

No. 62/3 Canadian Federal-Provincial Fiscal Arrangements

(Prepared in the Federal-Provincial Relations  
Division, Department of Finance)

The elements of federal-provincial fiscal arrangements in Canada are logically broken into the following components: tax rental, or tax collection agreements; equalization payments to the provinces by the federal government; and other subsidies to the provinces.

The tax rental agreements have been the main feature of federal-provincial fiscal arrangements since 1941. Under the Canadian constitution the federal government does not have exclusive jurisdiction in the fields of direct taxation. The provinces also have independent tax powers in these fields. Thus Canada has eleven taxing jurisdictions, one federal and ten provincial, in the fields of corporation income, personal income, estate, and other direct taxes. This situation, except that Newfoundland was not yet a Canadian province, faced the federal government in 1941 when it was trying to mobilize Canada's resources for World War II. It was then imperative that taxing powers in the major tax fields of personal and corporation income rest in one authority for the efficient planning of Canada's financial policies for the duration of the War. In order to induce the provincial governments themselves not to use, or permit their municipalities to use, personal and corporation income taxes, the federal government offered attractive payments in compensation, which the provinces accepted. The agreement made in 1941 lasted to 1947. But, after the war, the experience of the advantages of having one tax collecting agency encouraged the continuation of these agreements with modifications.

Actually the term tax rental agreement is a misnomer when applied to agreements preceding the 1957/62 agreement because the compensation paid did not reflect the value of the tax fields relinquished by the provinces but was an arbitrary formula unrelated to the tax revenue collected by the federal government in each province. This was changed in the 1957 agreement, which is the one in effect up to March 31, 1962. This agreement provides for payments to each province, which payments are a certain percentage of the agreed taxes collected from that province - that is, 13% of the yield of the personal income tax, 9% of corporation taxable income (i.e. 9% of the 18% rate of tax on taxable corporate income up to \$35,000 and 9% of the 47% rate of taxable corporate income in excess of \$35,000), and 50% of the yield of federal estate taxes.

The allocation of taxes collected is simplified by regulation. For personal income tax collections, the province in which the taxpayer is resident on the last day of the year is deemed to be the province of residence for the whole year. For corporation income tax, the allocation cannot be so simple and still be equitable, because many companies operate in more than one province. The regulation for the allocation of corporate income provides that the taxable income of corporations having permanent establishments