6. Taxation

Taxes are collected in Canada by the federal, provincial and municipal governments. The federal government derives most of its revenue from income taxes, indirect sales and excise taxes imposed upon manufacturers and importers, and customs duties. The provinces also levy income taxes (which are integrated with the federal tax), direct sales taxes at the retail level, and various taxes or royalties on natural resources. Municipalities are generally limited to property taxes for community services and school boards may, in some cases, levy tax on property for schooling purposes. All three levels of government collect fees or grant licenses for specific privileges or activities, but these are generally insignificant.

While the federal and provincial sales tax systems function in quite separate and distinct manners, most of the provinces have entered into tax collection agreements with the federal government for the collection and administration of income taxes. These provinces still retain the right to establish tax rates and thus the overall rates of income tax can, and do, vary from province to province. The Province of Quebec has not concluded a tax collection agreement with the federal government and thus administers and collects its own income tax, both corporate and personal. The Provinces of Alberta and Ontario administer and collect their own corporate income tax.

Income Tax Structure

Federal income tax is levied under the Income Tax Act on the taxable income of individuals and corporations resident in Canada for any part of a taxation year and on certain Canadian source income of non-residents. The Canadian income tax system is not based on the concept of citizenship or domicile.

To establish a taxpayer's tax liability for a year, it is necessary to determine the taxpayer's net income from all sources. Taxable income is net income for the year minus certain specified deductions. In the case of corporations, these deductions include charitable donations, certain types of dividends and loss carryovers.

All residents whether corporations or individuals are subject to Canadian income tax on their world income, subject to tax credits for foreign taxes imposed on non-Canadian income. These credits are allowed unilaterally and do not depend on the existence of tax treaties. However, in the case of corporate taxpayers, dividends from their foreign affiliates may in some cases be excluded from the corporation's taxable income if the dividend is paid out of earnings in a country with which Canada has a tax treaty.

Non-residents are generally only subject to Canadian income taxes on income derived in Canada and on capital gains realized on the disposition of taxable Canadian property.

Canada has a tax system in which income from all sources is aggregated and subject to flat rates in the case of corporations, or progressive rates, in the case of individuals.

A corporation's tax year is normally the fiscal period which it has adopted for accounting purposes. This period may not exceed 53 weeks. The tax year for individuals is the calendar year.

Corporate Taxation

Corporations are generally subject to tax at a rate of 46 per cent by the federal government, but this is reduced by a 10 per cent abatement in respect of income earned in the provinces, the Northwest Territories and the Yukon. Thus, foreign-source income not allocable to a province is the only element of income actually subject to the 46 per cent federal rate. The provinces, the Northwest Territories, and the Yukon levy their own corporate tax at rates ranging from 8 to 16 per cent for the 1983 taxation year. Thus, the overall rate of corporate tax on income earned in Canada ranges from 44 to 52 per cent depending upon the province in which the income is earned. Reductions in the general rate of tax are prescribed for certain small businesses controlled by Canadians and those that carry on manufacturing or processing activities.

A corporation that is resident in Canada is taxable on all income earned throughout the world in each taxation year. A non-resident corporation is only taxable on income earned from carrying on business in Canada or on capital gains from the disposition of certain types of Canadian property.

The starting point in the determination of taxable income is that reflected in the corporation's financial statements for the year, prepared in accordance with Canadian accounting principles. Special rules in the Income Tax Act are then used to determine the actual taxable income.

Dividend and Investment Income

Generally, Canadian corporations do not pay tax on dividends received from other taxable Canadian corporations. However, private corporations and other corporations that are controlled by or for the benefit of an individual or a group of related individuals may be liable for a special refundable tax of 25 per cent on such dividends. This tax is refundable on the payment of sufficient taxable dividends to shareholders. This tax is not