

Federal Compensation for Provincial Retail Sales Tax Reductions

The federal government has offered to compensate provinces to effect a temporary reduction in their general retail sales tax rates.

This offer to finance the provincial reductions takes the form of full compensation for a reduction of three percentage points for six months in the Atlantic Provinces. In all other provinces except Alberta where no retail sales tax is imposed, the federal government will compensate for the revenue forgone arising out of a two-point reduction for a period of six months, provided that these provinces agree to effect a further cut of one point. However, these provinces will have the option of reducing their sales taxes by three points for six months or by two points for nine months. In either event, the federal government will compensate these provinces to the extent of a two-point reduction for six months.

The federal share of the provincial sales tax reductions will be provided to the provinces in the form of a transfer of personal income tax room and, where necessary, by an additional cash payment. This transfer will be made through a temporary abatement of federal personal income tax which will reduce every taxpayer's federal tax liability by \$100 or net federal tax otherwise payable, whichever is less. Provinces accepting the offer will increase their income tax on each individual by exactly the amount of the federal abatement. In this way there will be no change in a taxpayer's total tax liability. Taxpayers will not be burdened by any extra calculation when they file their returns since the necessary adjustments will be made by Revenue Canada. In provinces where the amount of the federal reduction of income taxes is not sufficient to fully compensate the province for the agreed level of sales tax revenue forgone, the federal government will make a supplementary cash payment. Similarly, where the federal transfer results in over-compensation, a recovery will be made from the province.

The federal abatement and provincial income tax increase will not apply to residents of the Yukon and Northwest Territories since, like Alberta, these jurisdictions do not levy a retail sales tax.

The accompanying table shows the forecast values of the provinces' retail sales tax reduction and associated federal-provincial financing arrangements.