rebate

The Excise Tax Transportation Rebate introduced in 1991 and effective for the 1991 and 1992 calendar years allowed transportation businesses to receive an excise tax rebate of 3 cents for each litre of eligible fuel on which federal fuel excise tax of 4 cents per litre was paid. In exchange, businesses who elected to received this rebate were required to reduce their income tax losses by $10 for every $1 rebated. This provided the industry with an immediate cash-flow benefit at the cost of lower loss carry-forwards to offset income taxes as conditions improve.

This rebate was applicable to purchases of diesel and aviation fuel subject to federal excise tax during the 1991 and 1992 calendar years.

A simpler option was available for trucking businesses who could elect to receive a rebate of 1½ cents per litre up to a maximum of $500 per taxpayer in lieu of the 3 cent per litre rebate.

Non-taxation of registered charities and other non-profit organizations

Registered charities and other non-profit organizations, both incorporated and unincorporated, are exempt from income tax. This is a tax preference to the extent that the charity or organization has income, mainly investment income or profits from certain commercial activities.

No data are available.

Income tax exemption for provincial and municipal corporations

Provincial Crown corporations and municipal corporations are exempt from income tax. Under the benchmark tax structure, such corporations would be taxable to the extent that they had taxable income.

No data are available.

Non-taxation of certain federal Crown corporations

While federal Crown corporations are generally not subject to income tax, those Crown corporations that carry on significant commercial activities are taxable. It is possible, however, that some exempt corporations have income that would be taxable under the benchmark tax system.

No data are available.

Memorandum Items

Excess of tax depreciation over depreciation for financial statement purposes

Issues in calculating the cash-flow impact of the excess of tax depreciation over depreciation for financial statement purposes

Under the benchmark tax system, corporations would be permitted a deduction for the use of capital equipment equal to the economic depreciation rate. Since economic depreciation rates are difficult to estimate for many categories of assets, a practical alternative is to adopt the depreciation rates used by the corporations in their financial statements. These rates are accessible and follow accounting norms that generally make them similar to economic depreciation rates. That is, they represent the taxpayers' own estimates of the useful lives of their assets.

In keeping with the cash-flow concept for valuing tax measures in this report, the tax value of CCA provisions has been estimated in reference to the depreciation as recorded in taxpayers' financial statements. That is, the value of the forgone revenue arising from the CCA is equal to the difference between CCA claims and depreciation for financial statement purposes multiplied by the corporation's marginal tax rate. The figures reported in the tables show the change in federal tax revenues that would result if corporations had claimed depreciation for financial statement purposes instead of CCA in computing income for tax purposes. As discussed below, when CCA differs from depreciation for financial statement purposes, some but not necessarily all of this may represent a tax expenditure. There may be other reasons why there is a difference between depreciation for financial statement purposes and CCA that are unrelated to the existence of a tax preference, which is why this measure is classified as a memorandum item. Furthermore, the available data do not permit a separation of the tax expenditure component associated with this provision from the portion that is essentially part of the benchmark system.

Differences between CCA and depreciation for financial statement purposes

CCA may differ in several fundamental ways from depreciation for financial statement purposes. First, the CCA rates at which assets can be written off against income may be faster than the rates used in companies' financial accounts. As a result of tax reform in 1988, however, the number of asset classes that have accelerated depreciation rates was reduced significantly. Where fast write-offs are still available, the CCA system allows a larger deduction from income for the first few years after the property is acquired. During these initial years, this treatment results in lower taxable income and thus lower tax liability than if depreciation for financial statement purposes had been claimed. For later taxation years, however, depreciation for financial statement purposes would be greater than that allowed for tax purposes.

Thus, income for tax purposes in these later years would be higher than if depreciation for financial statement purposes had been used. On balance, there has been a deferral of taxes. In the case of growing firms with many assets, the larger CCA claims on the newer assets would always be sufficient to offset the smaller CCA claims on older assets, so that taxable income would be continually lower than it otherwise would be. In this case, the tax deferral becomes indefinite and would be equivalent to a tax reduction.

Second, the CCA rate may be less than the depreciation rate for financial statement purposes. An example of this situation could be rapidly depreciating equipment where the CCA rate has not kept pace with changes in technology, which quickly render some equipment obsolete. During the initial years, CCA would be less than depreciation for financial statement purposes and there would be a prepayment of taxes. During the later years, CCA would exceed depreciation for financial statement purposes and there would be a tax savings. If this situation arises, the estimate of the cost of the tax expenditure would be negative.

As a result of the static nature of the calculation used in this study, the amount of the tax preference arising from accelerated or deficient CCA rates cannot be identified. The calculation is made at a particular point in time (the 1991 or 1992 taxation year) and not over the entire life of the asset. For example, consider the case of an asset where an accelerated CCA rate is provided. Clearly, a tax preference is available since there is a deferral of tax over the lifetime of the asset. If we look at the difference between CCA and depreciation for financial statement purposes during one of the initial years of the asset's life, we would generate a positive estimate, which is the correct conclusion, although the actual amount would be incorrect from a lifetime perspective. On the other hand, if we were to perform the same calculation at a later year (i.e. when depreciation for financial statement purposes exceeds CCA) we would obtain a negative estimate, which would be incorrect.

The third difference between CCA claimed and depreciation for financial statement purposes is that taxpayers have discretion in choosing the amount of CCA to deduct in a year, subject to a maximum amount. If taxpayers do not have sufficient taxable income, they need not claim the CCA available to them in that year; they can wait for a future year. By doing so, taxpayers can avoid creating a tax loss, which is subject to a limited carry-over period during which it can be deducted (i.e. three years back, seven years forward). On the other hand, there is no time limit on using CCA. Consequently, observing tax depreciation that exceeds depreciation for financial statement purposes does not necessarily imply that a tax preference has been provided. For example, consider an asset where the CCA rate and the depreciation rate for financial statement purposes are identical. If a taxpayer does not deduct CCA in one year and then makes the deduction in subsequent years, the amounts claimed for tax and depreciation for financial statement purposes would be different in these years even though there is no tax preference associated with this asset. Viewed in this light, the discretionary nature of the CCA deduction

may be seen as another mechanism to carry over losses to future years. If differences arise between CCA and depreciation for financial statement purposes for loss carry-over reasons, these should not be considered to be tax expenditures.

The fourth difference between CCA claimed and depreciation for financial statement purposes arises from the pooling of assets into CCA classes. (There are some exceptions such as rental buildings costing at least $50,000, which are placed in a separate prescribed class.) Depreciation for financial statement purposes is determined by reference to each individual asset. If an asset that originally cost $100 has depreciated so that its current book value is $50, and it is sold for $70, at least in principle the $20 difference would be brought into income. However, under the CCA system, this asset would typically be grouped with other assets in a CCA class and the proceeds of a sale would serve to reduce the total undepreciated capital cost of the class. Generally, the effect of this pooling is that the $20 of unrealized recapture on the disposal of property is gradually brought into income as future CCA claims for the class are reduced accordingly. Thus, the recapture of any "excess" depreciation claim may be deferred well beyond the time of disposition of an asset. Similarly, there may be a corresponding deferral in the recognition of terminal losses when the asset is sold for less than its depreciated value.

Finally, tax depreciation and depreciation for financial statement purposes differ in their treatment of interest payments related to the acquisition of a capital asset. For accounting purposes, interest payments may be capitalized in the cost of the asset; for tax purposes, interest payments are generally expensed in the year they are incurred.

Specific provisions

The CCA rate exceeds depreciation for financial statement purposes in some cases. The more generous provisions for certain types of property are described below. Except for capital equipment used in scientific research and experimental development, specific valuations of these special provisions could not be made under the cash-flow method as depreciation for financial statement purposes cannot be attributed to the various CCA classes.

Manufacturing and processing assets (class 29, 39, 40, 43)

Specified property used primarily in manufacturing and processing was depreciated over three years at a 25-per-cent, 50-per-cent, 25-per-cent straight-line rate in class 29, if acquired after November 12, 1981 and before 1988.

After 1987, most M&P machinery and equipment assets went into class 39, which has a depreciation rate that diminished in stages to a 25-per-cent rate calculated on a declining balance basis with a half-year rule. In 1990, the rate was 30 per cent, which declined to 25 per cent in 1991. Effective February 25, 1992, manufacturing and processing assets are included in class 43, which has a depreciation rate of 30 per cent.

Certain assets (primarily lift trucks and computers) acquired in the calendar year 1988 or 1989 were placed in class 40, where the CCA rate was 40 per cent in 1988 and 35 per cent in 1989. These assets acquired after calendar 1989 fall into class 10 at a 30-per-cent declining balance rate.

Vessels (class 7)

Vessels are generally included in class 7 and are subject to a maximum CCA rate of 15 per cent. 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. For vessels acquired before July 14, 1990, this accelerated capital cost allowance was available only if the Minister of Industry, Trade and Commerce (now the Minister of Industry) certified that all the above conditions had been met. This certification requirement was withdrawn for acquisitions after July 13, 1990.

Offshore drilling vessels (class 7, 41)

Certain offshore drilling vessels qualify for an additional 15-per-cent CCA for an effective rate of 30 per cent, subject to the half-year rule. An offshore drilling vessel acquired after December 31, 1987 becomes a class 41 rather than a class 7 asset and is depreciated at 25 per cent.

Power-operated movable equipment (class 22, 38)

Such equipment designed for the purpose of excavating, moving, placing or compacting earth, rock, concrete or asphalt acquired after March 16, 1964 and before 1988 can be depreciated at a 50-per-cent CCA rate, subject to the half-year rule. Equipment acquired after 1988 is depreciated under class 38, at a 35-per-cent CCA rate in 1989 and 30 per cent after 1989.

Railway assets (class 35)

Railway cars acquired after May 25, 1976 qualify for class 35, which has a CCA rate of 7 per cent. Railway cars acquired on or before February 2, 1990 and not for rent or lease are eligible for an additional allowance of 8 per cent. The additional allowance is reduced to 6 per cent for cars acquired after February 2, 1990. Railway cars acquired before April 27, 1989 for rent or lease are eligible for an additional allowance of 8 per cent – diminished to 6 per cent over the 1990 to 1995 taxation years. The rate is reduced to 6 per cent for cars acquired after April 26, 1989. Railway cars acquired after December 6, 1991 by common carriers are eligible for an additional allowance of 3 per cent.

Communication satellites (class 30)

Unmanned telecommunication space craft acquired before 1988 can be written off on a 40-per-cent declining balance basis subject to the half-year rule.

Retailer's point-of-sale equipment (class 12)

A 100-per-cent CCA rate is applicable for certain types of point-of-sale equipment acquired after August 8, 1989 and before January 1, 1993. In addition, the half-year rule does not apply to these purchases. The equipment must be acquired for use in a business selling goods or providing services to consumers that is carried on in Canada or for lease to another taxpayer for use by that taxpayer in such a business.

Application software (class 12)

A 100-per-cent CCA rate, with the half-year rule, is applicable for application software or a right or license to use application software acquired after May 25, 1976.

Certified Canadian films (class 12, 10(w))

Certified productions acquired before 1988 qualify for a CCA rate of 100 per cent (class 12). Certified productions acquired after 1987 become class 10(w) property and are depreciated at a 30-per-cent declining balance rate, but are not subject to the half-year rule when acquired. An additional allowance up to the remaining undepreciated capital cost of the film property is deductible against income from Canadian films.

Energy-efficient equipment (class 34)

Straight-line depreciation of 25 per cent, 50 per cent and 25 per cent is applicable to certain equipment used for the generation of electricity or the production or distribution of heat. The equipment has to meet certain criteria relating to more efficient use of fuels or the utilization of waste materials to be eligible and be certified by the Minister of Natural Resources. Qualifying equipment includes equipment designed to: produce heat derived primarily from the consumption of wood wastes or municipal wastes; produce electrical energy by using wind energy; or recover heat that is a by-product of an industrial process. Also included as qualifying equipment are: hydro-electric installations not exceeding 15 megawatts; certain types of co-generation equipment; and certain types of active solar heating equipment.

(Changes to this class were announced in the 1994 budget. The changes effectively terminated new additions to class 34, redefined eligibility criteria, and reduced the depreciation rate to 30 per cent under class 43.1.)

Water and air pollution control property (class 24, 27)

Assets which are acquired primarily for the purposes of abating water or air pollution at a site qualify as class 24 or class 27. These assets are eligible for a straight-line allowance of 25 per cent, 50 per cent and 25 per cent over three years. This special allowance for water and air pollution control equipment is applicable only to new property that is used in operations that were started before 1974 and have been continuously carried on since that time. The eligibility of such property, once established, can flow through corporate amalgamations and wind-ups.

(Changes to this class were proposed in the 1994 budget that will sunset these two classes by 1999.)

Mining assets (class 28, 41)

Certain mining buildings, machinery and equipment acquired for use at a new mine or a major expansion of an existing mine may qualify for an accelerated CCA rate of up to 100 per cent. A 25-per-cent increase in a mine's capacity is generally considered to be a major expansion.

These mining assets were previously included in class 28, and depreciated at a 30-per-cent rate. For acquisitions after 1987, these assets are included in class 41, and depreciated at a 25-per-cent rate. In addition to the 25-per-cent allowance provided in class 41, a taxpayer owning such property and operating the mine may claim an addition allowance equal to the lesser of (1) the remaining undepreciated capital cost of property of the class, or (2) the income for the year from the new or expanded mine.

Fast write-off for Canadian development expense (CDE) and Canadian exploration expense (CEE)

The tax system provides deductions of a taxpayer's exploration and development expenditures through Canadian exploration expenses (CEE), Canadian development expenses (CDE), Canadian oil and gas property expenses (COGPE), and foreign exploration and development expenses (FEDE).

Intangible capital costs associated with developing an oil and gas property are classified as CDE and written off at a 30-per-cent declining balance rate. Pre-production development costs (such as the removal of overburden) incurred prior to the commencement of commercial production of a mine are CEE. Overburden removal and the construction of haulageways for mines that have commenced commercial production are classified as CDE. The costs of acquiring mineral properties are generally treated as CDE. Unused expenditures are accumulated in a separate account known as the cumulative Canadian development expenses (CCDE) account or pool. Any undeducted balances in the CCDE account can be carried forward indefinitely.

Expenditures incurred in determining the existence, location, extent or quality of mineral resources, and oil or gas, or incurred to develop mineral resources prior to commercial production in Canada are deducted for tax purposes at a rate of 100 per cent. These expenditures are recorded by the taxpayer in a separate account known as the cumulative Canadian exploration expense (CCEE) account and any undeducted balance may be deducted in future taxation years. There is no time limit on carrying forward these expenses.

For the taxation years under consideration, a principal business corporation (PBC) must deduct any balance in its CCEE account to the extent of its income for that taxation year and may not use this deduction to create a non-capital loss. This deduction is optional for a non-PBC or individual, and may be used by these taxpayers to create a non-capital loss.

(The December 1992 Economic and Fiscal Statement announced that mining and oil and gas companies will have more flexibility in utilizing non-capital losses before they expire by making the deduction of CEE elective, rather than mandatory, to the extent of the company's income for the year. This change is effective for taxation years ending after 1992.)

No estimates have been made of the tax expenditure costs for either FEDE or COGPE. The tax expenditure due to FEDE is relatively small. In the case of COGPE, the existing maximum deduction rate of 10 per cent is generally similar to the depreciation rate of the oil and gas property for financial statement purposes and so the current tax treatment does not give rise to a tax expenditure.

Differences between tax treatment and accounting treatment

Generally accepted accounting principles allow companies to depreciate exploration and development expenditures on either a "full cost" or a "successful efforts" basis. The full cost method requires that all costs, whether they result in new production or not, are capitalized and amortized as the reserves are depleted. The successful efforts method requires that only those costs which result in the discovery of reserves and which have a benefit in terms of future revenues are capitalized; other costs are expensed as incurred. Most Canadian-controlled companies follow the full cost method, while those in Canada that are foreign-controlled companies usually follow the successful efforts method.

The 30-per-cent declining balance rate for CDE may be in excess of the effective write-off rate. Whether or not the 30-per-cent rate is, in fact, accelerated depends on the life of the reserve being developed and on the rate of production of the reserve. For example, the 30-per-cent rate is accelerated in the case of those wells that have at least a 10-year life span.

The 100-per-cent write-off of CEE for tax purposes is more rapid than the amounts used for financial statement purposes which require the amortization of some of the expenditures. Thus, the fast write-off for CEE provides a deferral of tax.

Benchmark tax system

Under the benchmark tax system, corporations would be permitted an immediate deduction for unsuccessful exploration expenditures. However, those costs associated with successful exploratory activities (i.e. those costs that result in producing assets for both the mining and oil and gas sectors) would be permitted a deduction based on an amortization over the life of the asset. Similarly, development costs should be amortized over the life of the asset created by the expenditure. As noted in the previous section on depreciation, economic depreciation rates are difficult to estimate and a practical alternative would be to use the accounting treatment for such assets in financial statements.

Previous editions of this publication have identified CEE and CDE under the deferrals category of tax expenditures. The current publication combines the two items as a single tax expenditure and reclassifies the combined measure as a memorandum item to reflect the fact that the available data do not permit a separation of the tax expenditure component from the portion which is essentially part of the benchmark tax system. Due to this lack of data, the

estimates provided here do not include exploration and development write-offs for financial statement purposes in the benchmark in calculating the combined tax expenditure. Consequently, the estimate provided overstates the amount of any tax expenditure.

The estimation of any tax expenditure applies to a particular point in time (i.e. the 1991 or 1992 taxation year) and not over the entire life of the asset. The CDE and CEE write-offs allow a large deduction from income for the first few years after expenditures are incurred. During these initial years, this treatment results in lower taxable income and thus lower tax liability than if the corresponding deductions for financial statement purposes had been claimed. These deductions include depletion, exploration and development expenses (this latter item only for those companies following successful efforts accounting practices), and they represent an aggregate of intangible costs associated with exploration and development. For later taxation years, however, financial statement deductions would be greater than that allowed for tax purposes. Thus, income for tax purposes in these later years would be higher than if deductions for financial purposes had been used. On balance, it would appear that there has been a deferral of taxes arising from the CEE and CDE deductions. It should be noted however that, like depreciation, this is a static calculation.

Steps are being taken to collect the financial data necessary for the benchmark calculation so that future tax expenditure estimates for this item are more precise. An alternative set of estimates, which includes a benchmark comparison, has been calculated by Natural Resources Canada (NRCan) for the combined CDE and CEE tax expenditure for the oil and gas industry. The information on which this calculation is based was collected by the Petroleum Monitoring and Energy Statistics Division of NRCan. However, these data do not permit a tax expenditure estimate for CDE and CEE separately, and do not include the mining industry.

The NRCan approach takes into consideration the fact that a benchmark system would allow for some deductions in respect of exploration and development costs. For each company, the tax expenditure is derived by applying the corporate tax rate to the difference between the tax write-offs related to these costs and the corresponding accounting deductions. The results reflect the tax position of each company during the years in question. It should be noted that this approach is conceptually similar to the calculation of the excess of tax depreciation over depreciation for financial statement purposes discussed in this section. Using this approach, the tax expenditure estimates of the fast write-off for CDE and CEE in the oil and gas industry were $9 million in 1991 and $143 million in 1992. As a result of the economic downturn between 1991 and 1992, the industry shifted its activities away from more risky exploration and towards development. This had the result of lowering the proportion of unsuccessful spending, leading to a greater difference between tax and book write-offs, and thus a higher tax expenditure.

Finally, it should be noted that any estimates of the tax expenditures associated with CDE and CEE must be interpreted carefully. It is important to note that the ability of mining corporations and oil and gas corporations to flow out CEE, CDE and COGPE to investors through limited partnerships, joint exploration corporations or by issuing flow-through shares affects the allocation of the cost of the tax measure between personal and corporate income taxes and among industry sectors.

Deductibility of provincial royalties for the Syncrude project

Taxpaying participants in the Syncrude project are permitted to deduct both the resource allowance and provincial royalties (in this case, "joint venture" payments made to the province of Alberta in lieu of a royalty) in computing income subject to tax. This is accomplished through a remission order. Under the benchmark tax system, these taxpayers would be permitted to deduct only provincial royalties. The value of the tax expenditure is calculated as the value of the resource allowance deduction.

Deductibility of royalties paid to Indian bands

Royalties and lease rentals paid to Indian bands in respect of oil and gas and mining activities on Indian reservations are considered to be Crown charges paid to Her Majesty in Right of Canada or of a Province in trust to the Indian band. Unlike non-deductible Crown charges, amounts paid to the benefit of an Indian band are generally deductible for federal income tax purposes. In addition to the deductible Crown charges, a resource allowance is earned on the resource profits net of the deductible Crown charges.

In the benchmark tax system, the Crown charges would be deductible, but no resource allowance would be earned. Therefore, the cost of the tax expenditure is the value to the taxpayer of the resource allowance deduction.

There are no available data on the amount deducted. However, the amounts paid to the Government of Canada in the form of mining and oil and gas royalties/lease rentals paid to Indian bands are provided below:

Oil and gas and mining royalties/lease rentals paid to Indian bands

	1991-92	1992-93	1993-94	1994-95
		(millions of dollars)		
Oil and gas	53	50	59	76
Mining	1	0.8	0.2	0.7

Source: Accounting Operations Finance Branch, Indian and Northern Affairs Canada.

The following two items are parts of the tax system that provide some integration between the personal and corporate tax systems. Their values are calculated as additional corporate taxes that would be owing if corporations and individuals were treated as separate tax units.

Refundable Part I tax on investment income of private corporations

As a method of integrating personal and corporate income taxes, a portion of the income taxes paid on investment income received by a private corporation (excluding deductible inter-corporate dividends) is refunded to a CCPC when this income is paid out to shareholders as dividends.

(To further ensure the integration of corporate and individual income taxes, the 1995 federal budget announced the introduction of an additional refundable tax, to be levied after June 30, 1995, on the investment income received by a CCPC. This additional tax will also be refunded to a private corporation, along with refundable Part I tax, when the investment income is paid to shareholders as dividends.)

Refundable capital gains for special investment corporations

Capital gains realized by an investment 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 refund when it distributes capital gains dividends to its shareholders. Since these dividends are capital gains distributions, they are taxed as capital gains in the hands of the shareholder and not as dividends.

Loss carry-overs

Loss carry-overs are part of the benchmark tax system because the cyclical nature of business income suggests that such income should be viewed over a number of years. The loss carry-over rules permit taxpayers to apply their losses against past or future income. Where available, the revenue estimates indicate how much revenue the government forgoes by allowing current year losses to be applied against income from past years.

Non-capital loss

A non-capital loss is a company's loss from business operations. Non-capital losses may be carried back three years and forward seven years to reduce or offset the corporation's taxable income.

Net capital loss

A net capital loss can arise from the disposition of capital property. This type of loss may be carried back three years and forward indefinitely but applied only against net capital gains that are taxable.

No data are available.

Farm losses and restricted farm losses

A taxpayer who operates a farming or fishing business can deduct, in the calculation of its net income, a loss incurred from its business operation. The unused losses of a given year may be carried back three years and forward ten years.

When the major source of income is not farming, the amount of losses deductible in the year is restricted to a maximum of $8,750 against other income. 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 back three years and forward ten years but only against farm income.

Data are not available to estimate the forgone revenue.

Meals and entertainment expenses

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. Consequently, only a partial deduction for these expenses would be permitted under the benchmark tax system.

Until 1994, the deduction was limited to 80 per cent of the cost of food, beverages and entertainment. Where the cost of food, beverages or entertainment was part of a package price which included amounts not subject to the 80-per-cent limitation, for instance the fee for a conference, the taxpayer was required to determine the value or make a reasonable estimate of the amount subject to the 80-per-cent limitation.

(The 1994 budget reduced the deductible portion of meals and entertainment expenses to 50 per cent.)

Large corporations tax

The large corporations tax (LCT) was introduced on July 1, 1989 as a tax on the Canadian capital of large corporations. The rate of tax in 1991 and 1992 was 0.2 per cent.

This tax ensures that all large corporations with more than $10 million of taxable capital employed in Canada pay some federal tax. Amounts paid under the large corporations tax (LCT) could be used to reduce the Canadian portion of the 3-per-cent corporate surtax.

(The 1995 budget proposed an increase in the LCT rate to 0.225 per cent.)

Threshold

The $10 million capital deduction effectively exempts smaller corporations from the LCT as long as these corporations are not related to other corporations subject to the LCT. That is, the $10 million deduction must be shared amongst related corporations. This capital deduction is not considered to be a tax expenditure because it is generally available to all corporations.

Exempt corporations

Certain corporations such as non-resident investment corporations, deposit insurance corporations and corporations exempt from paying Part I income tax are exempt from paying the LCT. This exemption is a tax expenditure, but data are not available to estimate its value.

Patronage dividend deduction by credit unions and co-operatives

Patronage dividends (the excess of revenues over costs) paid out by a credit union or a co-operative to its members are deductible in computing the corporate income tax liability of credit unions and co-operatives. The taxpayer is required to withhold 15 per cent of all patronage dividends in excess of $100 paid to each customer who is resident in Canada.

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, this would not be a tax expenditure.

Alternatively, these payments could be perceived as the distribution to members of earnings which 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.

Logging tax credit

The logging tax credit reduces federal taxes payable by the lesser of $\frac{2}{3}$ of any logging tax paid to a province and $6\frac{2}{3}$ per cent of income from logging operations in that province. The mandatory nature of the tax paid to the provinces leads to the classification of this provision as expenses incurred to earn income.

Non-resident-owned investment corporation refund

A non-resident-owned investment corporation must pay income tax at a rate of 25 per cent. However, except for capital gains realized on taxable Canadian property, this tax is refundable when the surplus is distributed as taxable dividends to the shareholders and the applicable rate of withholding tax then applies. The refund is designed to relieve the dividends paid to non-residents from double taxation that would otherwise result. The corporation is essentially treated as a conduit for the flow-through of income. The amounts reported estimate the tax revenues that would be generated if the non-resident-owned investment corporation refund was not available.

Investment corporation deduction

Investment income is taxed at the corporation level and in the hands of the individual who receives it as dividend payments. In order to achieve a certain degree of integration between the personal and corporate tax systems, the

current rules allow an investment corporation to deduct from its Part I tax otherwise payable 20 per cent of the amount by which its taxable income exceeds its taxed capital gains.

Deferral of capital gains income through various roll-over provisions

The taxation of capital gains is affected by provisions that permit taxpayers to defer realization for tax purposes through various roll-over provisions. Roll-overs associated with amalgamations and other corporate reorganizations have been considered part of the benchmark tax structure. Since the benchmark tax structure includes all accrued gains, this item is identified separately for information purposes. Examples include:

- the transfer of assets to a corporation or partnership in consideration for share capital or a partnership interest,
- amalgamations of taxable Canadian corporations,
- the winding-up of a subsidiary corporation into its parent corporation, and
- share-for-share exchanges.

(The 1994 budget proposed changes that will curtail the use of various roll-over provisions in certain reorganizations.)

No data are available.

Excess deduction for intangible assets

Three-quarters of eligible capital expenditures on intangible assets is added to cumulative eligible capital. A deduction of up to 7 per cent of cumulative eligible capital at the end of the year is allowed. An example of intangible assets is goodwill purchased upon the acquisition of a business.

This treatment of intangible assets could give rise to positive or negative estimates depending upon the actual rate of depreciation relative to the amount that is permitted for tax purposes.

No data are available.

Tax exemption on income of foreign affiliates of Canadian corporations

The Canadian system for taxing the income of foreign affiliates of Canadian shareholders or the dividend income of the Canadian shareholders derived from foreign affiliates is based on the objectives of encouraging international competitiveness, protecting the tax base and eliminating double taxation.

Where the foreign affiliate earns active business income, Canada defers any recognition of that income until it is paid to the Canadian shareholders as a dividend on shares of the affiliate. In cases where the business income has been earned in a country with which Canada has a double taxation treaty, the dividend paid out of that income to Canadian corporate shareholders is not

subject to additional Canadian tax. Where the business income is earned in non-treaty countries, the dividend is taxed in Canada but a tax deduction is provided to Canadian corporate shareholders based on the underlying foreign tax paid.

Where the foreign affiliate earns passive income and the affiliate is a controlled foreign affiliate of a person resident in Canada, the passive income is taxed in the Canadian shareholder's hands on an accrual basis. The Canadian shareholder can deduct taxes paid in the foreign jurisdiction in determining its net additional Canadian tax liability. When the income earned in the foreign affiliate is actually paid to the shareholder in the form of a dividend, a deduction from income subject to tax is provided to the extent that the income was included in income subject to tax in a previous year.

Questions arise as to what should be the appropriate benchmark system to measure the value of the tax expenditure, if any, in this case. Basically, three different benchmarks could be contemplated:

(a) Canada should tax only Canadian-source income. This is the territorial approach. Under this approach, foreign subsidiaries of Canadian companies would face the same tax burden on foreign-sourced business income as locally owned enterprises in the foreign jurisdiction. This approach is consistent with the concept of capital-import neutrality. Capital-import neutrality results when the shareholders of subsidiaries do not face additional taxes in Canada with respect to the foreign business income earned by their subsidiaries. This is the approach that Canada has adopted with respect to dividends arising from affiliates in countries with which Canada has entered into a double taxation agreement. If this exempt dividend approach were to be considered as the benchmark, then no preference would be associated with the foreign dividend exemption.

(b) Income earned by a foreign affiliate should be taxable in Canada when dividends are paid to the Canadian shareholder and double taxation alleviated with a foreign tax credit. This is the approach used by a number of countries since it allows for additional taxes to be collected in the country of residence of the shareholder of a foreign affiliate at the time a dividend is paid to the shareholder by the affiliate out of foreign business income. These additional taxes would be levied when domestic tax payable exceeds the amount of foreign taxes paid both on the dividend itself and on the underlying foreign corporate profits out of which the dividend was paid. In Canada, dividends from foreign affiliates that do not qualify as exempt dividends are taxed on this basis. If this were to be considered the benchmark system, then the exempt dividend system would provide a preference, measured as the additional tax, net of the foreign tax credit, that would have been payable had the dividend been taxable in Canada.

(c) Income earned by foreign affiliates should be taxable in Canada as it accrues to the Canadian shareholder, i.e. on a current basis. This system is consistent with the concept of capital-export neutrality, which states that

income of foreign affiliates should be subject to the same tax in the hands of its shareholders on a current basis regardless of whether the income is earned domestically or in a foreign affiliate. Certain passive income earned by controlled foreign affiliates is taxable on this basis in Canada. If this system were to be viewed as the benchmark, the foreign tax credit approach would be said to provide a preference measured as the deferral of incremental Canadian tax from the time the income is earned until the time the dividend is paid out.

Each of these three possible benchmarks has a policy justification. Data required to compute the amount of tax preference associated with any of the benchmarks are currently unavailable.

Categorization of Items by Industrial Category

To provide more information, an industrial breakdown of the major corporate tax measures has been included in the tables. Tax expenditures and their associated costs were redistributed across industries to reflect other information where available. The broad industry classifications are defined by the 1980 Standard Industrial Classification Code (SIC) and are indicated below:

Industry	Standard Industrial Classification Code
Agriculture, Forestry, and Fishing	0100 – 0599
Manufacturing	1000-3599, 3700 – 3999
Construction	4000 – 4499
Transportation and Storage	4500 – 4799
Communications	4800 – 4899
Public Utilities	4900 – 4999
Wholesale Trade	5000 – 5999
Retail Trade	6000 – 6999
Finance	7000 – 7699
Services	7700 – 7799, 8500 – 9999
Oil and Gas	0630 – 0799, 0910 – 0919, 3600 – 3699
Mining	0600 – 0629, 0800 – 0899, 0920 –0999
All Corporations	0000 – 9999

Appendix C
Description of the Goods and Services Tax Provisions

Since the Goods and Services Tax (GST) is levied at all points in the production and distribution chain, the value-added nature of the tax makes it equivalent to a retail sales tax levied on the sale of goods and services to the final consumer. Based on this equivalency, the GST base can be estimated using Statistics Canada's input-output tables and the National Accounts.

The input-output tables provide the data required to derive detailed expenditures by commodity for households, public sector bodies, and exempt businesses. The personal expenditure categories of the input-output tables along with the investment categories for residential construction and real estate commissions are used to derive commodity expenditures for households. The commodity expenditures of public sector bodies are derived from certain personal expenditure categories, current government expenditure categories and appropriate investment categories contained in the input-output tables. (Public sector bodies include the federal government, provincial governments, municipalities, universities, school boards, public colleges, hospitals, charities, and non-profit organizations.) The commodity expenditures of exempt businesses are derived from the input matrix of the input-output tables.

The commodity data described above are used to identify the impact of the GST provisions which either zero-rate or exempt certain goods and services. Since final input-output tables for a given year are available only four years after the fact, National Accounts data are used to project the impact of each GST provision to the relevant year.

It is not possible to use the National Accounts and the input-output tables to estimate the costs of all the tax expenditures associated with the GST. In some cases, modifications had to be made to the estimates derived from the input-output tables and the National Accounts. In other cases, actual data from Revenue Canada were used for the tax expenditure estimates, and certain estimates were derived from entirely different sources. This appendix describes the various GST tax expenditure estimates and how they were derived.

Zero-Rated Goods and Services

Basic groceries

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 cost of the tax expenditure can be estimated by using input-output data and the National Accounts to identify commodities purchased by final consumers and public sector bodies which are currently not subject to tax. The majority of these purchases are contained in the category "Food and Non-Alcoholic Beverages".

Prescription drugs

Drugs that are controlled substances for which a prescription is required are zero-rated. This provision also includes other drugs that have been prescribed by a recognized health care practitioner. The associated dispensing fee is also zero-rated. However, this provision excludes those items labelled or supplied for veterinary use.

The estimate is derived from National Accounts and input-output tables. However, an adjustment is made to reflect the fact that the input-output commodity "Pharmaceuticals" includes both prescription and non-prescription medicine. The ratio used to separate these two categories of medicine is based on information provided by Health Canada.

Medical devices

A wide range of medical devices is zero-rated under the GST. Included in this provision are canes; crutches; wheelchairs; medical and surgical prostheses; ileostomy and colostomy devices; artificial breathing apparatus; hearing and speaking aids; prescription eyeglasses and contact lenses; various diabetic supplies; and, selected devices for the blind and for the hearing or speech impaired. In some instances, a device qualifies for tax-free status only if it is prescribed by a recognized health care practitioner.

The estimate is based on National Accounts and input-output tables. The zero-rated medical devices are found in the input-output commodities "Personal Medical Goods", "Medical and Dental Equipment and Supplies", and "Ophthalmic Goods". It should be noted that all of the expenditures made by final consumers on these commodities are assumed to be zero-rated even though a small portion of these expenditures are, in fact, ineligible for tax relief. However, no adjustment is made to this estimate due to limited information.

Agricultural and fish products and purchases

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

The main effect of this provision is on the cash-flow position of taxpayers. 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. Since the aggregate tax liability of these taxpayers remains unchanged, the revenue implications of this measure are small.

Certain zero-rated purchases made by exporters

This provision zero-rates certain supplies of goods and services delivered in Canada but subsequently exported. These include:

- the supply of a good to a recipient who intends to export the property, provided it is not an exciseable good (spirits, beer or tobacco) and the good is not further processed or modified in Canada by the recipient;
- a supply of an exciseable good to a recipient who, in turn, exports the goods in bond;
- a supply of natural gas made to a person who is exporting the gas by pipeline and not further processing or using the gas in Canada before its exportation other than as fuel or compressor gas to transport the gas; and
- goods sold to duty free shops licensed as such under the Customs Act.

As with agricultural and fish products, this provision has only cash-flow implications. Again, the impact of this measure on tax revenues is small.

Non-taxable importations

Certain importations are tax-free under the GST. These importations include goods, other than books and periodicals, valued at not more than $20 and mailed to residents of Canada from other countries. This provision also applies to duty-free personal importations such as goods valued at not more than $300 and imported by Canadians who have been outside the country for more than seven days (the limit was increased to $500 on June 13, 1995), as well as goods imported by foreign diplomats.

No data are available.

Tax Exempt Goods and Services

Long-term residential rent

Rentals of a residential complex (such as a house) or a residential unit (such as an apartment) for a period of at least a 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 based on the GST being applied on the commodity "cash rent" contained in the input-output tables, and incorporates the loss of the GST currently paid on business inputs purchased by the landlord.

Health care services

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. However, it excludes meals served in a cafeteria, parking charges, or haircuts for which a separate fee is charged.
- **Services provided by certain health care practitioners who must be licensed or otherwise certified to practise the particular profession in provinces.** This category includes services such as dental, optometric, chiropractic, physiotherapy, chiropodic, podiatric, osteopathic, audiological, and psychological services. It also includes speech therapy and occupational therapy.
- **Services covered by a provincial health insurance plan.** Most of these services are already covered by the previous two provisions.

All those exempt services which are covered by provincial health insurance plans are included in the benchmark because, Constitutionally, the GST cannot apply to purchases made by provincial governments. Thus, the only cost from this provision involves health services purchased by final consumers. The estimates for this provision are based on National Accounts and input-output data.

Education services (tuition)

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 public college.

The estimate is derived from the revenues that would be collected if tuition fees were taxed and input tax credits were allowed for taxable purchases. The estimate takes into account the fact that universities and public colleges currently receive a rebate of 67 per cent of the tax that they pay on their purchases.

The estimate is based on the input-output commodity "Education Services" as well as data contained in Statistics Canada's publication "University Finance Trend Analysis".

Child care and personal 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;
- 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 or disabled or underprivileged persons.

The estimate is derived from the input-output commodity "Personal Services, Including Child Care" contained in the final demand category "Domestic and Child Care Services". The estimate reported here is understated because it does not account for day care which might be paid by the government, or day care provided by a non-profit organization that could be eligible for a GST rebate.

Legal aid services

Legal services provided under a provincially authorized legal aid program are exempt under the GST. This includes payments by the client in respect of the legal aid services and payments by a legal aid society to a private lawyer for legal services.

There are two ways in which the tax is relieved:

- legal aid services delivered directly by the Crown or a Crown agency (as is the case in Nova Scotia, Newfoundland, Prince Edward Island, Manitoba, and Saskatchewan) are exempt;
- legal aid 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.

Revenue Canada supplied the data related to the rebates provided to legal aid plans in the provinces of New Brunswick, Quebec, Ontario, Alberta and British Columbia. To account for the other provinces where the service is explicitly exempt, provincial economic accounts data are used. Specifically, it is assumed that the value of legal aid services relative to the total expenditures contained in the provincial economic account category "Personal Business" in the tax-exempt provinces would be the same as in those provinces where a rebate is provided.

Ferry, road and bridge tolls

International ferry services are treated as zero-rated like other international transportation services. Other ferry, road and bridge tolls are exempt under the GST.

The estimate is derived from the input-output tables based on the expenditures of final consumers on the commodity "Highway and Bridge Maintenance".

Municipal transit

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. These municipal transit services are exempt under the GST.

The estimate is based on National Accounts and input-output tables.

Exemption for small businesses

Businesses or individuals with annual sales of $30,000 or less from taxable and zero-rated transactions may elect to be exempt under the GST. Such firms would not have to charge tax on their sales and would not be able to claim input tax credits on their business purchases.

The estimate is based on gross sales contained in the personal and corporate income tax models. From this data, one can estimate that the total sales from firms with annual sales of less than $30,000 accounts for approximately 0.5 per cent of all sales in the Canadian economy. This ratio can then be applied to the total gross GST collections to approximate the revenues which would arise from eliminating the small business threshold.

Quick method accounting

Small businesses registered under the GST are eligible to elect to account for GST using Quick Method Accounting. Under the scheme, businesses do not have to keep track of the tax paid on most of their inputs. Instead, these firms remit a prescribed percentage of the GST which they collect on their sales. The remaining GST collected is kept by the firm in lieu of the unaccounted input tax credits. The firm is eligible to claim an input tax credit for the tax paid on capital goods.

The estimate is derived from micro-statistical data for 1991 supplied by Statistics Canada. The take-up rate of this provision for eligible small businesses is about 22 per cent. The estimate for subsequent years is derived by projecting the 1991 estimate based on information regarding the growth in total input tax credits claimed which is obtained from Revenue Canada.

Water and basic garbage collection services

Charges levied for water and basic garbage collection services are captured in the commodity "Water, Waste Disposal and Other Utilities" contained in the input-output tables. The estimate is based on expenditures on this commodity in the input-output tables and National Accounts data.

Domestic financial services

Financial services are defined to include services relating to financial intermediation, market intermediation and risk pooling. However, in many cases, the price of a financial service is implicit. For example, when banks

provide lending and deposit-taking services, the bank's fee for these services is the spread between interest rates received from borrowers and the 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.

The GST also permits corporations to elect to be treated as "closely related" if there is at least 90 per cent common ownership. The purpose of this provision is to allow for grouping only in those situations where the members of the group operate, for all intents and purposes, like a single company. As a result, members of a closely related group which contains a listed financial institution may make an election that deems supplies of services and property made between them to be exempt financial services.

Data are not available.

Exempt supplies made by non-profit organizations

The exempt goods and services supplied by non-profit organizations include recreational services provided primarily to children aged 14 and under; recreational services provided to the underprivileged or disabled; supplies of food, beverage and lodging to relieve poverty or distress of individuals; and certain amateur performances.

No data are available.

Tax Rebates

Rebates for municipalities

Recognized municipalities are entitled to a rebate of 57.14 per cent of the GST paid on their purchases used in the course of supplying exempt municipal services.

The estimate is based on data from Revenue Canada.

Rebates for hospitals

Public hospitals are eligible for a rebate of 83 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for schools

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.

The estimate is based on data from Revenue Canada.

Rebates for universities

Universities which are recognized degree-granting institutions 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.

The estimate is based on data from Revenue Canada.

Rebates for colleges

Public colleges which 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.

The estimate is based on data from Revenue Canada.

Rebates for charities

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 supply of exempt services.

The estimate is based on data from Revenue Canada.

Rebates for non-profit organizations

The organizations eligible for this rebate are government-funded non-profit organizations. They include registered amateur athletic associations and organizations operating a facility or part thereof to provide nursing home intermediate care or residential care, which receive at least 40 per cent of their funding from governments, municipalities or Indian bands. These organizations are eligible for a rebate of 50 per cent of the GST paid on purchases related to their supply of exempt services.

The estimate is based on data from Revenue Canada.

Housing rebate

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 priced at or below $350,000, the rebate is 36 per cent of the total GST paid to a maximum of $8,750. The rebate is phased out for houses priced between $350,000 and $450,000.

The estimate is derived from the data on the value of residential housing contained in the National Accounts as well as the detailed newly constructed housing data contained in the Starts and Completions Survey conducted by Canada Mortgage and Housing Corporation.

Rebate to foreign visitors on accommodation

Non-residents visiting Canada are entitled to a rebate for the GST paid on most goods and short-term accommodation. Specifically, the rebate covers:

- goods for use primarily outside Canada, excluding exciseable goods such as alcoholic beverages and tobacco products, provided the goods are exported within 60 days of purchase;
- the tax paid on short-term lodging, but not including meals, where the period of stay is less than one month;
- the total tax paid must be at least $20.

However, goods for use outside Canada are essentially the same as other exported goods and should be considered as part of the benchmark. Thus, the cost of to this provision is only the rebate associated with short-term accommodation.

The estimate is based on data from Revenue Canada.

Special credit for certified institutions

A special credit is provided in the period from January 1, 1991 to the end of 1995 to certified institutions which employ mentally or physically disabled individuals in the manufacturing of goods. These institutions are treated in the same manner as other businesses under the GST. However, they receive a special credit calculated on the basis of 100 per cent of the GST collected from sales on manufactured goods in 1991, 75 per cent in 1992, 50 per cent in 1993 and 25 per cent in both 1994 and 1995.

No data are available.

The GST credit

As part of the introduction of the GST, a GST Credit was established to ensure that families with annual incomes below $30,000 would be better off under the new sales tax regime. The amount of the GST Credit depends upon family size and income. In 1992 and 1993, the basic adult credit was $199. Families with children 18 years and younger received a basic child credit of $105 for each child. However, single parents could claim a full adult credit of $199 for one dependent child. In addition to their basic credit, single adults (including single parents) were eligible for an additional credit of up to $105. The value of the credit was reduced for families with incomes of over $25,921. Both the credit amounts and the income threshold are adjusted annually to increases in the consumer price index in excess of 3 per cent.

The estimate is based on data from Revenue Canada.

Memorandum Items

Meals and entertainment expenses

In the normal operation of the GST, registrants are allowed to claim full input tax credits for the tax paid on their purchases. However, in the case of the tax paid on meals, beverages and entertainment expenses, the registrant is allowed to recover only 80 per cent of the GST paid as an input tax credit. There is no input tax credit allowed for the GST paid on membership fees or dues in any club whose main purpose is to provide dining, recreational or sporting facilities.

(The 1994 budget proposed that the input tax credit for business meals and expenses be reduced from 80 per cent to 50 per cent for purchases made after February 1994.)

The estimate is based on the cost of the meals and entertainment tax expenditures contained in the Personal and Corporate Income Tax Expenditure tables. These figures are first grossed up to arrive at the total meals and entertainment expenses in the entire economy using the marginal federal income tax rates by sectors. Then, 15 per cent is removed to account for expenses incurred in GST-exempt activities since they are ineligible for any input tax credits. The cost of this provision is equal to the above net expenses multiplied by 7 per cent.

Rebate to employees and partners

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, the employee is allowed to claim a rebate equal to 7/107ths of the capital cost allowance on an automobile, aircraft or musical instrument that is used in his or her employment and on which GST is payable. Also, the GST rebate is 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.

The estimate is based on data from Revenue Canada.

Sales of personal-use real property

The sale of personal-use real property by an individual or a trust (all the beneficiaries of which are individuals) is exempt under the GST. Examples include the sale of used owner-occupied homes and country properties kept for personal use. However, the exemption does not include real property that is sold in the course of a business.

No data are available.

APPENDIX D RECENT CHANGES TO PERSONAL INCOME TAX EXPENDITURES

Transitional measures phased out in 1994

- For the 1989 to 1994 taxation years, married taxpayers were able to transfer up to $6,000 annually of their periodic pension payments from registered pension plans or deferred profit sharing plans to their spouse's RRSP.
- Residents of communities no longer eligible for the Northern Residents Deductions following the reform of northern benefits were eligible for transitional benefits until 1994.

Measures announced in 1994 budget

- Eliminate the $100,000 Lifetime Capital Gains Exemption.
- Eliminate exemption for the first $25,000 of coverage under employer-paid life insurance.
- Phase out the age credit for high income seniors.
- Reduce from $250 to $200 the threshold for the higher tax credit on charitable donations.
- Continue homebuyers' plan for first-time homebuyers only.

Measures announced in 1995 budget

- Exempt donations of ecologically sensitive land from the 20-per-cent limit.
- Reduce the contribution limits for Registered Retirement Savings Plans (RRSPs) and money-purchase Registered Pension Plans (RPPs) to $13,500. Reduce the allowable RRSP over-contribution from $8,000 to $2,000, and eliminate the tax-free rollover of retirement allowances to RRSPs for service after 1995.
- Require non-resident recipients of Old Age Security (OAS) benefits to report their world income for purposes of the OAS high-income clawback.
- Reinstate the 21-year rule for accrued capital gains on property held by trusts.
- Eliminate the preferred beneficiary election for most beneficiaries.

Measures included in the 1995 Technical Bill

- Eliminate double claims of personal credits in year of personal bankruptcy.
- Expand taxation of non-residents' gains on Canadian capital property.

Measures announced in 1996 budget

- Cease the inclusion of child support payments in the recipient's income, and disallow the deduction of these amounts by the payer, effective May 1, 1997.
- Increase to $750 the maximum Working Income Supplement (WIS), beginning on July 1, 1997. The maximum WIS benefit will increase again, reaching $1,000 on July 1, 1998.
- Increase from 14 to 16 the age limit for eligible children with respect to the child care expense deduction. Allow single parents attending school full-time to claim the child care expense deduction against all types of income, and recognize full-time attendance at secondary school for the purpose of this deduction.
- Increase the education amount available to full-time students from $80 to $100 per month.
- Increase from $4,000 to $5,000 the limit on the transfer of tuition fees and the education amount to a supporting spouse, parent or grandparent.
- Increase the annual and lifetime limits on contributions to Registered Education Savings Plans (RESPs), beginning in 1996.
- Increase the credit for infirm dependants, as well as the income threshold at which phase out of the credit begins.
- Reduce the tax credit in respect of Labour-Sponsored Venture Capital Corporations (LSVCCs), as well as the maximum purchase eligible for the credit. Increase the minimum-holding period with respect to the credit. Deny eligibility for the credit for three years following the redemption of an LSVCC share.
- Allow unlimited carry-forward of unused RRSP room.
- Freeze annual contribution limits for RRSPs and money-purchase RPPs until 2003, and freeze annual benefit limits for defined benefit pension plans until 2005.
- Reduce to 69 the age limit for contribution to RRSPs, RPPs and Deferred Profit Sharing Plans (DPSPs).
- Eliminate the administrative fee deduction for Registered Retirement Income Funds (RRIFs) and RRSPs.
- Limit the withholding tax relief available to non-resident recipients of Canadian pension income.
- Increase the annual limits on charitable donations.
- Propose to replace OAS and GIS with a new Seniors Benefit commencing in 2001.

RECENT CHANGES TO CORPORATE INCOME TAX EXPENDITURES

Measures announced or effective in 1993

- Lower the tax rate for manufacturing and processing – one percentage point reduction in the tax rate from 23 per cent to 22 per cent.
- Extend enhanced rate of SR&ED tax credit to small businesses with taxable income between $200,000 and $400,000.
- Eliminate annual limit on claiming investment tax credits.
- Separate class election for certain computer equipment, software, and office equipment.
- Patents may be placed in a new CCA class and be eligible for a 25-per-cent write-off rate.
- Exempt arm's length payments in respect of rights to use patented information concerning scientific experience from the non-resident withholding tax.
- Affirm commitment to exempt computer software from non-resident withholding tax.

Measures announced or effective in 1994

- Introduce a temporary 40-per-cent surcharge on tobacco manufacturing profits.
- Lower tax rate for manufacturing and processing – one percentage point reduction in the tax rate from 22 per cent to 21 per cent.
- Reduce from 80 per cent to 50 per cent the deduction for business meals and entertainment expenses to account for the personal consumption element of the expenses.
- Phase out access to the small business deduction for those larger private corporations having taxable capital between $10 and $15 million.
- Phase out access to refundable scientific research and experimental development (SR&ED) tax credits for those larger private corporations having taxable capital between $10 and $15 million.
- Require financial institutions and investment dealers to recognize accrued gains and losses on certain securities annually on a mark to market basis.
- Eliminate the 30-per-cent Special Investment Tax Credit and the 30-per-cent Atlantic SR&ED credit.
- Reduce the Atlantic Canada Investment Tax Credit from 15 per cent to 10 per cent.

- Eliminate the accelerated depreciation for air and water pollution abatement equipment effective 1999.
- Reduce the accelerated depreciation rate for energy conservation equipment from 50 per cent straight-line to 30 per cent declining balance.
- Tighten the rules applicable to foreign affiliates.
- Tighten the rules applicable on forgiveness of debt.
- Eliminate the use of "purchase butterflies" as a method to avoid tax on dispositions of appreciated corporate property.
- Increase the refundable tax on dividends received by private corporations (Part IV tax).
- Eliminate the special preference for sole-purpose SR&ED performers.
- Constrain certain tax shelter schemes that had been developed utilizing convertible debt and negative adjusted cost bases.
- Limit SR&ED tax credits to expenditures identified within 180 days following the year in which the expenditures are incurred.
- Require property and casualty insurers to fully discount unpaid claims.

Measures announced or effective in 1995

- Replace film tax shelter mechanism with an investment tax credit.
- Eliminate the deferral of business income using off-calendar fiscal periods.
- Tighten the rules relating to non-arm's length contract SR&ED, non-arm's length provision of goods and services for SR&ED and certain third-party payments.
- Subject to the findings of the review of information technology SR&ED, place an immediate "moratorium" on the claims for information technology SR&ED undertaken by financial institutions.
- Increase the large corporations tax rate from 0.2 per cent to 0.225 per cent and the corporate surtax rate from 3 per cent to 4 per cent.
- Introduce an additional tax on investment income of private corporations.
- Introduce a temporary 12-per-cent capital tax surtax on large deposit-taking institutions.

Measures announced or effective in 1996

- Tighten the resource allowance rules to provide a more consistent and stable resource allowance calculation and eliminate uncertainties related to court decisions.

- Tighten flow-through shares (FTS) to better focus the incentive – ensure that FTS are used to finance the more risky expenditures, such as exploration and development costs and not property-related costs.
- Reduce the threshold levels and introduced a new restriction on reclassifications of expenses by oil and gas companies using FTS to better target this incentive to junior companies in start-up situations.
- Exclude off-the-shelf seismic costs as eligible costs for FTS.
- Modify rules for accelerated CCA for mining activities – companies can earn accelerated CCA when they undertake large capital expenditures (i.e. above 5 per cent of gross revenues). In addition, oil sands projects using in situ extraction processes will also be eligible for accelerated allowances.
- Enhance incentives to invest in renewable energy – relaxing the specified energy property rules and expanding eligibility for flow-through shares.
- Extend the capital tax surcharge on large deposit-taking institutions by one year.
- Announce pending changes to the taxation of life insurance companies and a three-year extension of additional capital tax in life insurance, to take effect in 1996.
- Limit amount of wages and salaries eligible for SR&ED tax credits for specified employees.
- Terminate transitional provision for certain building rental payments in respect of SR&ED.
- Removed moratorium on claims for information technology SR&ED undertaken by financial institutions.

Recent Changes to GST Expenditures

The government has introduced over 100 measures to streamline and simplify the operation of Canada's sales tax. Many of the proposed legislative changes were developed in response to concerns raised by businesses, charities, non-profit organizations and other organizations during consultations over the last two years. The measures can be categorized as follows:

- measures to simplify the operation of the tax for many businesses, charities and non-profit organizations;
- measures to improve the fairness of the Goods and Services Tax for businesses and consumers; and
- clarifications and measures to ease compliance.