SENATE OF CANADA

Second Session, Thirty-third Parliament, 1986-87

TAX REFORM IN CANADA

Twentieth Report
(Interim)

Standing Senate Committee on Banking, Trade and Commerce

DECEMBER 1987

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Second Session
Thirty-third Parliament 1986-87

Deuxième session de la
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SENATE OF CANADA

SÉNAT DU CANADA

Proceedings of the Standing Senate Committee on

Délibérations du comité sénatorial permanent des

Banking, Trade and Commerce

Banques et du commerce

Chairman
The Honourable IAN SINCLAIR

Président
L'honorable IAN SINCLAIR

Tuesday, December 1, 1987

Le mardi 1er décembre 1987

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Twelfth proceedings on:

Tax reform in Canada

Douzième fascicule concernant:

Réforme fiscale au Canada

TWENTIETH REPORT OF THE COMMITTEE

VINGTIÈME RAPPORT DU COMITÉ

MEMBERSHIP OF THE COMMITTEE

The Honourable Ian Sinclair, *Chairman*
The Honourable Finlay MacDonald (*Halifax*), *Deputy Chairman*

and

The Honourable Senators:

Anderson	Kirby
Buckwold	* MacEachen, P.C. (or Frith)
Cogger	* Murray, P.C. (or Doody)
Cottreau	Perrault, P.C.
Flynn, P.C.	Riel, P.C.
Kelly	Roblin, P.C.

* *ex officio* Members

Note: The Honourable Senators Asselin, P.C., Barrow, Bosa, Doyle, Godfrey, Haidasz, P.C., Marshall, Olson, P.C., Stewart *(Antigonish-Guysborough)* and Turner also served on the Committee at various stages.

Research Staff:

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Professor Thomas J. Courchene.

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Mr. Charles M. Rotenberg.

From the Research Branch, Library of Parliament:
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Mr. Anthony Chapman, Research Officer, Economics Division;
Mr. Marion Wrobel, Research Officer, Economics Division.

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Timothy Ross Wilson

Clerk of the Committee

ORDERS OF REFERENCE

Extract from the *Minutes of the Proceedings of the Senate*, Tuesday, 26th May 1987:

"The Honourable Senator Sinclair moved, seconded by the Honourable van Roggen:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to study and report upon tax reform in Canada, or any matter relating thereto; and

That the Committee submit its report no later than 29th February 1988.

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the *Minutes of the Proceedings of the Senate*, Tuesday, 23rd June 1987:

"With leave of the Senate,
The Honourable Senator Sinclair moved, seconded by the Honourable Senator Stewart *(Antigonish-Guysborough)*:

That the Standing Senate Committee on Banking, Trade and Commerce which was authorized by the Senate on 26th May 1987, to study and report upon tax reform in Canada, or any matter relating thereto, be further authorized to examine and consider the documents tabled in the Senate on 22nd June 1987, relating to tax reform 1987 (Sessional Paper No. 332-402).

The question being put on the motion, it was—
Resolved in the affirmative."

Charles A. Lussier

Clerk of the Senate

REPORT OF THE COMMITTEE

The Standing Senate Committee on Banking, Trade and Commerce has the honour to present its

TWENTIETH REPORT

In obedience to the Orders of Reference of Tuesday, 26th May 1987 and Tuesday, 23rd June 1987, your Committee has proceeded to study tax reform in Canada, or any matter relating thereto, and now presents an interim report.

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Recommendations

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1. We recommend that the family allowance not be taxable and that the proposed $65 tax credit for those who support children eligible for the family allowance be rejected.

2. We recommend a $130 tax credit for financially dependent children between the ages of 18 and 21 and, in addition, for those in full-time attendance at a post-secondary institution.

3. We recommend that a supported spouse be allowed to earn $1,000 a year before any erosion of the marital tax credit apply. We further recommend that a child under 18 be allowed to earn $2,500 before any "tax-back" apply to a supporting parent.

4. We recommend that once the quantum of transferable credits has been identified in the normal way, the supported spouse have the option of transferring the credits to the supporting spouse or claiming a refund of the transferable amount.

5. We recommend that a general averaging provision similar to that in place from 1972 to 1981 be re-instated. We also recommend the retention of block averaging for farmers and fishermen.

6. The Committee recommends that the stage one legislation limit the inclusion rate of capital gains at $66\frac{2}{3}$ percent.

7. We recommend that a tax credit for Canadian source investment income be instituted at the rate of 17 percent of such income to an annual maximum of $170, transferable between spouses.

8. We recommend that the Government not proceed with the proposed preferred share tax and that it develop a more effective alternative to prevent dividends from receiving preferential treatment when they are paid by low-tax or non-taxed corporations.

9. We recommend that the status quo be maintained for private investment in Canadian film and television production.

10. We recommend that the current rules relating to MURBs be retained for those who owned or were legally committed to a MURB purchase on June 18, 1987. We also recommend that the first subsequent purchaser of a MURB from an individual be treated as though the property were acquired on or before June 18, 1987.

11. We recommend that the cost base of flow-through shares be reduced only by the fair market value of the shares at the time they are acquired.

12. The Committee recommends that the R&D investment tax credit not be limited to 50 percent of taxes payable.

13. The Committee recommends that the Government not proceed with the proposal to require developers to capitalize vacant-land carrying costs.

14. The Committee recommends that construction period soft costs be required to be capitalized but that the amounts be completely capitalized to the building.

15. We recommend that the tax rules relating to farmers remain as they are at present, and in particular recommend that farmers be allowed to use cash accounting and retain block averaging.

16. We recommend that some different approach be taken to ensure that those who own farms or have passive farm investments but do not qualify as full-time farmers be subject to a more restrictive tax regime than are full-time farmers and that more satisfactory tests be devised to determine into which category any particular individual falls.

17. We recommend that the rules proposed in the White Paper to limit capital cost allowance claims to one-fifth the norm where businesses' driving ranges from 20 percent to 90 percent be rejected, and that the claim be based on the ratio of business driving to total driving.

18. We recommend that the $20,000 limit for deducting capital cost allowance on automobiles be accepted but that to this amount be added provincial sales taxes plus transportation costs. We also

recommend that the $20,000 figure be in place for 1988 and 1989 and that an appropriately adjusted figure, taking into account rising prices, be enacted for 1990, with a similar adjustment being made no later than every second year thereafter.

19. We recommend that meals consumed by a business person while away from home on business travel or while in attendance at a convention or seminar (whether or not at home) remain fully deductible.

20. We recommend that deductions for loan losses be permitted only when it is determined that the loans are partially or totally uncollectible.

21. We recommend that financial institutions be permitted to accumulate tax deductible reserves up to one percent of the first $100 million of eligible assets.

22. We recommend that existing reserves that would not be allowed under the new system be brought into income in equal amounts over a seven-year period.

23. We recommend that the Government not proceed with the 15 percent insurance investment income tax.

24. We recommend that as soon as practicable the Government introduce legislation to implement a broad-based multi-stage sales tax to replace the existing federal sales tax system.

25. We recommend that the proposal with respect to the application of the federal sales tax to related marketing companies not proceed.

26. We recommend that the Government proceed with legislation to impose a tax on telecommunication services but that such legislation specify that the ten percent tax be withdrawn upon implementation of a multi-stage sales tax levied on a broad range of goods and services including telecommunication services.

27. We recommend that the general anti-avoidance provision proposed in the White Paper not be proceeded with. We further recommend that if a new measure is prepared, it not be enacted retroactively. We further recommend that any future draft of such legislation be made public to

allow discussion and that it not become effective until Royal Assent is given to the enabling legislation.

28. **We recommend that the proposal to impose a penalty tax equal to 50 percent on interest due for failure to remit tax instalments on time not be implemented and that the current rules continue to apply in such circumstances.**

29. **We recommend that the Department of Finance begin consultations with interested groups to determine which parts of the *Income Tax Act* would lend themselves to structural simplification and to proceed with dispatch to amend the Act, using the same guidelines as were used in simplifying the small business rules.**

Chapter I

The Shape of Tax Reform

1.1 On June 18, 1987, the Honourable Michael H. Wilson, Minister of Finance, presented to Parliament the Government's tax reform proposals. The Committee welcomes the opportunity to comment on these proposals. We also express thanks to the many witnesses who made personal or written submissions (see appendices). In what follows, the terms "White Paper", "tax reform proposals" and "tax reform" will be used interchangeably to refer to the ensemble of documents tabled on June 18, 1987.

The First Stage

1.2 Reform is to take place in two stages. The first stage, which is intended to come into effect January 1, 1988, but will be reflected in take-home pay only on July 1, 1988, focuses largely on base-broadening and lowering marginal rates for personal and corporate income taxation. In terms of the personal income tax, the previous ten tax brackets have been reduced to three: 17 percent for the first $27,500 of taxable income; 26 percent on taxable income between $27,500 and $55,000; and 29 percent for taxable income above $55,000. These are federal rates. For the nine provinces which are signatories to the Tax Collection Agreements for personal taxation (all except Quebec, which has its own, separate, personal income tax system), the combined federal-provincial rates will range from 24.9 percent, 38.1 percent and 42.5 percent for Albertans (with a 46.5 percent rate on federal basic tax) to 27.2 percent, 41.6 percent and 46.4 percent for Newfoundlanders (with a 60 percent rate on federal basic tax).

1.3 Table 1 contains these combined federal-provincial marginal rates. They exclude the three percent surcharge on federal rates which will remain in place for the first stage of the reform. The base-broadening measures include the removal of some existing deductions and tax shelters and the placing of limits on other deductions such as those relating to automobile expenses, meals and entertainment expenses, and home office expenses. Relatedly, several measures will have an

important impact on the tax treatment of investment income: the $500,000 lifetime capital gains exemption will be capped at $100,000; the proportion of capital gains (above the $100,000 threshold) to be brought into income will increase from the present 50 percent to 66⅔ percent for 1988 and 1989 and then to 75 percent thereafter; the dividend tax credit, already reduced for the 1987 tax year from 50 percent to 33⅓ percent, will be further reduced to 25 percent; and the $1,000 interest and dividend deduction will be eliminated. Accompanying this base-broadening and lowering of marginal rates is the conversion of most of the existing tax exemptions into tax credits, generally but not uniformly at the 17 percent rate.

Table 1
Combined Federal/Provincial Tax Rates Post-Reform

	Provincial Tax Rates as a proportion of federal basic tax	Combined Federal-Provincial Marginal Rates		
		Low	Middle	High
		⇐(Percentage)⇒		
Newfoundland	60.0	27.2	41.6	46.4
Prince Edward Island	55.0	26.4	40.3	45.0
Nova Scotia	56.5	26.4	40.7	45.4
New Brunswick	58.0	26.9	41.1	45.9
Quebec	–	–	–	–
Ontario	50.0	25.5	39.0	43.5
Manitoba	54.0	26.2	40.0	44.7
Saskatchewan	50.0	25.5	39.0	43.5
Alberta	46.5	24.9	38.1	42.5
British Columbia	51.4	25.8	39.4	43.9

Note: These rates do not include the three percent federal surtax on federal rates.

1.4 Base-broadening and lowering rates also characterize the changes in corporation income tax in the first stage. The current 36 percent federal statutory rate for general business will be reduced to 28 percent while the statutory rate in manufacturing business will be reduced in stages from the existing 30 percent to 23 percent in 1991. Small business rates, now set at 15 percent for general business and 10 percent for manufacturing, will henceforth be 12 percent. These proposed changes are summarized in Table 2.

Table 2
Federal Corporate Income Tax Rates

	Current rates	New rates effective July 1 each year			
		1988	1989	1990	1991 and subsequent years
		⇐(per cent)⇒			
General business	36	28	28	28	28
Manufacturing business	30	26	25	24	23
General small business	15	12	12	12	12
Small manufacturing business	10				

Note: These changes will not affect the tax rate reductions scheduled to take effect on July 1, 1987. All the rates are after the 10-per-cent provincial abatement.

Source: *Income Tax Reform*, Chapter 5, p. 98.

1.5 Emphasis on the corporate side is placed on narrowing the existing variations in effective tax rates across industries. In this context, among the most significant proposals are revenue-raising measures directed at the finance, insurance and real-estate industries. Other key provisions include:

- replacing the current immediate write-off of the cost of new debt securities with a deduction spread over the life of the debt or five years, whichever is greater;

- introducing a tax on dividends paid on new preferred share issues, designed to make it more difficult for non-tax paying corporations to "borrow" funds through preferred shares;
- phasing out of depletion allowances and introducing tighter rules on the deduction of write-offs from limited resource partnerships;
- proposed cutbacks in the capital cost allowance system for buildings, contractors' equipment, and most machinery. The key allowance on manufacturing and processing equipment would be reduced from the present three-year straight-line write-off to a declining balance rate of 25 percent;
- after 1989, depreciation would be allowed only when an asset is "put-in-use", a change that will slow down write-offs and increase investment costs on major new projects.

In addition, the above-mentioned disallowance of 20 percent of meals and entertainment expenses, the reduction in the dividend gross-up, and the increased inclusion rate for capital gains in excess of the $100,000 threshold will also affect the corporate sector.

1.6 Despite its acknowledged flaws, the manufacturers' sales tax (MST) will remain in place throughout the first stage. Moreover, the tax will be extended to apply to sales by marketing companies related to the manufacturer and, for a limited range of products, it will be shifted from the manufacturers' level to the wholesale level. Some MST increases will be introduced as well: paint and wallpaper will be taxed at 12 percent rather than 8 percent, and, most significantly, a new telecommunication services tax will be applied at a 10 percent rate. Increases in refundable sales tax credits (from $50 to $70 per adult and $25 to $35 per child) will ensure that low-income households are protected somewhat from the MST increases which will amount to $1 billion in revenues for 1988-89.

1.7 Finally, there are a number of significant compliance and administration procedures as part of the first stage. There will be an acceleration of source deductions and quarterly instalments of personal income tax, and an accumulation of sales and excise tax payments which will generate once-and-for-all revenue increases of $1.1 billion and $1.6 billion respectively. The White Paper proposals

also include a general "anti-avoidance" rule designed to prevent artificial tax avoidance.

1.8 The first stage is designed to be revenue neutral. Table 3 presents the relevant White Paper revenue and cost projections. Over the period 1988-1992, personal income tax payments will fall (from what they would otherwise have been) by just over $10 billion, while corporate tax collections will increase by $3.8 billion. Increased expenditures related to equalization and the established programs will "decrease" revenues by a further $1.5 billion. This will be offset by $4.8 billion of revenues from the new sales tax measures and $2.7 billion from the tax-liability-management procedures. Overall, the first stage is essentially neutral – an increase in net revenue over the 1988-1992 period of $0.5 billion.

The Second Stage

1.9 The centre-piece of the second stage of tax reform will be to replace the MST with a multi-stage sales tax. The White Paper proposes three alternatives to the MST, all of which would mean substituting a broadly based sales tax for the current tax on manufacturers. The base of the tax would be extended to include retail sales of services as well as goods. In addition, the federal government is canvassing the provinces to see if the retail sales taxes they now collect can be integrated into a new national sales tax.

1.10 The arguments in favour of replacing the MST with some version of a multi-stage or value-added tax are very persuasive. As the White Paper emphasizes, the base of the MST is not only narrow but, for those sectors included, the applicable rates vary considerably. Most importantly, in terms of Canada's foreign trade, the MST is a highly distortionary tax. Our exports bear the tax, to the tune of an estimated $2 billion of the roughly $15 billion collected, while imports to Canada frequently escape the tax. All of the three alternatives for the MST embody export rebates and ensure that imports will not be tax-preferred relative to domestic production.

Tableau 3

Incidences financières de la première étape de la réforme fiscale

A. Effet direct total sur les recettes et les dépenses des mesures touchant l'impôt des particuliers et des sociétés	1988-89	1989-90	1990-91	1991-92	Total
	⇐(millions de dollars)⇒				
Effet sur les recettes					
Impôt direct des particuliers					
Conversion des exemptions en crédits et réductions des taux marginaux d'imposition	-2 185	-5 910	-4 600	-4 905	-17 600
Élargissement de l'assiette et autres mesures	480	2 070	2 255	2 495	7 300
Réduction nette de l'impôt des particuliers	-1 705	-3 840	-2 345	-2 410	-10 300
Impôt direct des sociétés					
Réduction des taux d'imposition	-635	-1 545	-1 645	-1 665	-5 490
Mesures élargissant l'assiette	1 165	2 170	2 810	3 190	9 335
Augmentation nette de l'impôt des sociétés	530	625	1 165	1 525	3 845
Réduction nette totale des recettes	-1 175	-3 215	-1 180	-885	-6 455
Effet sur les dépenses					
Hausse des paiements de Financement des programmes établis et de péréquation	340	360	385	395	1 480
B. Mesures connexes touchant les recettes					
Changement de la taxe fédérale de vente et du crédit remboursable au titre de cette dernière					
Déplacement de la taxe fédérale de vente au niveau du gros pour certains articles et changement du régime des sociétés de commercialisation	295	310	315	330	1 250
Taxe de 10 p. 100 sur les services spécifiés de câblodiffusion et de télécommunications	870	945	1 000	1 055	3 870
Taxation de la peinture et du papier peint au taux général	60	60	65	65	250
Hausse du crédit remboursable de 20 $ par adulte et de 10 $ par enfant	-120	-150	-155	-160	-585
Hausse nette du produit de la TVF	1 105	1 165	1 225	1 290	4 785
Gestion des rentrées fiscales					
Accélération des retenues à la source et acomptes provisionnels d'impôt des particuliers		1 100			1 100
Accélération des remises de taxes de vente et d'accise	1 600				1 600
Hausse totale des recettes résultant de la gestion des rentrées fiscales	1 600	1 100			2 700
Augmentation nette totale des recettes	+2 705	+2 265	+1 225	+1 290	+7 485
Effet de la première étape de la réforme fiscale sur le déficit	-1 190	1 310	340	-10	+450

Source: *Réforme fiscale 1987, Perspectives économiques et financières*, p. 34 (modification: ajout de la dernière colonne).

1.11 The broadest possible multi-stage or value-added tax, exempting only non-commercial items such as medical insurance payments, would generate roughly $3 billion of revenues for each point of the tax. For illustrative purposes, Finance uses an eight percent rate which would generate revenues of roughly $24 billion. With these revenues, the second stage proposes to accomplish four objectives:

- to replace the revenues now obtained from the MST;
- to remove the existing three percent personal and corporate tax surcharges;
- to provide significantly enriched refundable tax credits that would ensure a greater degree of tax fairness for low-income Canadians; and
- to fund further income tax reductions for middle-income Canadians.

Thus, Stage Two represents a considerable shift away from taxing income and toward taxing consumption. For example, the existing surtaxes on federal personal and corporate taxation amount to just under $2 billion of revenue. However, there is no specific timetable set out for the inauguration of the second phase.

1.12 While this brief summary has touched upon only selected highlights of the reform proposals, it is sufficient to provide the needed background information for the analysis that follows.

The broadest possible multi-stage or value-added tax, [illegible] only [illegible] items such as medical insurance premiums, [illegible] [illegible] revenues for each point of the tax. For [illegible] [illegible] current rate which would generate revenues of roughly $24 billion. With [illegible] the second stage proposes to accomplish four [illegible]

- [illegible] revenues now obtained from the [illegible]
- to remove the existing three percent [illegible] surcharges.
- to provide significant, [illegible] refundable tax credits that would [illegible] greater degree of tax fairness for low-income Canadians. [illegible]
- to [illegible] further income tax reductions for middle income Canadians.

A [illegible] considerable shift away from taxing income and [illegible] consumption. For example, the existing surtaxes [illegible] personal [illegible] amount to not less than $2 billion [illegible] for the inauguration of the second phase.

[illegible] this brief summary has touched upon [illegible] it is sufficient to provide [illegible]

Chapter II

Tax Reform: An Overview

Introduction

2.1 With the brief description of tax reform as backdrop, the Committee now begins its analysis and evaluation of the White Paper. The purpose of this present chapter is to focus, first, on the underlying thrust of the reform and, second, on some of the major strengths and weaknesses of the reform. To anticipate the conclusion somewhat, the Committee's view is that, taken as an integral package (i.e. the combination of the first and second stage), the broad tax reform thrusts merit high marks, although there are a few general areas and many specific issues where the Committee believes that significant improvements can and should be made (Chapter VI will deal with these areas in more detail). However, if the second stage does not materialize soon, then the Committee's assessment is considerably less sanguine. While we shall spell out our concerns in this case, the preferred way for the Government to deal with them is to commit itself quickly to the second stage of the reform.

The Underlying Reform Thrusts

2.2 The White Paper selected "Lower rates, fairer system" as an appropriate capsule summary of the thrusts of the reform. However, in order to address the various reforms, the Committee prefers to focus on: a) equity, both horizontal equity (that is equal-treatment-of-equals) and vertical equity (appropriate treatment of unequally-situated individuals, one aspect of which is the progressivity of the system); and b) neutrality, where a more neutral tax system incorporates elements of efficiency on the one hand and compatibility with the tax regimes of our major trading partners on the other.

2.3 At the outset it is important to note, perhaps to a degree beyond that in the White Paper, that the recent United States tax reform is driving much of Canadian reform. This is particularly the case for corporate tax reform. With major rate cuts in the U.S., substantial reductions in nominal corporate tax rates need to be

implemented in Canada. Failure to do so will result very quickly in a sharp erosion of the Canadian tax base. If our rates remain substantially higher, some industries would relocate to the United States to benefit from lower rates. The more immediate problem is that multinationals (Canadian or foreign) would begin "shifting" income to the U.S. to reap the benefit of lower tax rates and "shifting" expenses to Canada where their deductions would produce greater tax savings. With the Government's concern for equity or fairness and its earlier commitment to generate a larger share of tax revenues from the corporate sector, this constrains the nature of corporate tax reform.

2.4 Similarly, personal taxation reforms in the U.S. have also placed constraints on the proposals for personal income taxation. Moreso than on the corporate side, Canada can probably tolerate a marginal rate structure higher than that in the U.S., largely because our network of public and social services is more comprehensive than that in the U.S. Moreover, most Canadians attach substantial positive value to these services. The existing differentials in marginal rates are nonetheless, in the view of the Committee, and obviously in the view of the White Paper, too large. As noted in one of the briefs, pre-reform there exists a tendency for young, mobile, highly-skilled Canadians to seek their fortune in the U.S. and then to return to Canada to enjoy the benefits of the health, social programs and even tax benefits accorded the elderly. The Committee takes this mobility potential seriously and agrees with the White Paper that Canadian top marginal tax rates must be reduced substantially. Some have also argued that marginal rate reduction is important to stem the growing importance of the underground economy and the tendency for an increasing amount of investment to be directed toward tax avoidance. Indeed, many of the so-called tax loopholes are a direct result of high marginal rates. Evidence from the Reagan administration's 1981 tax reform indicates that the lowering of top marginal rates in the U.S. resulted in higher, not lower, revenues being collected from upper-income people. In any event, if one accepts that upper-income Canadians are to be given a break in terms of lower marginal rates, how does one then satisfy the equity or progressivity concerns? Part of the White Paper's answer is to move from a system of exemptions to a system of credits and to increase the degree to which some of these credits are refundable. While the Committee may have different views of just what constitutes a "progressive" tax system, we have only plaudits for the White Paper in terms of the introduction of a credit-based system for personal taxation.

2.5 The point of all of this is to emphasize the complex balancing act that is inherent in any major tax restructuring exercise. One can adopt laudable goals such as increasing horizontal equity, progressivity and efficiency, but one also has to recognize that these goals must be situated in the context of an increasingly mobile world where the tax regimes of our major trading partners effectively constrain some of the degrees of freedom of tax reformers. As one of the briefs before the Committee noted:

> The tax reform package is put together with finely balanced tradeoffs between economic rationality and political expediency, between immediate patching and long-term reform, between the competitive need to bring down personal and corporate tax rates and the obscene revenue requirements of the bulging government deficit, and between the different interests of numerous pressure groups. Overall, the package stands as an excellent example of the possible. (Robert D. Brown, "The Effects of Tax Reform on Business", in *Tax Reform: Perspectives on the White Paper*, Submission by the C.D. Howe Institute, October 1987)

Tax reform will always be thus.

2.6 Partly in recognition of these inherent compromises in tax reform and partly to give the White Paper its full due, the Committee now focuses on the degree to which the tax reform proposals reflect the underlying reform thrusts. To be sure, this casts tax reform in its most favourable light. The exercise is inherently valuable, however, because it not only underscores the analytics underpinning tax reform but, as well, it indicates which suggestions for altering the provisions of the White Paper are consistent with the underlying thrusts and which are not. Consistency need not be a virtue, either in terms of assessing the reform proposals or in recommending alternatives, but it does impart a useful framework to our ensuing analysis. We begin by focusing on the horizontal equity (equal-treatment-of-equals) aspect of tax reform.

Horizontal Equity

2.7 In all three areas of taxation – personal, corporate and sales – the White Paper proposals attempt to narrow the existing tax differentials. On the personal

side this is largely accomplished by base-broadening measures such as capping the lifetime capital gains exemption at $100,000 rather than $500,000, eliminating or reducing various tax shelters and applying more rigid eligibility criteria for certain allowances relating to income from self-employment. The net result will be a more uniform taxation of income, regardless of source. The proposed changes to the corporate tax regime would also reduce the variations in taxes across different sectors. Part of this levelling process arises from provisions that would reduce the number of profitable corporations that pay no tax and from new tax levies on certain sectors such as finance and real estate in order that they bear a more equitable share of the tax burden. This equal-treatment-of-equals approach is probably most evident in the proposed conversion of the MST to some version of a comprehensive value-added tax: not only is the base broadened dramatically but the tax rate will become much more uniform.

2.8 The Committee welcomes this general approach to taxation. In addition to improving equity, it should also be efficiency-enhancing in the sense that tax considerations will henceforth play a smaller role in allocating investment across industries.

Vertical Equity/Progressivity

2.9 Reducing marginal tax rates, particularly the top marginal rates, does transfer after-tax dollars to high-income persons. To a degree this is offset by the various base-broadening provisions relating to non-wage income, which in some cases leaves high-income Canadians worse off, post-reform. The Committee accepts this as a necessary consequence of tax reform, particularly given the profile of the new marginal rates in the United States. Given this constraint, the Committee welcomes, as noted earlier, the conversion of exemptions to credits. Of and by itself, this provision substantially enhances the progressivity of the personal income tax system. The proposed low-income sales tax credits, provided they are substantial, will also go a long way toward alleviating the regressive nature of the multi-stage sales tax. Indeed, if the introduction of the sales tax is accompanied, as indicated in the White Paper, by a lowering of marginal rates for the middle-income class and by generous tax credits for low-income persons and families, then the Committee is satisfied that an increased degree of sales taxation can be integrated successfully and fairly into our overall tax system.

Neutrality

2.10 The reduction of marginal rates, both personal and corporate, will bring our tax regime more in line with that south of the border and will serve to minimize the inevitable migration of people and capital that would otherwise occur. The Committee is also pleased that the Government has finally taken the initiative to replace the distortion-laden MST with a multi-stage sales tax. This is important on both equity and efficiency grounds. In terms of the latter, it will effectively remove the $2 billion "tax" on our exports, which is a significant issue in its own right but becomes even more essential in the context of the Canada-U.S. free trade agreement. Relatedly and obviously also critical, imports will no longer have a tax advantage relative to domestic manufacturers.

Summary

2.11 In summary, therefore, the Committee endorses the broad themes underlying tax reform. However, endorsing in principle the general thrusts is not inconsistent with finding that specific aspects of the reform are wanting. Indeed, many of these relate to a failure on the part of the White Paper to carry through with its broad themes of horizontal equity, progressivity and neutrality. Prior to focusing on these selected aspects, the Committee wishes to address two major concerns it has with the White Paper proposals. The first has to do with the way in which the new tax brackets affect the middle-income class. Simply put, marginal rates, and under some reasonable assumptions average rates as well, will rise for a significant group of middle-income Canadians. The second area relates to the tax treatment of investment income and, more generally, to the integration of the personal and corporate tax system. In terms of the above themes, the first of these concerns is really a progressivity issue while the second relates both to horizontal equity and to neutrality in the important sense that the investment-income and corporate-tax measures may adversely affect our international competitiveness. It is the Committee's view that the problems or concerns in both of these arise in part from the "staging" process. The following chapters will elaborate on these themes.

footprint. [illegible]

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Chapter III

The Tax Treatment of Middle-Income Canadians

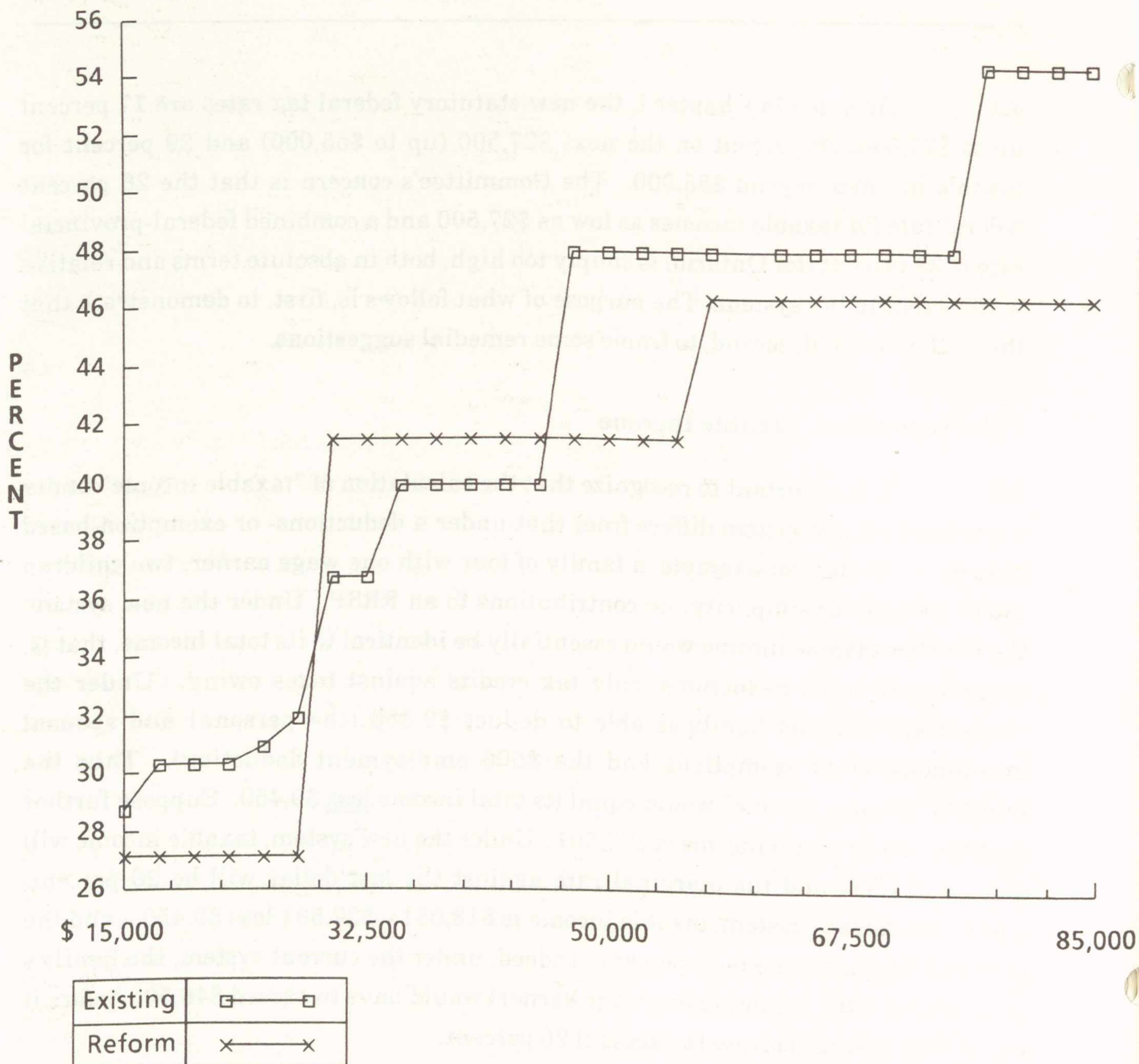
3.1 As noted in Chapter I, the new statutory federal tax rates are 17 percent up to $27,500, 26 percent on the next $27,500 (up to $55,000) and 29 percent for taxable incomes beyond $55,000. The Committee's concern is that the 26 percent federal rate for taxable incomes as low as $27,500 and a combined federal-provincial rate of 39 percent (for Ontario) is simply too high, both in absolute terms and relative to the existing tax system. The purpose of what follows is, first, to demonstrate that this is the case and, second, to frame some remedial suggestions.

Total Income vs. Taxable Income

3.2 It is important to recognize that the calculation of "taxable income" under a credit-based tax system differs from that under a deductions- or exemption-based system. Consider, for example, a family of four with one wage earner, two children under 18 and, for simplicity, no contributions to an RRSP. Under the new system, the family's taxable income would essentially be identical to its total income, that is, there would be no deductions, only tax credits against taxes owing. Under the current system, this family is able to deduct $9,450 (the personal and spousal exemptions, child exemptions and the $500 employment deduction). Thus the family's "taxable income" would equal its total income less $9,450. Suppose further that the family's total income is $27,501. Under the new system, taxable income will also be $27,501 and the marginal rate against the last dollar will be 26 percent. Under the current system, taxable income is $18,051 – $27,501 less $9,450 – and the relevant marginal rate is 20 percent. Indeed, under the current system, the family's total income (still assuming one wage earner) would have to exceed $46,500 before it would face a marginal rate in excess of 26 percent.

Figure 1

Pre- and Post-Reform Marginal Tax Rates for a Two-Adult Family with One Wage Earner



Source: Marion Wrobel, "Tax Reform and Its Impact on Families", Report prepared for the Standing Senate Committee on Banking, Trade and Commerce (Ottawa, Library of Parliament, 1987), p. 3.

3.3 The Committee desired to investigate this further and requested the Library of Parliament to undertake research comparing the new and old tax systems for the middle-income class. Figure 1 presents some of these findings. The new marginal rate profile exceeds the current profile at $27,500, as expected, and remains above the current rate until approximately $46,500. Actually, the cross-over point is somewhere below $46,500. This occurs partly because the computer simulations incorporate the complexities of the tax system whereas the previous example was highly abstract, but largely because the Figure 1 "family" has no children so that the cross-over point is, as a result, $940 lower than our earlier example (since the deduction for children under 18 is $470 per child).

3.4 Since what is driving this comparison is essentially the differences between marginal rate schedules on the one hand and the difference between total income and taxable income pre- and post-reform on the other, it is clear that the level of deductions plays a critical role. Indeed, if one were to rework Figure 1 for an elderly family (both 65 or over) the cross-over point would occur at a much higher income level since the allowable deductions are greater. Specifically, the family would be eligible to claim the age exemption which, for a couple, would amount to $5,340. The impact of this on Figure 1 would shift the cross-over point to over $50,000. This cross-over level of income would rise even further if interest, dividends and/or capital gains featured prominently in the family's income (since the $1,000 interest and dividend deduction has disappeared and dividends and capital gains are treated less generously, post-reform). In other words, it is likely that for some elderly families the marginal tax rate, post-reform, would exceed the existing marginal tax rate, pre-reform, for the <u>entire</u> $27,500 – $55,000 middle-income tax bracket.

3.5 The Committee recognizes fully that this analysis is somewhat biased. For example, it focuses only on marginal rates, not on average tax rates. Phrased differently, while marginal rates may be higher, post-reform, the typical Canadian may be more interested in the pre- and post-comparisons of take-home pay, that is in <u>average</u> tax rates. The following section will address this. However, at this juncture the Committee would like to make the point that marginal rates <u>do</u> matter. A university graduate in the latter half of the 1980s can aspire (depending on the discipline) to a starting income in the $27,500 range. Faced with a combined federal-provincial tax rate of effectively 40 percent, the incentives for the young, highly educated Canadians are surely tilted toward migration to a more congenial tax

clime. Given the emphasis that Canada places on the role of knowledge-intensive industries as the cutting edge of comparative advantage in the 1990s and beyond, it is questionable whether we ought to implement a tax system that may result in human capital being one of our principal exports.

3.6 Nonetheless, focusing only on marginal rates is only part of the story. After all, the new marginal rate structure is such that it exceeds the current rate for some portion of the lower-income class as well. This is offset by the fact that tax reform ensures that these higher statutory marginal rates are largely irrelevant for these lower-income groups since a large number of previously taxpaying Canadians will, under tax reform, no longer be paying tax.

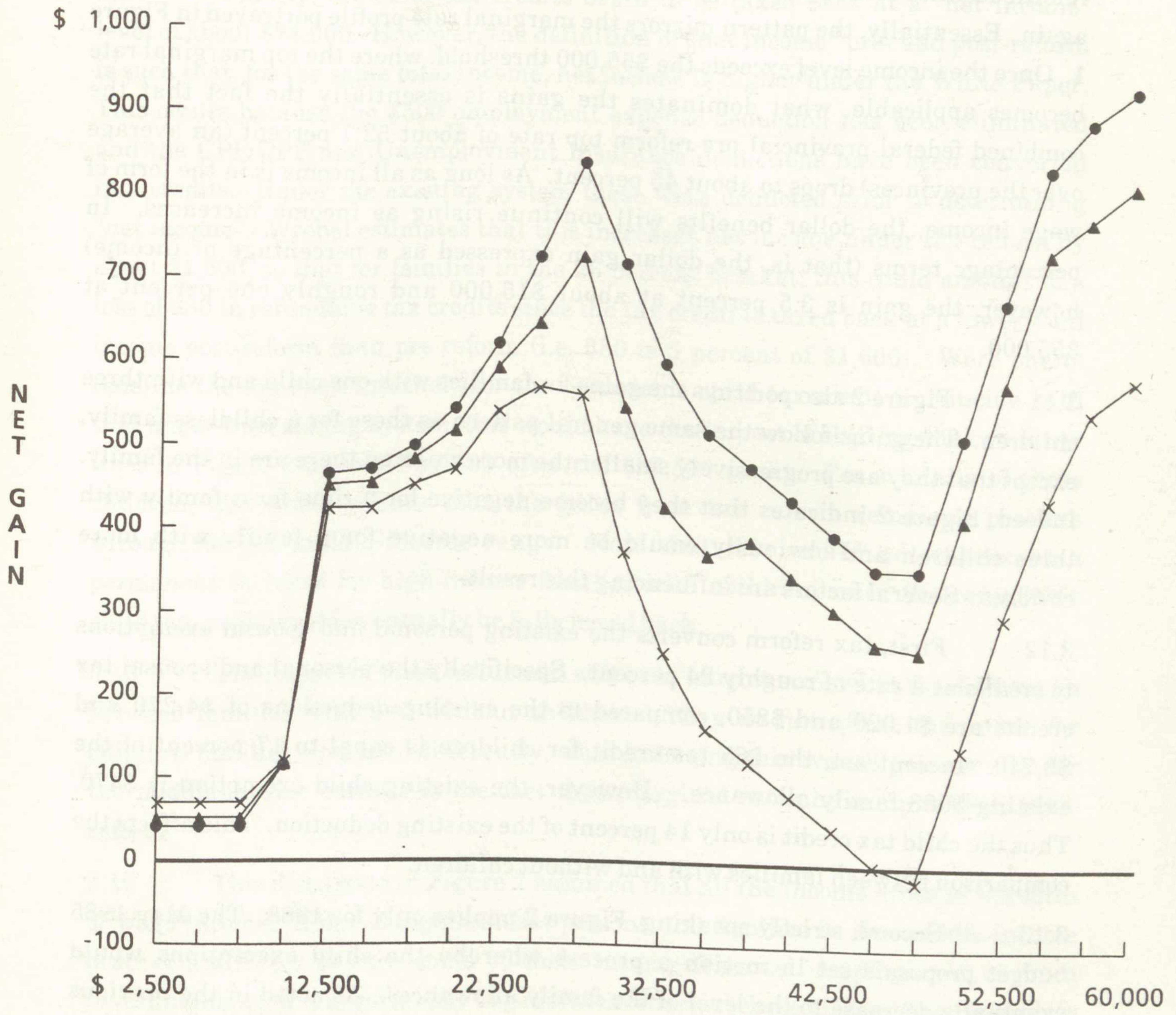
Average Tax Rates

3.7 Not surprisingly, perhaps, the White Paper proposals did not focus on marginal tax rates. Rather, pre- and post-reform comparisons were directed to average tax rates or "take-home-pay" comparisons. Figure 2 presents a comparison of average tax rates or, more precisely, the gains by income level as a result of reform. Again, the assumption is that all income is wage income.

3.8 At the low end of the income scale, where there are no taxes paid pre- or post-reform, the small benefits from the White Paper proposals arise because the refundable sales tax credits have been increased slightly under the stage one reform. Since the credit applies to children as well as adults, the families with children benefit more than those without children.

3.9 Once family income is sufficient to place families in a taxable position, the net benefits from reform increase dramatically. At this point, families will benefit particularly from the conversion of exemptions and deductions to credits. Because these credits are not refundable, families with a low level of taxable income cannot make full use of these credits, because their tax liability may be lower than the credits available. Over a certain income range, then, the dollar value of the net gain to families will increase with income. At $12,500 annual income, tax reform offers a net gain to families of three percent to over 3.5 percent of total income, depending upon family size. The dollar value of benefits continues to rise with income until about $27,500, where the 26 percent tax rate begins.

Figure 2
Stage 1 Net Tax Gain for a
Two-Adult Family with One Wage Earner



Source: Marion Wrobel, "Tax Reform and Its Impact on Families", Report prepared for the Standing Senate Committee on Banking, Trade and Commerce (Ottawa, Library of Parliament, 1987), p. 8.

3.10 After this point, the value of credits tends to be lower than the value of the exemptions and deductions they replaced. As a result, the net gain from tax reform declines steadily until about $47,500, after which the net gains begin to rise again. Essentially, the pattern mirrors the marginal rate profile portrayed in Figure 1. Once the income level exceeds the $55,000 threshold, where the top marginal rate becomes applicable, what dominates the gains is essentially the fact that the combined federal-provincial pre-reform top rate of about 52.7 percent (an average over the provinces) drops to about 45 percent. As long as all income is in the form of wage income, the dollar benefits will continue rising as income increases. In percentage terms (that is, the dollar gain expressed as a percentage of income) however, the gain is 3.5 percent at about $15,000 and roughly one percent at $55,000.

3.11 Figure 2 also portrays the gains for families with one child and with three children. The gains follow the same general pattern as those for a childless family, except that they are progressively smaller the more children there are in the family. Indeed, Figure 2 indicates that they become negative for a time for a family with three children and obviously would be more negative for a family with more children. Several factors are influencing this result.

3.12 First, tax reform converts the existing personal and spousal exemptions to credits at a rate of roughly 24 percent. Specifically the personal and spousal tax credits are $1,020 and $850, compared to the existing deductions of $4,270 and $3,740. In contrast, the $65 tax credit for children is equal to 17 percent of the existing $388 family allowance. However, the existing child exemption is $470. Thus the child tax credit is only 14 percent of the existing deduction. This affects the comparison between families with and without children.

3.13 Second, strictly speaking, Figure 2 applies only for 1988. The May 1985 budget proposals set in motion a process whereby the child exemptions would eventually decrease to the level of the family allowances. As noted in the previous paragraph, Figure 2 assumes that the pre-reform value of the exemption will be $470, whereas the steady-state value of the exemption will be $388, the value of the family allowance. Correcting for this would not increase post-reform incomes for families with children, but it would decrease their benefits under the existing system by roughly $21 per child. Thus, incorporating this change into Figure 2 would increase the gains for the three-child family by $63, enough to remove that part of the curve which exhibits negative gains as a result of tax reform. More generally, it

would narrow slightly the differences between families with and without children compared to their pre-reform position.

3.14 Finally, the child tax credits begin to be taxed back at a "net income" level of about $24,000. However, the definition of "net income" pre- and post-reform is such that, for the same total income, net income is higher under the White Paper. This occurs because the $500 employment expense deduction has been eliminated and the CPP/QPP and Unemployment Insurance deductions have been converted into credits. Under the existing system these were deducted prior to determining "net income". Wrobel estimates that this increases net income under tax reform by about $1,600, so that for families in the 26 percent bracket, this could amount to a loss of $80 in refundable tax credits since the tax credit is taxed back at a lower total income post-reform than pre-reform (i.e. $80 is 5 percent of $1,600). Were one to redefine the tax-back threshold for the refundable child tax credit to coincide with that under the existing system, this would have the impact of shifting the two lower lines in Figure 2 upwards by $80 after the $27,500 peaks. For a family of three children, this would ensure that the gains from tax reform remained positive throughout the middle-income range. Note that this would not represent a permanent increase for high-income families with children, since the refundable child tax credit would eventually be fully taxed back.

3.15 The impact of these influences will be to narrow somewhat the differences between families with and without children. They do not affect the curve for childless families – phrased differently, what is driving this overall gains profile for the middle-income earners is the fact that marginal rates have increased, post-reform.

3.16 This discussion of Figure 2 assumed that all the income arose in the form of wage income. If one recognizes that persons and families in the middle-income bracket are likely to earn some of their income from self-employment or from investments, then it is quite easy to generate scenarios where all families, regardless of whether they have children, are worse off after tax reform. This arises because of the manner in which the White Paper proposals approaches the taxation of investment and self-employment income. Such an exercise would also reveal a further feature of the reforms. Although high-income Canadians whose source of income is wages will clearly benefit from tax reform, the benefits accruing to high-income Canadians for whom tax "loopholes" and investment income played an important role, pre-reform, will be considerably less and can even become negative.

Thus it can be very misleading to focus only on the reduction of marginal rates at the top end and to extrapolate from this the benefits that tax reform confers on the rich.

The Marginal Rate Profile

3.17 The final piece of evidence relating to the taxation of middle-income Canadians relates to the profile of marginal rates. Again, consider a family of four with one wage earner and, for simplicity, with no CPP/QPP or Unemployment Insurance tax credits. The family qualifies for two sorts of additional tax credits. The first is the refundable sales tax credit which equals $210 for a family of two adults and two children. With a five percent tax-back rate, it takes $4,200 of income to exhaust this credit. Given that the credit begins to be clawed back at $16,000, it is exhausted at $20,200. Second, the refundable child tax credit of $524 per child is also clawed back at five percent beginning at $24,020. Since it takes $10,500 of income to exhaust each of these credits and since they are taxed back consecutively, the family would exhaust the credits at an income of $45,020. Finally, under tax reform, families would pay no net tax below $18,500.

3.18 After $18,500, the federal marginal-tax-rate profile is as follows:

- 22 percent up to $20,200, i.e. the statutory rate of 17, plus the five percent tax for the sales tax credit;
- 17 percent from $20,200 to $24,020;
- 22 percent from $24,020 to $27,500, reflecting the five percent tax on the refundable child tax credit;
- 31 percent from $27,500 to $45,020, i.e. 26 percent statutory rate plus the five percent tax until the child credit exhausts at $45,020;
- 26 percent from $45,020 to $55,000; and
- 29 percent for income beyond $55,000.

Note that if there were three children in the family the child tax credits would exhaust at $55,520, that is the family would <u>never</u> face a 26 percent rate. Rather, the marginal rate profile would be altered as follows: 31 percent from $27,500 to $55,000; 34 percent from $55,000 to $55,520; and 29 percent thereafter.

3.19 To be sure, these anomalies also exist within the current system. Nonetheless, they are exacerbated under tax reform because of the very large rise in

marginal rates at the $27,500 threshold – nine federal tax points and roughly 14 combined federal-provincial points. The Committee believes that this middle-income tax rate is too high.

3.20 So, apparently, does the Government since, as noted in Chapter 1 of the White Paper, one of the main goals of the second stage is to reduce taxes for the middle-income group. While the White Paper does not elaborate on how the middle-income groups would benefit, several options are possible. One is to alter the middle-income tax bracket so as to accomplish the dual objective of reducing the tax burden on the middle class and ensuring that, even with the five percent claw-backs of the tax credits, no one in the middle bracket would face a federal marginal rate above the top federal rate. A second approach would be to raise the income threshold where the 26 percent rate begins to apply.

3.21 The Committee is very concerned about the tax treatment of middle-income Canadians. Why should the first stage embody a rate and bracket structure that is recognized by the White Paper as being inappropriate? Admittedly, if any of the various alternatives suggested above were introduced in the first stage, this would result in Stage One no longer being "fiscally neutral". However, if the second stage is to be legislated shortly, then there is no long-term fiscal issue. If there is a "transitional" fiscal problem, then it would seem appropriate to implement the "appropriate" longer term rate and bracket structure and to finance this by a "transitional surcharge" on all income levels. If the second stage is likely to be delayed, or perhaps never legislated, then the argument for first stage, middle-income relief is much stronger. Why lock in place a marginal rate structure that even the White Paper recognizes as inappropriate?

3.22 The Committee makes no recommendations at this point (although we will make specific recommendations later), preferring simply to highlight the fact that this is one of the two general areas where the White Paper needs rethinking. The other is the treatment of investment income, to which we now turn.

Chapter IV

Investment and Investment Income

4.1 The White Paper proposals shift the tax burden from personal taxes to corporate and sales taxation. From Table 3, business will pay an additional $3.845 billion in taxes over the four year period, 1988/89 to 1991/92. And unless the provinces reduce their corporate rates, business could pay almost this much again in additional provincial corporate taxes. Given the nature of the U.S. reforms, which also saddle business with additional taxes, this shifting of the tax burden is not entirely unexpected. Indeed, representatives of some industries (e.g. financial institutions) recognized that they ought to shoulder a larger tax burden provided it was allocated fairly across the corporate sector.

4.2 However, some perspective is needed here. Even prior to the reform proposals, Canadian corporations already bear corporate taxes that are higher than the average for developed countries. Data contained in the C.D. Howe submission indicated that as a percentage of gross domestic product (GDP), Canada's corporate burden in 1984 amounted to three percent of GDP, slightly above the Organization for Economic Cooperation and Development (OECD) average of 2.9 percent, but sharply above that of the U.S. (2.1 percent), West Germany (2.0 percent), Sweden (1.9 percent) and France (1.9 percent). As a share of total taxes, the 8.8 percent for Canada is also above the OECD average of 7.9 percent. What we heard time and again from the business community was that at the very least the *quid pro quo* must be swift action in terms of replacing the MST with the multi-stage sales tax. The concern that there may be a delay in introducing the second stage is considerably heightened by the Canada-U.S. free trade agreement, in light of the fact that the MST penalizes our exports and encourages imports. The Committee supports these observations.

4.3 The thrust of this chapter is different, although related. Specifically, the Committee is concerned that the White Paper proposals embody an "anti-risk" and "anti-equity" bias. While some of the following measures proposed by the White

Paper are appropriate, taken as a package they constitute a frontal assault on investment and investment income by:

- capping the $500,000 lifetime capital gains exemption at $100,000;
- eliminating the $1,000 interest and dividend income deduction;
- increasing the non-exempt capital gains that must be brought into income from 50 to 75 percent;
- failing to allow an inflation correction for capital gains, which for even relatively low rates of inflation can imply taxation in excess of the real return (moving from 50 to 75 percent inclusion sharply increases this likelihood);
- reducing the dividend tax credit and effectively reducing the degree of integration between the personal and corporate tax system. Under tax reform, double taxation of dividends for taxpayers in the top bracket will begin when corporate tax rates exceed 20 percent, down from the 25 percent level in 1987 and from the $33\frac{1}{3}$ percent level in prior years.

The package also affects the corporate side by:

- removing investment tax credits;
- reducing capital consumption allowance which, in the view of some witnesses, will mean that for the first time in decades the effective depreciation rates on most machinery and equipment in Canada would be below those in the United States;
- implementing the "put-in-use" rule which would seriously reduce the expected rate of return from large new investments such as resource megaprojects;
- replacing the current immediate write-off of the cost of issuing new securities with a deduction spread over the life of the debt or five years, whichever is greater;
- introducing a tax on dividends paid on new preferred share issues, designed to make it more difficult for non-taxpaying Canadian corporations to acquire funds through preferred shares; and
- reducing the attraction of flow-through shares: a) directly by phasing out depletion allowances and introducing tighter write-offs from

limited resource partnerships, and b) indirectly, by the provision requiring that 75 percent of capital gains be brought into income.

There are, of course, a host of sector or industry-specific measures which would also influence investment but we are focusing here only on general provisions.

4.4 The obvious counterargument to all of this is that both corporate and personal marginal tax rates have fallen so that it is appropriate to embark on these initiatives. The Committee recognizes this point. However, evidence adduced before us did not allay our initial concerns. In the view of the Economic Council of Canada, for example, the White Paper proposals do enhance efficiency in the sense of ensuring a better allocation of capital across industries, but the long-term impact of the first stage would be to increase the effective tax rate on new corporate investment and, therefore, deter investment. The Council goes on to note that the removal of the sales tax on capital inputs (i.e. the second stage) would go a long way to restoring neutrality. The C.D. Howe Institute argued that, relative to the U.S., Canada would generally maintain the slight advantage that it now enjoys, but that the combined effect of base and rate changes would be to decrease after-tax cash flow by about five percent. The U.S. reforms have also reduced after-tax cash flow by a similar amount. The brief then goes on to note:

> Canadian business, faced with lower after-tax expected rates of return on some investments . . . a reduced flexibility on financing methods (particularly in start-up situations), and a less favourable tax treatment of equity investments for individual investors, obviously would have greater difficulties in securing new financing under the proposed tax reform package. (Robert D. Brown, "The Effects of Tax Reform on Business", in *Tax Reform: Perspectives on the White Paper*, Submission by the C.D. Howe Institute, October 1987)

Moreover, new investment will remain under a further cloud of uncertainty unless the tax avoidance measures are clarified in an equitable manner.

4.5 In the Committee's view, this is taking too great a risk with the nation's competitive future. If anything, investment should be favoured, not hindered. We urge the Government to rethink its tax proposals as they relate to investment. Of particular concern to the Committee are the proposals relating to dividends and capital gains. As a package, the reduction in the dividend tax credit and the degree

of personal-corporate integration, the 75 percent inclusion rate of capital gains in income, the lack of inflation correction for capital gains and the favouring of dividend source income relative to capital gains income are simply unacceptable. Evidence before us indicates that the reduction in the dividend tax credit to provide full integration at a 20 percent corporate rate clearly violates horizontal equity since the tax rate of corporations that typically pay dividends is well above 20 percent. Indeed, if the goal were to avoid double taxation, as horizontal equity would require, then the pre-1987 integration level at a $33\frac{1}{3}$ percent corporate rate is the preferred approach. Similarly, the theoretically appropriate treatment for corporate-related capital gains is to treat them like dividends – a capital gains tax credit to offset the double taxation – and for capital gains generally to index them for inflation.

4.6 The Committee recognizes that if the first stage of reform is to take effect in the new year, a major reworking of the full range of proposals in this area is probably not in the cards. What is possible, however, is for Finance to recognize that its Stage One proposals have come down too hard on investment. In Chapter VI, we shall make a series of recommendations as to how the situation can be ameliorated on a transitional basis. As part of the second stage, the Committee firmly believes that Finance must rethink its approach to investment and investment income and generate a set of proposals more favourable to investment and the country's long-term competitive needs.

Chapter V

The "Staging" Process

5.1 As the Committee reviews and assesses the reform proposals, it is becoming increasingly clear to us that the process appears to be conditioning the reforms. We have already noted many of our concerns in this regard, but they merit further emphasis.

5.2 The Committee recognizes the advantages of bringing the provinces on side for the multi-stage sales tax and recognizes as well that this cannot be done instantaneously. Nonetheless, introducing tax reform in two stages, without a timetable or schedule for the second stage, immensely complicates the entire reform process. Among the Committee's many concerns with this process, not all of which were enumerated above, are the following:

- The very favourable general overview of the White Paper thrusts presented in Chapter II does not apply if there is no second stage.

- On efficiency grounds, there is almost universal acceptance of the fact that the very distortionary MST must be replaced by some version of a value-added tax. It is difficult to imagine that the Government intends to open the Canada-U.S. border to free trade with the MST still in place, indeed exacerbated by stage one proposals.

- The promise to provide middle-income Canadians with a tax break in the second stage leaves the Committee puzzled. Is the intent to have yet another full debate on a new second stage rate and bracket structure? Will this not mean that the Government will have to "buy-off", yet another time, all the special interests? It is almost surely the case that such a two-stage process will lead to a quite different tax system than that which would arise from an integrated approach.

- The Committee is of the view that the decision to make the first stage fiscally neutral has led to some inappropriate tax measures. This is surely the case for the first stage measures relating to the MST. We

suggest that it is also part of the reason why the first stage came down so hard in terms of the treatment of capital income.

- The implicit, if not explicit, rule that any changes in the stage one proposals that decrease revenues must be matched by equivalent changes that garner new revenues is likewise a certain recipe for inappropriate measures. Further, it has led to the belief among our witnesses that the second stage may not materialize soon.
- While the first stage may be fiscally neutral, *vis-à-vis* pre-reform, it is not likely to be "fiscally stable". As some of our witnesses pointed out, the fiscal plan does not incorporate the proposals with respect to day-care nor does it incorporate the fact that the aid to Western farmers may be more than a once-and-for-all event. Moreover, the assumptions underlying the White Paper proposals are implausibly rosy, in the view of some of our witnesses. The Committee's fear here is that, without the second stage, the whole reform process may be overturned and the rate schedule raised to capture more revenues.

For all these reasons, the Committee is of the view that the Government must commit itself to an immediate schedule for implementing the second stage of its White Paper reforms.

5.3 A final word on tax reform and deficits. With the recent stock market plunge and deficit reduction measures in the United States, there may well be some fiscal implications for Canada. As a percentage of GNP, our deficit is substantially larger than the American deficit - probably twice as large if one includes the provinces and states in the comparison. It is true that Canadian savings rates exceed those in the U.S. so that on this count, for identical deficit percentages, we need not seek recourse to foreign borrowing as quickly as the Americans. Nonetheless, these recent events probably complicate the tax reform process and may dictate that Canada, too, look closely at the expenditure side of the budget. Ensuring fiscal integrity is a key ingredient in generating an inviting investment climate.

5.4 The Committee now turns its attention to a series of comments and recommendations that focus on some of the specific White Paper proposals and initiatives.

Chapter VI

Detailed Recommendations

Personal and Family Taxation

6.1 The Committee fully supports in principle the White Paper proposal to convert existing personal exemptions and some deductions to tax credits. Indeed, we did not receive a single submission which suggested that the current system should be retained. We do, however, have some problems with the overall package.

6.2 We are concerned about the proposed credit system as it affects families. In general, we feel that the proposals enacted by Parliament in 1985 to limit the personal exemption for under 18-year-olds to the amount of the family allowance and, for other dependents, to double the amount of the family allowances, were appropriate. The current proposals, however, give the equivalent of this relief only to families with children who are 18 or under where the taxable income of the claimant is $27, 500 or below.

6.3 We are also concerned about a number of related issues. First, despite the 1985 legislation, a parent with taxable income in excess of $27,500 will lose a part of the Family Allowance cheque to taxes. Where there are several children in the family, this seems inappropriate. Second, in many provinces, children who are 18 and above are still in secondary school or its equivalent and it seems to us some tax relief should be given to parents. The situation also pertains to a single parent who would claim the equivalent-to-married credit for a child who is over 18. Third, while we consider the relief offered to parents of students in Universities and other post-secondary programmes, through transferable tax credits, to be a step forward, it seems unfair that many other dependent children, especially in areas of high youth unemployment, get short shrift from the proposals. Finally, we consider the proposals to limit the earnings of supported family members to $500 before the tax credits are eroded, to be unreasonably low. This is particularly true of teen-aged children who could earn less than $10 a week with the consequence that a supporting parent would have the tax credit eroded.

6.4 1. **We recommend that the family allowance not be taxable and that the proposed $65 tax credit for those who support children eligible for the family allowance be rejected.** This will retain the existing policy of not taxing family allowances, since the exemption has always been at least equal to the family allowance. While at first blush this proposal, adopted from the brief of the National Action Committee on the Status of Women, might appear to be regressive, this is not really the case. First, according to Department of Finance figures, 66 percent of taxpayers are in the lowest proposed tax bracket and another 26 percent are in the middle tax bracket. In addition, evidence suggests that where one parent is in the lowest bracket and another in the top bracket, the family allowance will be claimed by the lower-income parent.

6.5 Second, this proposal will provide benefits for those families with children receiving the sales tax credit who are above the $16,000 threshold amount and for those receiving child tax credits who are above the $24,000 level, thus increasing progressivity. This result follows because family incomes will drop, increasing the amount of the refundable credit.

6.6 Third, this proposal would ensure that families which are not in the lowest tax bracket but have several children under the age of 18 will not have their much-needed Family Allowance payments eroded. The White Paper proposal looks only at taxable income in determining whether the allowance would be partially taxed back, not at the number of members in the family.

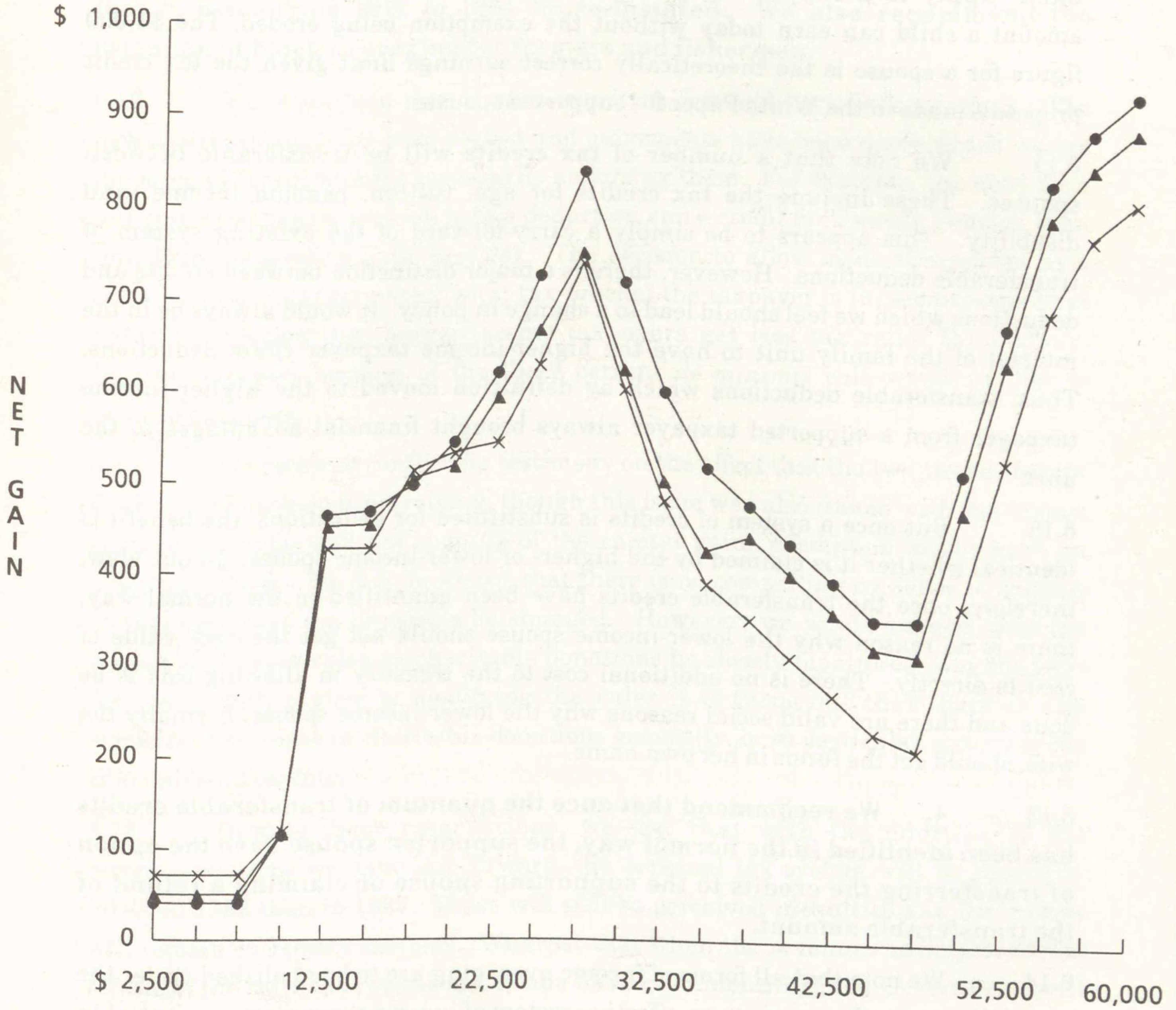
6.7 This proposal would also have a significant impact in terms of simplification, since the Government need not report the quantum of payments to each family each year and the taxpayers need not report the income nor claim the credit on their tax returns.

6.8 Figure 3 shows the effect of this proposal, when compared with Figure 2 above.

6.9 2. **We recommend a $130 tax credit for financially dependent children between the ages of 18 and 21 and, in addition, for those in full-time attendance at a post-secondary institution.** In essence, we are proposing to retain the 1985 rules for these children, but with a conversion from an exemption to a credit. The amount of the credit would be reduced on a dollar-for-dollar basis where the child uses or transfers tuition fee credits. This proposal would also apply to the equivalent-to-married exemption, but with a tax credit of $850.

Figure 3*

The Impact of the Family Allowance Recommendation (Recommendation 1)



* **To be compared with Figure 2 on page 21.**

6.10 **3. We recommend that a supported spouse be allowed to earn $1,000 a year before any erosion of the marital tax credit apply. We further recommend that a child under 18 be allowed to earn $2,500 before any "tax-back" apply to a supporting parent.** The $2,500 figure is approximately the amount a child can earn today without the exemption being eroded. The $1,000 figure for a spouse is the theoretically correct earnings limit given the tax credit proposals made in the White Paper for supported spouses.

6.11 We note that a number of tax credits will be transferable between spouses. These include the tax credits for age, tuition, pension income, and disability. This appears to be simply a carry-forward of the existing system of transferable deductions. However, there is a major distinction between credits and deductions which we feel should lead to a change in policy. It would always be in the interest of the family unit to have the higher-income taxpayer claim deductions. Thus, transferable deductions which by definition moved to the higher-income taxpayer from a supported taxpayer always brought financial advantages to the unit.

6.12 But once a system of credits is substituted for deductions, the benefit is identical whether it is claimed by the higher- or lower-income spouse. In our view, therefore, once the transferable credits have been quantified in the normal way, there is no reason why the lower-income spouse should not get the cash value of credits directly. There is no additional cost to the treasury in allowing this to be done and there are valid social reasons why the lower-income spouse, normally the wife, should get the funds in her own name.

6.13 **4. We recommend that once the quantum of transferable credits has been identified in the normal way, the supported spouse have the option of transferring the credits to the supporting spouse or claiming a refund of the transferable amount.**

6.14 We note that all forms of income averaging are to be abolished under the proposed system. In our view, an effective system of income averaging is essential in any progressive tax system. We are not convinced by the argument put forward by officials of the Department of Finance, that reducing the number of rate brackets to three, eliminates the need for income averaging. In particular, the impact of a combined federal/provincial rate jump of 14 percent when taxable income exceeds $27,500 creates serious difficulties. Figures we have seen suggest that those with

fluctuating income (such as artists, commission salespeople and new entrants to the work force) face significant tax penalties compared to those with stable incomes.

6.15 **5. We recommend that a general averaging provision similar to that in place from 1972 to 1981 be re-instated. We also recommend the retention of block averaging for farmers and fishermen.**

6.16 We would end this discussion with a few additional observations. The new credit system is far from perfect and judgements have been made which we are prepared to accept without necessarily endorsing them. For example, the need for a self-employed person to claim both a deduction and a credit for Canada Pension Plan contributions seems a little complex. The decision to allow medical expenses as a credit at 17 percent no matter what tax-bracket the taxpayer is in, seems somewhat harsh considering that higher-income taxpayers get less tax relief than lower-income taxpayers because of the three percent *de minimis* rule which applies to medical expenses.

6.17 We received conflicting testimony on the effect that the two-tiered charity credit might have on fund-raising, though this issue was also linked with the impact reduced tax rates and the capping of the capital gains exemption might have on potential donors. We feel, however, that there is no compelling evidence to suggest at this time that the proposals be changed. However, we would suggest that the impact of the new rules on charitable donations be closely monitored over the next few years with a view to modifying the rules if it turns out that there is any significant decrease in charitable donations generally, or to particular sectors of the charitable community.

6.18 Despite these reservations, we feel that with the addition of the recommendations we have put forward, the personal tax system will be generally fairer in 1988 than in 1987. There will still be perceived inequities and the system will remain extremely complex. We trust that when the revenues anticipated from reform of the sales tax regime in Canada have been identified, the Government will again examine the personal tax system with a view to making further appropriate modifications.

Investment

6.19 The Committee has gone on record earlier as saying that it is extremely concerned about the thrust of the White Paper proposals insofar as Canadian

investment is concerned. While each separate proposal may have its supporters or detractors, it is apparent that the package as a whole tends to discourage equity investment and risk-taking by Canadians. We believe that this approach, which reduces the after-tax cash flow of investments and increases the cost of corporate financing, works against Canada's long-term competitive needs.

6.20 We recognize that fiscal considerations preclude any significant tax relief for capital during the first stage of tax reform. It is important, however, to signal to Canadians that the taxation of investment will be subject to more favourable rules in the future. One aspect of this that clearly is feasible in Stage One, is to cap at $66\frac{2}{3}$ percent the amount of capital gains that will be taken into income. There are several cogent arguments for this:

- If capital gains are taxed at 75 percent, as projected for 1990 and beyond, this will reverse the recent favourable treatment of capital gains versus dividends and set in motion a process to convert gains to dividends which will surely trigger the anti-avoidance procedure and presumably a raft of specific measures. Capping the gains at two-thirds inclusion will eliminate most of this conversion.
- An inclusion rate of $66\frac{2}{3}$ percent roughly offsets the impact of lowering marginal rates so that capital gains (apart from the capping of the lifetime exemption) will be treated similarly pre- and post-reform. (Note that for those in the middle-income class, and particularly for the elderly, the marginal rates, post-reform, are already higher so that even a $66\frac{2}{3}$ percent inclusion rate represents harsh treatment of capital gains income.)
- Moving to 75 percent inclusion implies that even modest inflation rates can result in taxes in excess of real returns. Limiting inclusion to $66\frac{2}{3}$ percent is not a substitute for indexing gains for inflation, but it is a transitional measure that accommodates this goal.
- The proposal will not affect revenues over the next two years, since the 75 percent rate was intended to come into effect only in 1990. However, the announcement of a $66\frac{2}{3}$ percent cap will have a positive effect with respect to investment and will prevent early realization of gains and/or measures to convert gains to dividends.

6.21 **6. We recommend that the stage one legislation limit the inclusion rate of capital gains at $66\frac{2}{3}$ percent.**

6.22 Continuing with our concerns with respect to investment, we have noted with interest submissions which have suggested that the abolition of the $1,000 investment income deduction would have a particularly negative impact on lower-income Canadians and the elderly. Many of these people have modest savings in the form of bank accounts, Canada Savings Bonds and shares purchased under employee share-ownership programs. The effect of the reform proposals is to increase the federal tax burden on the first $1,000 of income generated from these sources to at least 17 percent from nil. Revenue Canada figures for the 1984 taxation year, the most recent available, show that nearly three-quarters of the total amount of investment income deductions claimed was accounted for by taxpayers with incomes of $30,000 or less. Taxpayers aged 65 and over accounting for 8.2 percent of total income assessed in 1984 but were responsible for 25 percent of the total amount of investment income deductions claimed that year.

6.23 **7. Accordingly, we recommend that a tax credit for Canadian source investment income be instituted at the rate of 17 percent of such income to an annual maximum of $170, transferable between spouses.**

6.24 We would also comment on the proposed preferred share dividend tax which was unveiled on 18th June but which, strictly speaking, is not part of the tax reform package. We recognize that there is a significant problem where companies which pay little or no tax declare dividends which are treated in the hands of the recipient as though they come from fully taxable profits. On the other hand, the complexity of the rules stand in stark contrast to promises to simplify the tax system. There are other solutions available which might be considered.

6.25 **8. We recommend that the Government not proceed with the proposed preferred share tax and that it develop a more effective alternative to prevent dividends from receiving preferential treatment when they are paid by low-tax or non-taxed corporations.**

6.26 The White Paper proposals with regard to investment in the domestic film industry are extremely troubling. While we note that significant government financing for the film industry is available through Telefilm Canada, the fact remains that all evidence indicates that private investment in films and television productions will be cut off if the White Paper proposals are proceeded with.

6.27 **9. We recommend that the status quo be maintained for private investment in Canadian film and television production.** We feel that it is important for Canadian culture and for the industry that private funds not be curtailed and we note that prior to the White Paper proposals, significant new private funds were in fact being invested in Canadian productions. We feel that the retention of the alternative minimum tax and the proposed rules relating to cumulative net investment losses offers the Government sufficient protection to ensure that the current generous rules, if retained, will not be abused.

6.28 We would also note that there is an uncharacteristic element of retroactivity with regard to the proposals relating to Multiple Unit Residential Buildings (MURBs) contained in the White Paper. In essence, the preferential tax rules relating to such investments will cease at the end of 1990 even where an owner purchased the property before the announcement of the White Paper proposals. We also note that a subsequent purchaser who acquires a MURB before 1991 will receive no tax benefits, which makes it difficult for a current owner to sell his or her interest.

6.29 **10. We recommend that the current rules relating to MURBs be retained for those who owned or were legally committed to a MURB purchase on June 18, 1987. We also recommend that the first subsequent purchaser of a MURB from an individual be treated as though the property were acquired on or before June 18, 1987.** We believe that these proposals would undo the offensive element of retroactivity and believe that the Government can devise rules to ensure that the benefits which might accrue to the first subsequent buyer are limited in such a way that abusive tax practices do not develop.

6.30 Flow-through shares have become an increasingly important source of risk capital for exploration activities in recent years. Several submissions to the Committee made the point that this financing vehicle would be very adversely affected as an indirect – and apparently inadvertent – result of the proposed tax reforms. The proposals having a negative effect on flow-through financing include the reduction of the amount of capital gains exemption by the cumulative "net investment losses" after 1987, the increase in the proportion of capital gains that will be taxable, the capping of the capital gains exemption at $100,000, and the elimination of mining earned depletion. Taken together, these changes would make it impossible to issue flow-through shares at a premium, thereby eliminating the

advantage of issuing such shares. Small- and medium-sized companies in the mining and petroleum sectors would be most negatively affected.

6.31 Evidence we have received suggests that the viability of flow-through share financing can be preserved by limiting the erosion in the adjusted cost base of flow-through shares. Under existing provisions, the cost base is reduced by the amount of tax deduction claimed by the investor (the purchaser of the shares). This implies that at disposition of the shares, all of the proceeds of disposition will be a capital gain. Given the reform proposals already noted, the tax liability so generated would normally make flow-through investments uneconomical.

6.32 **11. We recommend that the cost base of flow-through shares be reduced only by the fair market value of the shares at the time they are acquired.** This means that the cost base of the shares for purposes of calculating capital gains will be the amount of the premium paid for those shares, rather than zero, as is the case at present.

Non-Financial Business Taxation

6.33 It is quite apparent that one of the fundamentals of the entire tax reform exercise is to shift a portion of the tax burden from individuals to business. While we would note that in the final analysis all taxes are borne by individuals either directly or indirectly, this Committee does not argue with the principle that it is appropriate that business bear a larger overall share of the national tax burden, nor that the share borne by business be equally distributed among the various sectors of the business community. At the same time, a healthy economy requires that businesses not be subject to exorbitant taxes to the point where they cannot compete with those in other countries or where it might make good business sense to transfer operations to a foreign country.

6.34 Beyond these general observations, there are a number of areas where the Committee believes immediate modifications should be made to the rules proposed in the White Paper.

6.35 Existing tax provisions allow firms engaged in Research and Development (R&D) to claim a credit against taxes payable. The credit ranges from 20 percent to 35 percent of R&D investments, depending on location and size of firm. As a measure intended to help ensure that profitable corporations pay tax, the White

Paper proposes that tax reduction through the use of R&D credits be limited to one-half of a taxpayer's federal tax payable in a taxation year.

6.36 The revenues expected from this proposal are fairly low. Witnesses appearing before the Committee argued that there may be no gains at all, because the proposal will have the effect of discouraging R&D activities or diverting R&D spending to foreign jurisdictions. It is certainly the case that the proposal favours firms doing less R&D over those engaging more intensively in R&D efforts, since the former will be better able to deduct the full amount of credits earned within the limit of 50 percent of taxes payable. In the Committee's view this is contrary to the long-run interest of the economy and contrary to stated government policy.

6.37 **12. We recommend that the R&D investment tax credit not be limited to 50 percent of taxes payable.**

6.38 The White Paper proposes that land developers be required to capitalize the carrying cost with respect to vacant land held for use in the course of business and that they capitalize construction-period "soft costs".

6.39 According to evidence we received, it is inappropriate to capitalize interest and other carrying costs of vacant land since land represents inventory to developers and builders. If carrying costs are capitalized to vacant land, they cannot be recovered until the land is sold because land is not eligible for depreciation. Indeed, land may be held for long periods of time pending its sale or subsequent development and the carrying costs should remain deductible as do inventory carrying costs in manufacturing or retailing.

6.40 Both the Canadian Institute of Public Real Estate Companies and the Canadian Home Builders' Association noted that the loss of current deductibility for land carrying costs would likely be more prejudicial to small homebuilders who, in certain cases, would be required to pay income tax for years in which they make no cash profit.

6.41 With respect to the capitalization of soft costs, the Canadian Home Builders' Association contended that these should remain deductible in the year incurred. However, the Canadian Institute of Public Real Estate Companies supported the capitalization of soft costs.

6.42 In the Committee's view, construction-period soft costs should be capitalized since they represent expenditures which give rise to definite future

benefits and therefore meet the criterion of an asset. Permitting the capitalization of soft costs totally to the building would allow developers to amortize these along with the acquisition cost of the asset.

6.43 To a developer, however, vacant land is analogous to inventory in a retail or manufacturing operation; carrying costs should thus remain deductible as they are incurred.

6.44 **13. We recommend that the Government not proceed with the proposal to require developers to capitalize vacant-land carrying costs.**

6.45 **14. We recommend that construction period soft costs be required to be capitalized but that the amounts be completely capitalized to the building.**

6.46 A close examination of the whole set of proposals relating to the taxation of farmers including the various "tests" as to who is a farmer, the elimination of block averaging and, most particularly, the dual accounting system, appears to us to be more of an attempt to ensure that non-farmers do not benefit from tax advantages traditionally extended to farmers, rather than an attempt to meet the needs of farmers themselves. We are fully cognizant of the legislative and judicial problems which have arisen because of the role of the part-time farmer and, more to the point, the hobby farmer. We sympathize with the thrust of what the Government wants to do, namely draw a distinction between "true" farmers and those who use farm activities as a form of tax shelter.

6.47 Having said that, we feel that genuine farmers should not be made to carry the brunt of proposals designed to limit benefits which others attempt to get for themselves. While we feel that it is quite legitimate for the Government to try to devise new rules to identify other than full-time farmers and to prevent them from getting excessive tax benefits, we feel that the tests and rules laid down in the White Paper are inappropriate.

6.48 **15. We recommend that the tax rules relating to farmers remain as they are at present, and in particular recommend that farmers be allowed to use cash accounting and retain block averaging.** We also note that an administrative *modus vivendi* has been achieved in the past with regard to farmers having offices in their homes. We would like the assurance of Revenue Canada that

despite the new rules on home offices, farmers would still be able to claim write-offs as in the past.

6.49 16. **We recommend that some different approach be taken to ensure that those who own farms or have passive farm investments but do not qualify as full-time farmers be subject to a more restrictive tax regime than are full-time farmers and that more satisfactory tests be devised to determine into which category any particular individual falls.** In an equally contentious situation, by issuing Interpretation Bulletin 504, Revenue Canada was able to do just this to determine whether an individual qualifies as an artist for tax purposes.

6.50 Having alluded to the issue of the deduction of costs for home offices, we would point out that there were many submissions made to the Committee over the proposals to limit deductibility of expenses associated with such offices. While officials from the Department of Finance tended to speak of professionals who deducted expenses for home offices, the evidence before us suggested that those most affected would include real estate and insurance agents, commission sales people, artists, farmers and small entrepreneurs who operated second businesses out of their homes. While we are not convinced that the new rules are needed in this area, we are prepared to wait to see whether they will in the future inhibit the deductibility of legitimate business expenses. If it appears that the statute or administration is causing hardship in legitimate businesses, we think the matter might be looked at again.

6.51 This brings us to the issue of automobiles. The proposed new rules have been attacked by more briefs than almost any other proposal. It struck us, when we heard testimony from officials of the Department of Finance, that they did not argue that the proposals relating to deductions based on use were fair.

6.52 For our part, we do not see in what way the current system of pro-rating deductible expenses (including those relating to capital cost allowances) is unfair. The notion proposed in the White Paper that the same rules be applied whether a person uses his or her car 21 percent of the time or 89 percent of the time for business driving is the type of proposal which brings the tax system into disrepute among ordinary Canadians. We reject the proposal.

6.53 We accept, however, that there should be some limitation deductions associated with luxury automobiles, and we also recognize that there can be great

differences of opinion as to what constitutes "luxury". We are prepared to accept the $20,000 limitation proposed in the White Paper for capital cost allowance purposes as reasonable with the following *caveat:*

6.54 **17. We recommend that the rules proposed in the White Paper to limit capital cost allowance claims to one-fifth the norm where businesses' driving ranges from 20 percent to 90 percent be rejected, and that the claim be based on the ratio of business driving to total driving.**

6.55 **18. We recommend that the $20,000 limit for deducting capital cost allowance on automobiles be accepted but that to this amount be added provincial sales taxes plus transportation costs. We also recommend that the $20,000 figure be in place for 1988 and 1989 and that an appropriately adjusted figure, taking into account rising prices, be enacted for 1990, with a similar adjustment being made no later than every second year thereafter.** In the absence of rules relating to provincial sales taxes and transportation, the type of car deductible in, say, St. John's would be significantly different than in Toronto or Calgary. Finance officials also indicated an intention to "index" the cost of automobiles in some fashion, but we would prefer having a specific rule set out to ensure that the limitation would expire if steps are not taken to update the base.

6.56 Another area of business expenses which has generated considerable reaction has been the proposal to limit the deductibility of meals and entertainment to 80 percent of the actual cost. Some have pointed out the administrative problems which can arise. Others have pointed out that there is an inherent inequity in that employers which are non-profit (such as the federal government) remain unaffected, while taxable entities incur additional tax costs. Some have pointed out that eating out with potential clients or customers does not, for most people, constitute a particularly pleasurable activity but rather a business necessity. Yet most concede that there is a cogent argument to be made that there is an element of personal consumption present, though why a business should pay a tax cost for the personal consumption of a potential customer is not clear.

6.57 In general, we accept the validity of the proposal. However, we do feel that when a person is travelling on business away from his or her home, the personal element disappears since the option of eating at home has been removed.

6.58 **19. We recommend that meals consumed by a business person while away from home on business travel or while in attendance at a convention or seminar (whether or not at home) remain fully deductible.**

6.59 Most of the tax issues relating to corporations have been subsumed in the general discussions in this paper on business. We do, however, commend the federal government on its move to cut corporate tax rates and wish to express our hope that provincial governments will follow suit, so that overall Canadian corporate rates are not too far out of line with those of the United States.

6.60 We would also like to state for the record our approval of the recent announcement by Finance Minister Wilson that would allow Canadian-controlled private corporations and private companies to elect to set their fiscal year-ends on 31st December 1987 or 30th June 1988 and thus avoid some of the negative consequences of the new capital gains proposals. The Committee had been concerned about this issue and the press release was completely responsive to those concerns.

Financial Institutions

6.61 It is widely recognized – even readily acknowledged by the industry itself – that in recent years financial institutions have been paying extremely low taxes. Low profit levels, resulting from unusually depressed and volatile markets in the early 1980s, are partly responsible for this fact. But even in relation to their profits, financial institutions are very lightly taxed. The White Paper notes that the average federal tax on financial institutions is about 14.5 percent of income compared to an average rate of nearly 19 percent for the corporate sector as a whole. One objective of the tax reform proposals is to increase the effective tax rate of financial institutions to something closer to rates paid by firms in other sectors.

6.62 Even without the White Paper proposals, effective tax rates paid by financial institutions will rise over the next few years. This is in part because the loss carry forwards accumulated in the early 1980s will be running out. In addition, and more important, holdings of tax-exempt securities by financial institutions will decline substantially. Over the past ten years, holdings of tax exempt securities have enabled financial institutions to lower significantly their effective tax rates.

6.63 It is worth pointing out that the major beneficiaries of this tax-lowering have been the issuers of tax exempt securities (i.e. the borrowers), not the lending firms. Tax exempt securities, consisting of income debentures, term preferred shares

and small business bonds, are very similar to loans in the type of risks or rights they confer upon the lender, but have the distinguishing feature that the income which they generate is not subject to tax. Consequently, they require much lower yields than ordinary loans in order to provide the lender with the same after-tax return. To illustrate, at the current general corporate tax rate of 46 percent, a lender could earn the same after-tax yield from a tax-exempt loan substitute yielding 5.4 percent as from an ordinary loan bearing an interest rate of ten percent. Under competitive conditions, the after-tax yield from both types of security would be equalized. This would mean that the benefit of the exemption from tax accrues entirely to the borrower, who receives a loan at 5.4 percent rather than the normal rate of ten percent.

6.64 Beginning with the budget of 16th November 1978, successive restrictions on the use of loan substitutes have virtually eliminated new issues of this type of debt financing. Hence, as existing holdings mature, the volume of loan substitutes outstanding will steadily decline. By the early 1990s, holdings will have been reduced to negligible levels. Correspondingly, taxes paid by financial institutions will rise substantially.

- *Tax Treatment of Doubtful Loans*

6.65 It remains true, nevertheless, that even with the elimination of loan substitutes, our tax system continues to provide financial institutions with wide scope for avoiding taxes. One area where this is possible is in the treatment of reserves for doubtful debts. As a general principle, the *Income Tax Act* allows deductions only for debts that have clearly gone bad during the tax year. Paragraph 18(1)(e) of the Act specifically denies a deduction for "an amount credited to a reserve, contingent account or sinking fund". The Act makes an exception for financial intermediaries, however, allowing them to claim a reserve deduction against the eventuality that part of their loan portfolio may become uncollectible. Moreover, the method used to determine reserves normally allows setting aside reserve amounts which exceed amounts justified by the probability of loss inherent in the loan portfolio. Since the deductions allowed for reserves exceed losses actually incurred by financial institutions, the existing provisions for establishing reserves enable financial institutions to defer payment of accrued tax liabilities.

6.66 The *Income Tax Act* contains separate reserve provisions for the different kinds of financial institutions.

6.67 Reserve provisions are most involved for chartered banks. The amount of tax deductible reserves that can be set aside by banks is determined by the Prescribed Aggregate Reserve (PAR) rules issued by the Office of the Superintendent of Financial Institutions. The PAR rules entitle banks to establish specific provisions for losses on particular doubtful loans and general provisions for losses on loans to 34 heavily-indebted countries. In addition, banks are allowed to build up a contingency reserve intended to cover their exposure for losses higher than those specifically provided for. The maximum amount of the contingency reserve is limited to 1.5 percent of the first $2 billion of eligible assets plus one percent of eligible assets in excess of $2 billion. Eligible assets consist essentially of all customer loans and securities other than those guaranteed by the federal government, the government of a province or another chartered bank.

6.68 Trust and mortgage loan companies, credit unions and life insurance companies are also allowed a general deduction for contingency reserves based on a formula similar to that provided under the PAR rules for banks. In short, these institutions are allowed to accumulate a tax deductible reserve of up to 1.5 percent of the first $2 billion and one percent thereafter, of eligible assets. Trust and mortgage loan companies and credit unions have the option of claiming a reasonable amount as a reserve for specific doubtful loans in lieu of the formula based on fixed percentages of eligible assets.

6.69 The White Paper proposes to eliminate the existing formula-based provisions. Instead, deductions will be permitted only for reserves with respect to loans determined to be doubtful. The reserves will be established on a loan-by-loan basis or, if this is not feasible, on a pooled basis. A prescribed recovery rate, which reflects the average rates that have been observed historically, will be established to prevent excessive estimates of the amounts of reserves appropriate.

6.70 Industry spokesmen expressed concerns about various aspects of the proposed new provisioning rules. The Canadian Bankers' Association (CBA) contended that the proposal to reduce the allowable loan loss reserve by a prescribed loss recovery factor would result in inequitable treatment as between different financial institutions: an institution that accurately forecasts its loan losses (implying zero recovery), "would be penalized because its permitted loan loss reserve deduction, after the prescribed recovery factor disallowance, would be less than its actual experience." The CBA also argued that the notion of a prescribed recovery rate is conceptually flawed. Specific provisions, the CBA emphasized, are

established on the basis of the facts available at the time the decision is made. While subsequent events may reveal that the provisions established were excessive, it would be unreasonable to set provisions on the basis of hindsight.

6.71 The Trust Companies Association of Canada and the Canadian Co-operative Credit Society expressed opposition to the removal of a formula-based method of designating reserves. Loan-by-loan provisioning, they argued, would make the process of establishing reserves more subjective and complex. They acknowledged that the existing formulae may be too generous, allowing larger reserve deductions than actual loan loss experience justified. However, rather than eliminate the formula-based approach for determining reserves, they recommended that the formula be retained and the percentage ceilings be reduced to more appropriate levels.

6.72 Serious concerns were also expressed to the Committee about the bunched costs to financial institutions during the transition stage from the present provisioning system to the one proposed. Contingency reserves form part of the capital base of financial institutions. Any reduction in those reserves, therefore, will result in an equivalent reduction in the capital of those institutions, which will have to be offset through new infusions of equity. Representatives from all sectors of the financial industry maintained that the transitional provisions in the White Paper do not reflect sufficient recognition of the serious impact of the new provisioning rules on the capital base and cash flow of financial institutions during the transition period. Moreover, the impact will be very uneven, and could even place some of the smaller and weaker institutions in jeopardy.

6.73 The stated aims of the White Paper proposals respecting loan loss provisions is to ensure: a) avoidance of tax deferrals, and b) consistency of tax treatment among competing financial institutions. We support these aims, but believe that the proposals made fail to achieve them.

6.74 While all financial institutions will, under the proposed new rules, be subject to the same method of determining reserves, the prescribed recovery rate based on the average rates that have been observed historically seems not only conceptually deficient, since it does not account for changing conditions, it is also bound to have an inequitable impact across financial institutions, since each institution has its own unique poor loan portfolio.

6.75 The White Paper views the prescribed recovery rate as a mechanism for eliminating the deferral of tax. The proposed new provisioning rules, however, would retain the possibility of tax deferral even when applied precisely as intended. Under the new rules, financial institutions will continue to be entitled to deductions for anticipated rather than actual loan losses. Deductions for future losses, even if correctly anticipated, yield reductions in reported income before the income loss actually occurs. In effect, therefore, they represent a form of tax deferral and should not be permitted under a tax system which accounts for income and losses as they accrue.

6.76 **20. We recommend that deductions for loan losses be permitted only when it is determined that the loans are partially or totally uncollectible.** In other words, except as provided in paragraph 6.78 below, we recommend that financial institutions no longer be permitted to claim deductions for expected future losses. Loan losses should be deductible only as they occur.

6.77 The advantages of this approach are that: a) in the tax treatment of bad debts, it places financial institutions in a similar position to non-financial firms; b) it is fairly straightforward - it maintains the present system of deductions for bad debts; and c) it provides an appropriate measure of economic income as the basis of taxation.

6.78 **21.** In order to minimize the effect of the proposal on smaller, regional institutions, we would retain the possibility of accumulating small amounts of tax deductible reserves on the basis of a standard formula. Specifically, **we recommend that financial institutions be permitted to accumulate tax deductible reserves up to one percent of the first $100 million of eligible assets.** Since reserves are provided in recognition of the risk of loss associated with a portfolio, the definition of eligible assets should exclude securities bearing little or no risk.

6.79 **22. To ease transition into the new system for providing reserves, we recommend that existing reserves that would not be allowed under the new system be brought into income in equal amounts over a seven-year period.**

- *Life Insurance Companies*

6.80 The White Paper makes a number of recommendations designed: a) to restrict excessive reserve deductions allowed to the life insurance industry, and b) to

ensure that an appropriate portion of the income of insurance companies with international operations is attributed to Canadian operations and hence subject to tax in Canada. On the whole, the industry recognizes the validity of the reasons that have prompted these proposals and finds the proposals themselves acceptable.

6.81 The one proposed measure that has generated strong opposition from the industry is the proposal to impose a 15 percent tax on the investment income accruing to fund liabilities with respect to whole life insurance policies. Under existing tax provisions, this income is exempt from taxation unless it is received as a result of a policy loan or upon surrender of the policy. Spokesmen for the life insurance industry have argued that the tax, while payable by the insurers, will in fact be passed on to the policy owners and their families. The industry estimates that the tax will cause an increase of 10-20 percent in premiums for non-participating whole life policies or reductions of 20-40 percent in dividends for participating policies.

6.82 The position implicit in the White Paper is that life insurance policies are a type of savings instrument, and that making income from such policies tax exempt creates a bias in favour of insurance.

6.83 Although we view life insurance policies as consisting of a protection as well as a savings component, we are nevertheless in substantial agreement with the White Paper position in that the non-taxation of the build-up in insurance policies creates a bias in favour of insurance. We do not view such a bias, however, as an undesirable effect. There inheres a significant social benefit in any policy that encourages people to provide for themselves or their families, rather than relying on public welfare for their security.

6.84 Given the inefficiencies normally associated with government redistribution mechanisms, subsidizing life insurance policies may in fact be a less costly means of providing social assistance. We also agree with the argument of the life insurance industry that the 15 percent investment tax is in fact a tax on policy holders rather than on the life insurance companies. As such, it is an inequitable tax, since it applies at the same rate to low and high income policyholders alike.

6.85 **23. We recommend that the Government not proceed with the 15 percent insurance investment income tax.**

6.86 To recap, special provisions in the *Income Tax Act* have enabled financial institutions to pay taxes at rates significantly lower than other sectors. We think

that this is neither equitable nor efficient. As we have already indicated, one major source of tax-sheltering – holdings of tax-exempt securities – is being phased out. The White Paper proposals to restrict tax avoidance and deferrals, most of which we support, will have the effect of further increasing the taxes paid by financial institutions. Our own proposal concerning the tax treatment of doubtful debts, which would virtually eliminate deductions for anticipated losses, would also increase the tax liabilities of financial firms. We believe that all these measures, taken together, will bring about a situation in which the effective tax rates on financial institutions are not materially different from those of other business sectors. Should this turn out not to be so, alternative means of bringing this about, including the implementation of a minimum corporate tax, should be considered.

Changes to Sales and Excise Taxes

6.87 The numerous faults in the current federal sales tax, commonly known as the manufacturers' sales tax, have been well documented and are acknowledged by the Government in the White Paper. These flaws include: application to a too narrow base; distortion of production and distribution decisions; widely different effective tax rates producing a varying effect on prices of commodities; inclusion of the tax on business inputs disadvantaging exports; preferential treatment to imports which are not taxed on distribution and marketing costs; the regressivity of the tax; the complexity of the tax imposing high compliance and administrative costs; and the instability of the tax base due to increasing court challenges by taxpayers.

6.88 To correct for these deficiencies, the Government proposes to introduce a form of broadly-based multi-stage sales tax in Stage Two of tax reform. In the meantime, the Government is proposing to make the following alterations to the present federal sales and excise tax systems:

1. The federal sales tax will apply to sales by marketing companies related to a manufacturer or to a foreign exporter.
2. For a range of products, the federal sales tax will be shifted from the manufacturers' level to the wholesale level.
3. Sales tax at a rate of ten percent will apply to telecommunication services, such as telephone and telex services, but will not include charges for local residential telephone lines. The sales tax on cable and pay television

services will be increased to ten percent from the present eight percent.

4. Paint and wallpaper will be deleted from the list of construction materials that are taxable at the lower sales tax rate of eight percent.

5. The refundable federal sales tax credit will be increased by $20 per adult and $10 per child.

6. Federal sales and excise tax remittances will be accelerated, effective 1st April 1988.

6.89 In proposing these measures, the Government appears to be motivated by three main concerns: maintenance of the sales tax base; enhancement of sales tax revenues; and equity. While the Committee would have preferred that the Government had moved tax reform forward in one complete package, thus obviating the necessity of interim sales tax measures, it understands the present requirement for some transitional changes to the system. However, it is clear to the Committee that some of the measures proposed to patch up the current sales tax system are inadequate and will only result in the introduction of further inequities into the system.

6.90 24. **We recommend that as soon as practicable the Government introduce legislation to implement a broad-based multi-stage sales tax to replace the existing federal sales tax system.**

• *Application of Tax to Marketing Companies Related to Manufacturers*

6.91 A clear example of how patchwork alterations to the sales tax system merely create further injustices is presented by the Government's proposed changes to the rules regarding the taxation of transactions between manufacturers or foreign exporters and related distributors.

6.92 Under the current system, manufacturers are able to reduce the cost base on which they are charged the federal sales tax by selling their goods to separate but related marketing companies. The incremental costs of distribution and marketing thereby escape the cost base upon which the sales tax is calculated.

6.93 Existing legislation does authorize the Minister of National Revenue, in transactions between related companies, to set a fair price for purposes of tax

calculation. However, a recent court decision (*Vanguard Coatings and Chemicals Ltd. v. MNR*, [1986] 2 CTC 431) set aside the power of the Minister in this regard, further promoting the establishment of separate marketing companies.

6.94 The Government proposes in the White Paper to address this problem by requiring: "that where a manufacturer sells goods primarily through a related person, that person will be deemed to be the manufacturer of all such goods sold by him and will be liable for tax on his sale price". The new rules would apply to:

- products of domestic manufacturers making sales in Canada to one or more distributors related to the manufacturer;
- imported products where the primary distributors are related to the foreign manufacturer; and
- imported products where the primary distributors are related to the foreign exporter and the product bears the brand or trade name of that exporter, or is produced under a patent, copyright or industrial design of, or used by, such person.

6.95 In their submission to this Committee, the Commodity Taxation Committee of the Canadian Bar Association and the Commodity Taxation Committee of the Canadian Institute of Chartered Accountants pointed out that these rule changes would place integrated Canadian manufacturers at a competitive disadvantage. Marketing companies related to manufacturers would be deemed to be manufacturers and taxed on the selling price inclusive of distribution and marketing costs while independent marketing companies would be taxed only on the manufacturers' selling price.

6.96 Similarly, under the proposed rules, importing distributors, which are related to foreign exporters or manufacturers, would be deemed to be manufacturers and taxed on a base inclusive of marketing and distribution costs while independent importers would be taxed only on the duty paid value. Again, non-integrated companies would gain an advantage over those which are inter-related.

6.97 The Committee takes the view that although the establishment of related marketing companies is likely to erode the sales tax base, the proposed marketing company rules will create further inequities in the sales tax system and increase the incentive for companies to separate their marketing and distribution systems.

6.98 **25. We recommend that the proposal with respect to the application of the federal sales tax to related marketing companies not proceed.**

• *Changes in Trade Level for Imposition of Federal Sales Tax*

6.99 In the White Paper, the Government proposes to shift the application of the existing federal sales tax to the wholesale level for: household chemicals; pet litter; games, toys and sporting goods and equipment; amd records, audio and video tapes and discs and related accessories.

6.100 The Committee is aware that there may be some problems in levying this tax at the wholesale level. However, given the Government's revenue needs, the Committee supports the imposition of the federal sales tax at the wholesale level for the products specified in the White Paper.

• *Tax on Telecommunication Services*

6.101 The White Paper proposes that a ten percent sales tax be imposed on telecommunication services with the basic line charge for local residential telephone service exempted. Although the original proposal applied to the residential touch-tone feature, the Government has since announced that the tax will not apply to rural mileage charges or charges for touch-tone service and custom-calling features such as speed-dialing and call-forwarding.

6.102 It is also proposed that the rate of tax applied to cable and pay television services be increased from eight to ten percent.

6.103 The Committee notes that a major drawback of imposing the telecommunication services tax is that it will become embedded in the cost of business inputs. When other taxes, both federal and provincial, are applied to this tax base, the result will be tax cascading. This compounds the present sales tax system's distortions and biases against domestically produced goods compared with imports and also harms Canadian exports.

6.104 **26. We recommend that the Government proceed with legislation to impose a tax on telecommunication services but that such legislation specify that the ten percent tax be withdrawn upon implementation of a multi-stage sales tax levied on a broad range of goods and services including telecommunication services.**

Administration

6.105 The White Paper contains an array of administrative proposals, primarily designed to improve compliance, reporting and financial management. Generally speaking, this Committee is supportive of these proposals.

6.106 However, a vast majority of briefs and testimony we heard referred to the Government's new anti-avoidance provision. With good reason, not a single voice was heard in support of this proposal. We will content ourselves with pointing out that there is a broadly-based consensus that it will significantly inhibit business and tax planning, not because such planning is abusive, but rather because nobody knows what the scope of the provision is and there would be a gap of literally years before the Canadian courts could start to clarify its meaning. Department of Finance testimony would have us believe that it would be a power used sparingly and wisely. Officials also tried to make the case that the meaning of the statute is not nearly as obscure as its critics have alleged. However, in the face of diametrically opposed views from organizations representing the legal, accounting and business community, we cannot be sanguine about the introduction of the proposal as written.

6.107 We received testimony from the Tax Executives Institute, Inc. that they have had ongoing consultations with Finance and feel that a better version of the general anti-avoidance rule may be developed. Other revised proposals have been made public. This Committee had no intention of producing its own alternative draft. Indeed, we have received no evidence to suggest that the current legislation, along with recent judicial pronouncements, are insufficient to protect the fisc from predatory taxpayers. On the other hand, we are aware of the inherent problems associated with specific tax avoidance measures and we are aware that many other countries have enacted general provisions.

6.108 **27. We recommend that the general anti-avoidance provision proposed in the White Paper not be proceeded with. We further recommend that if a new measure is prepared, it not be enacted retroactively. We further recommend that any future draft of such legislation be made public to allow discussion and that it not become effective until Royal Assent is given to the enabling legislation.** In making these recommendations, the Committee wishes to ensure that any future proposal is subject to the widest possible scrutiny and

comment before being enacted and that the debate take place in an atmosphere which is not tainted with any tinge of retroactivity.

6.109 One further element of the administrative package has caused the Committee some concern. This is the proposal that there be a penalty equal to 50 percent of the normal interest costs where a taxpayer has failed to make his or her quarterly payments on time or in sufficient amounts. We would note that until 1981, the *Income Tax Act* had a dual interest rate system, charging taxpayers more interest on amounts owed the Government than it would pay to a taxpayer to whom it was indebted. This system was abolished as being unfair. The new proposal in part revives the old system. The problem is underlined when one considers that subsequent assessments of tax, sometimes years after the fact, can have an impact on the quantum of the required instalment. And the penalty is exacerbated by the fact that interest owing to the Government is compounded daily. Given all these factors, the Committee feels that this proposal should not be proceeded with.

6.110 **28. We recommend that the proposal to impose a penalty tax equal to 50 percent on interest due for failure to remit tax instalments on time not be implemented and that the current rules continue to apply in such circumstances.**

Simplification

6.111 The Committee notes that one of the stated objectives of the tax reform exercise was to simplify the tax system. A clearly understandable set of rules would be of benefit both to taxpayers and administrators.

6.112 Representatives from the Department of Finance suggested that some actions leading to simplification have been taken, notably the reduction in the number of tax brackets and the elimination of income averaging provisions. We do not believe that the reduction in the number of tax brackets in any way simplifies the system. And, as we have noted earlier in this report, the cost in fairness of eliminating averaging provisions more than outweighs any benefits which might accrue from simplifying the Act.

6.113 Indeed, we were struck by the number of representations which were made which suggested that the new system would be more complex than the old. Without suggesting that the list is in any way comprehensive, the following

proposals would all make the understanding of and compliance with the Act more difficult:

- the combination of cash and accrual systems for farmers;
- the preferred share tax;
- the need for setting up new capital cost allowance pools for assets acquired under the new system;
- the elimination of the special rules applicable to employees who use cars for less than 12,000 kilometers a year for personal driving;
- the acceleration of tax remittances, especially for businesses which are not in urban areas;
- segregating meal and entertainment expenses so as to be able to comply with the 80 percent rule;
- the two-tier tax credit for charitable donations;
- the requirement that a self-employed individual claim both a deduction and a credit with respect to Canada Pension Plan contributions;
- the need for small companies to recompute their refundable dividend accounts;
- the requirement for additional reporting by financial institutions and promoters;
- the obscure anti-avoidance proposals;
- the complex phase-in and grandfathering provisions.

6.114 While we are not suggesting that any or all these proposals be abandoned (beyond the specific recommendations already made in this Chapter) because they are complex, by no stretch of the imagination can it be said that the tax reform exercise has any aspect of simplification to it. The *Income Tax Act*, and compliance with it, will be greatly complicated by the proposals.

6.115 We suggest to both the Minister of Finance and the Minister of National Revenue that steps be taken to simplify the structure of the system itself as well as tax returns and other reporting documents. There is precedent for this. Major ameliorating changes were made to the tax system as it applied to small businesses a

number of years ago which resulted (at least for a while) in a set of rules which was much more understandable and manageable. And the Province of Quebec took steps to simplify its own tax returns, providing a model which those in the rest of Canada might envy.

6.116 These experiences demonstrate that if there is a will to do so, both the system itself and reporting under the system can be made easier. It is apparent that simplification was not a high priority when the White Paper was drafted. The issue might be addressed first in the context of the legislation which will be tabled to implement the White Paper proposals. Particular thought might be given to whether the game, as evidenced by the revenue and equity issues related to any particular proposal, is worth the candle if the implementing legislation can only be understood by the draftspeople themselves.

6.117 **29. We recommend that the Department of Finance begin consultations with interested groups to determine which parts of the *Income Tax Act* would lend themselves to structural simplification, and to proceed with dispatch to amend the Act, using the same guidelines as were used in simplifying the small business rules.**

Fiscal Implications

6.118 We estimate the net costs of our recommendations to the federal treasury at close to one billion dollars. Given the size of the federal deficit, we do not view such an impact lightly. However, this impact is largely due to the staging process of tax reform. Many of our recommendations have the effect of bringing forward into stage one aspects of reform promised in the second stage. If the second stage proceeds expeditiously, as we have urged throughout the report, the fiscal concern will be a temporary one. We view our recommendations as necessary for a sound and fair system of taxation: they should not be sacrificed to affect a temporary improvement in deficit projections. Should the interim between the two stages be longer than anticipated, we expect Finance to adopt appropriate initiatives consistent with fiscal restraint and an integrated approach to tax reform.

Appendix A
List of Witnesses

Monday, September 14, 1987: (Issue No. 32)

From the Department of Finance:

Mr. David A. Dodge, Senior Assistant Deputy Minister, Tax Policy & Legislation Branch;
Mr. R.A. (Al) Short, General Director of Legislation, Tax Policy & Legislation Branch;
Mr. David Holland, Director, Corporate & Resource Tax Analysis, Tax Policy & Legislation Branch;
Mr. Michael Sabia, Head, Sales Tax Reform Group, Tax Policy & Legislation Branch;
Mr. Gerard Lalonde, Senior Tax Policy Officer, Tax Policy & Legislation Branch.

Wednesday, September 16, 1987: (Issue No. 32)

From the Department of Finance:

Mr. David A. Dodge, Senior Assistant Deputy Minister, Tax Policy & Legislation Branch;
Mr. R.A. (Al) Short, General Director of Legislation, Tax Policy & Legislation Branch;
Mr. David Holland, Director, Corporate & Resource Tax Analysis, Tax Policy & Legislation Branch;
Mr. Paul Dick, Chief, Special Projects, Tax Policy & Legislation Branch.

Thursday, September 17, 1987: (Issue No. 33)

From the Economic Council of Canada:

Mrs. Judith Maxwell, Chairman;
Mr. Robert Jenness, Senior Policy Advisor;
Mr. Ross Preston, Senior Project Director;
Mr. Sylvester Damus, Project Leader.

Tuesday, October 27, 1987: (Issue No. 39)

From the Canadian Federation of Labour:

Mr. James McCambly, President;
Mr. Ed. Herechuk, President, Ontario Provincial Council of Labour.

From the Alliance of Canadian Cinema, Television and Radio Artists:

Mr. Garry Neil, General Secretary.

Wednesday, October 28, 1987: (Issue No. 40)

From the Canadian Life and Health Insurance Association Inc.:

Mr. Gerald M. Devlin, Q.C., President;
Mr. James Witol, Vice President, Taxation and Research;
Mr. Jules Ducasz, Vice President, Sun Life Assurance Company of Canada;
Mr. Peter Safran, Actuary, The Canada Life Assurance Company;
Mr. C. Garfield White, F.C.I.A., Manager, Government Relations.

Tuesday, November 3, 1987: (Issue No. 41)

From the Canadian Pulp and Paper Association:

Mr. T.O. Stangeland, President & Chief Operating Officer, Consolidated Bathurst Inc.;
Mr. A. Desautels, Vice-President, Finance, Rolland Inc;
Mr. J. Ricard, Director of Taxation, Domtar Inc.
Dr. D.A. Wilson, Director, Economic and Forest Policy, CPPA.

From the Life Underwriters Association of Canada:

Mr. Robert B. Templeton, CLU, Chairman and Chief Executive Officer;
Mr. Arthur A. Schooley, CLU, Director;
Mr. Karl Keilhack, Vice-President of Taxation.

Monday, November 16, 1987: (Issue No. 42)

From the Canadian Bankers' Association:

Mr. Andrew G. Kenyon, Chairman, Taxation Committee; Senior Vice President, Canadian Imperial Bank of Commerce;
Mr. David L. Burn, Member, Taxation Committee; Vice President, Taxation, Bank of Montreal;
Mr. Richard Barnowski, Assistant Director, Financial Affairs.

From the Canadian Restaurant and Foodservices Association:

Mr. William Frank, President; Vice President, Operations, Edwards Fine Food Ltd.;
Mr. Timothy Whitehead, Director; General Manager, Ottawa Westin Hotel;
Mr. Douglas Needham, Executive Vice President and Chief Operating Officer.

From the Canadian Co-operative Credit Society:

Mr. Gary Rogers, Taxation Advisor;
Mr. Warren Hanstead, Director; General Manager, National Defence Credit Union;
Mr. Albert F. Chambers, Director, Government Affairs.

From the National Anti-Poverty Organization:

Ms. Havi Echenberg, Executive Director.

From Bell Canada:

Mr. Gary Bray, Vice-President, Government and Regulatory Affairs;
Mr. Dale Orr, Chief Economist;
Mr. Saleem Hasan, Assistant Vice-President, Taxation and Depreciation;
Mr. Charles Campbell, Director, Commodity and Property Taxes.

Tuesday, November 17, 1987: (Issue No. 43)

From the Tax Executives Institute, Inc.:

Mr. Thomas M. Nee, President; Vice President, Taxes, American Home Products Corp.;
Mr. D. John Nichol, Vice President, Region I (Canada); Director, Ad Valoreum Tax, Petro-Canada Inc.;
Mr. Michel Dell'Aniello, Chairman, Canadian Income Tax Committee; Director of Taxation, Joseph E. Seagram & Sons, Limited;
Mr. James Hutchison, Chairman, Canadian Commodity Tax Committee; Director, Taxes, IBM Canada Limited;
Mr. Timothy J. McCormally, Tax Counsel,

From the National Action Committee on the Status of Women:

Ms. Louise Dulude, President.

From the Business Council on National Issues:

Mr. Thomas P. d'Aquino, President and Chief Executive Officer;
Mr. G.R. Heffernan, President and Chief Executive Officer, Co-Steel Inc.;
Mr. J.H. Smith, President and Chief Executive Officer, Domtar Inc.
Mr. T. Rutley, Director of Research.

From the Commercial Travellers' Association:

Mr. T.J. Ruffell, General Manager.

From the One-Voice - Seniors Network (Canada) Inc.:

Mrs. Margaret Chown, Vice President, Board of Directors;
Mrs. Jean Woodsworth, Secretary, Board of Directors;
Mr. Ivan Hale, National Secretary;
Mr. Richard Shillington, Consultant;
Mr. Andrew Aitkens, Research Consultant.

From the Federation of Automobile Dealers Association of Canada:

Mr. Donald Megaffin, President;
Mr. Ken Graydon, Executive Vice President;
Mr. Donald Beach, C.A., Tax Consultant, Coopers & Lybrand Consulting Group;
Mr. J. William MacKinnon, Q.C., Director, Government Relations.

Wednesday, November 18, 1987: (Issue No. 44)

From the Canadian Petroleum Association:

Mr. W.A. (Bill) Gatenby, Chairman; President and Chief Executive Officer, Texaco Canada Resources;
Mr. Randy Hogg, Chairman, Income Tax Committee; Chief, Taxation Policy, Texaco Canada Resources;
Mr. Hans Maciej, Vice President, Technical Affairs.

From the Vanier Institute of the Family:

Dr. Robert Glossop, Coordinator of Programs and Research;
Mr. Alan Mirabelli, Coordinator of Administration and Communications/ Information.

From the Canadian Institute of Public Real Estate Companies:

Mr. Donald King, President; President and Chief Executive Officer, Marathon Realty Company Limited;
Mr. Ron Daniel, Executive Director;
Mr. L. Ross Cullingworth, President and Chief Executive Officer, Coscan Development Corporation;
Mr. William Anderson, Partner, Peat Marwick Limited.

From the Canadian Homebuilders' Association:

Mr. Norman Godfrey, President;
Dr. John Kenward, Chief Operating Officer.

From the Canadian Association of Oilwell Drilling Contractors:

Mr. Gordon Rowan, President;
Mr. Brian Krausert, Vice President;
Mr. Gordon Dibb, Vice President, Nabors Drilling Ltd.;
Mr. Don Herring, Managing Director.

From the Trust Companies Association of Canada:

Mr John L. Evans, President and Chief Executive Officer;
Mr Joseph Chertkow, Associate General Counsel, Royal Trust;
Mr David Lebbell, Director, Corporate Taxation, Royal Trust;
Mr Jake Van Ginkel, Vice President, Taxation, National Trust Company.

Thursday, November 19, 1987: (Issue No. 45)

From the Canadian Council on Social Development:

Mr. Terrance Hunsley, Executive Director.

Tuesday, November 24, 1987: (Issue No. 46)

From the Insurance Bureau of Canada:

Mr. J.L. Lyndon, President;
Mr. J. Cerasani, Chairman, Panel on Taxation.

From the Canadian Institute of Chartered Accountants:

Mr. William J. Strain, Co-Chairman, Joint Committee on Taxation.

From the Canadian Bar Association:

Mr. Howard J. Kellough, Co-Chairman, Joint Committee on Taxation.

Wednesday, November 25, 1987: (Issue No. 47)

From the C.D. Howe Institute:

Mr. Edward A. Carmichael, Vice President.

From the Consumers' Association of Canada:

Ms. Sally Hall, National President;
Dr. Robert Kerton, Chairman, Economic Issues Committee;
Mr. Tom Delaney, Member, Economic Issues Committee;
Ms. Kathleen Stephenson, Director, Association Policy & Activities.

Appendix B

List of Briefs Received

In addition to over 2,000 letters from individuals expressing their views on tax reform, the Committee received the following written submissions:

ABSTAINERS/MAPLEX GENERAL INSURANCE COMPANIES
Toronto, Ontario

AGRICULTURAL INSTITUTE OF CANADA
Ottawa, Ontario

AIR CANADA
Montreal, Quebec

ALBERTA ASSOCIATION OF MUNICIPAL DISTRICTS AND COUNTIES
Edmonton, Alberta

ALBERTA ENERGY COMPANY LTD.
Calgary, Alberta

ALLIANCE OF CANADIAN CINEMA, TELEVISION AND RADIO ARTISTS
Toronto, Ontario

ASSOCIATION OF UNIVERSITIES AND COLLEGES OF CANADA
Ottawa, Ontario

AUTOMOTIVE INDUSTRIES ASSOCIATION OF CANADA
Ottawa, Ontario

BELL CANADA
Ottawa, Ontario

BOBIT PUBLISHING CANADA LIMITED
Don Mills, Ontario

BORDEN & ELLIOT
Toronto, Ontario

BRITISH COLUMBIA TELEPHONE COMPANY
Vancouver, British Columbia

BRITISH COLUMBIA AND YUKON CHAMBER OF MINES
Vancouver, British Columbia

BROMLEY, MR. BLAKE G.
Vancouver, British Columbia

BUSINESS COUNCIL ON NATIONAL ISSUES
Ottawa, Ontario

BUTLER BROS. LIMITED
Armdale, Nova Scotia

C.D. HOWE INSTITUTE
Toronto, Ontario

CANADIAN ASSOCIATION OF BROADCASTERS
Ottawa, Ontario

CANADIAN ASSOCIATION OF OILWELL DRILLING CONTRACTORS
Calgary, Alberta

CANADIAN ASSOCIATION OF OPTOMETRISTS
Ottawa, Ontario

CANADIAN ASSOCIATION OF WHOLESALE SALES REPRESENTATIVES
Toronto, Ontario

CANADIAN BANKERS' ASSOCIATION
Toronto, Ontario

CANADIAN BAR ASSOCIATION
Toronto, Ontario

CANADIAN BUSINESS PRESS
Toronto, Ontario

CANADIAN CENTRE FOR PHILANTHROPY
Toronto, Ontario

CANADIAN CHEMICAL PRODUCERS' ASSOCIATION
Ottawa, Ontario

CANADIAN CONFERENCE OF THE ARTS
Ottawa, Ontario

CANADIAN CO-OPERATIVE CREDIT SOCIETY
Islington, Ontario

CANADIAN COUNCIL OF GROCERY DISTRIBUTORS
Saint-Laurent, Quebec

CANADIAN COUNCIL ON SOCIAL DEVELOPMENT
Ottawa, Ontario

CANADIAN CRAFTS COUNCIL
Montreal, Quebec

CANADIAN DENTAL ASSOCIATION
Ottawa, Ontario

CANADIAN DIAMOND DRILLING ASSOCIATION
North Bay, Ontario

CANADIAN EXPORTERS' ASSOCIATION
Ottawa, Ontario

CANADIAN FEDERATION OF AGRICULTURE
Ottawa, Ontario

CANADIAN FEDERATION OF INDEPENDENT BUSINESS
Willowdale, Ontario

CANADIAN FEDERATION OF LABOUR
Ottawa, Ontario

CANADIAN GAS ASSOCIATION
Don Mills, Ontario

CANADIAN HOME BUILDERS' ASSOCIATION
Ottawa, Ontario

CANADIAN INSTITUTE OF CHARTERED ACCOUNTANTS
Toronto, Ontario

CANADIAN INSTITUTE OF PUBLIC REAL ESTATE COMPANIES
Toronto, Ontario

CANADIAN LABOUR CONGRESS
Ottawa, Ontario

CANADIAN LIFE AND HEALTH INSURANCE ASSOCIATION INC.
Toronto, Ontario

CANADIAN MEAT COUNCIL
Islington, Ontario

CANADIAN MEDICAL ASSOCIATION
Ottawa, Ontario

CANADIAN PENSIONERS CONCERNED INC.
Toronto, Ontario

CANADIAN PETROLEUM ASSOCIATION
Calgary, Alberta

CANADIAN PULP AND PAPER ASSOCIATION
Montreal, Quebec

CANADIAN REAL ESTATE ASSOCIATION
Ottawa, Ontario

CANADIAN RESTAURANT AND FOODSERVICES ASSOCIATION
Toronto, Ontario

CERTIFIED GENERAL ACCOUNTANTS' ASSOCIATION OF CANADA
Vancouver, British Columbia

CLARKE, MR. BROCK F., Q.C.
Montreal, Quebec

COALITION OF CANADIAN TRANSPORT ASSOCIATIONS AND CARRIERS
Toronto, Ontario

COHEN, MR. JORDAN M.
Toronto, Ontario

COMMERCIAL TRAVELLERS' ASSOCIATION OF CANADA
Toronto, Ontario

COMMUNITY SERVICES COUNCIL
St. John's, Newfoundland

CONFERENCE BOARD OF CANADA
Ottawa, Ontario

CONSUMERS' ASSOCIATION OF CANADA
Ottawa, Ontario

COOPERS & LYBRAND CONSULTING GROUP
Montreal, Quebec

COUNCIL OF FOREST INDUSTRIES OF BRITISH COLUMBIA
Vancouver, British Columbia

DesBRISAY, MR. JOHN T., Q.C.
Toronto, Ontario

DUNWOODY & COMPANY
Toronto, Ontario

DURACELL INC.
Mississauga, Ontario

ECONOMIC COUNCIL OF CANADA
Ottawa, Ontario

ELKIND, LIPTON & JACOBS
Toronto, Ontario

EXPOS, MONTREAL BASEBALL CLUB LTD.
Montreal, Quebec

FEDERAL SUPERANNUATES NATIONAL ASSOCIATION
Ottawa, Ontario

FEDERATION OF AUTOMOBILE DEALER ASSOCIATIONS OF CANADA
Willowdale, Ontario

FEDERATION OF INDEPENDENT SCHOOLS IN CANADA
Edmonton, Alberta

FINANCE, DEPARTMENT OF
Ottawa, Ontario

FOERSTER, MR. LAWRENCE
Toronto, Ontario

GENERAL EQUIPMENT LIMITED
Vancouver, British Columbia

GREAT-WEST LIFE ASSURANCE COMPANY
Winnipeg, Manitoba

HALIFAX BOARD OF TRADE
Halifax, Nova Scotia

HAYES-DANA INC.
St. Catharines, Ontario

HOGG, PROF. PETER W.
North York, Ontario

HOTEL ASSOCIATION OF CANADA
Edmonton, Alberta

INDEPENDENT PETROLEUM ASSOCIATION OF CANADA
Calgary, Alberta

INSTITUTE OF ASSOCIATION EXECUTIVES
Toronto, Ontario

INSTITUTE OF CHARTERED ACCOUNTANTS OF BRITISH COLUMBIA
Vancouver, British Columbia

INSTITUTE OF DONATIONS AND PUBLIC AFFAIRS RESEARCH
Montreal, Quebec

INSURANCE BUREAU OF CANADA
Toronto, Ontario

INTERCONTINENTAL MAPS & CHARTS LTD.
Toronto, Ontario

INVESTMENT DEALERS ASSOCIATION OF CANADA
Toronto, Ontario

J.G. LOZO REAL ESTATE INVESTMENTS
Toronto, Ontario

J.S. JONES FUNERAL HOME LIMITED
Georgetown, Ontario

JOHNSON, MRS. RUTH AND MR. RALPH
Caroline, Alberta

JOINT SECURITIES INDUSTRY COMMITTEE ON TAX REFORM
Toronto, Ontario

LEONARD KURLAND INC.
Westmount, Quebec

LEVY, MR. EDWARD J.
Toronto, Ontario

LIFE UNDERWRITERS ASSOCIATION OF CANADA
Don Mills, Ontario

LONDON LIFE ASSURANCE COMPANY
London, Ontario

MAHEU NOISEUX
Montreal, Quebec

MANUFACTURERS LIFE INSURANCE COMPANY
Toronto, Ontario

MATHESON, MR. W.G.
Colborne, Ontario

MINING ASSOCIATION OF BRITISH COLUMBIA
Vancouver, British Columbia

MINING ASSOCIATION OF CANADA
Ottawa, Ontario

MITEL CORPORATION
Kanata, Ontario

MONTREAL BOARD OF TRADE
Montreal, Quebec

MUTUAL LIFE ASSURANCE COMPANY OF CANADA
Waterloo, Ontario

NATIONAL ACTION COMMITTEE ON THE STATUS OF WOMEN
Toronto, Ontario

NATIONAL COUNCIL OF WELFARE
Ottawa, Ontario

NATIONAL HOCKEY LEAGUE PLAYERS' ASSOCIATION
Toronto, Ontario

NATIONAL VOLUNTARY ORGANIZATIONS
Ottawa, Ontario

NEWMAN, MR. GEOFFREY
Montreal, Quebec

NORTHERN TELEPHONE LIMITED
New Liskeard, Ontario

ONE VOICE - THE CANADIAN SENIORS NETWORK
Ottawa, Ontario

ONTARIO ASSOCIATION OF ARCHITECTS
Toronto, Ontario

ONTARIO TELEPHONE ASSOCIATION
Kanata, Ontario

PROCTER & GAMBLE INC.
Toronto, Ontario

QUEBEC CHAMBER OF COMMERCE, PROVINCE OF
Quebec, Quebec

QUEBEC PROSPECTORS' ASSOCIATION
Ottawa, Ontario

REALISTIC EQUAL ACTIVE FOR LIFE WOMEN
Thornhill, Ontario

RETAIL COUNCIL OF CANADA
Toronto, Ontario

ROTHMANS, BENSON & HEDGES INC.
North York, Ontario

ROY, DR. A.K.
Ottawa, Ontario

ROYAL LIFE INSURANCE COMPANY OF CANADA
Toronto, Ontario

RUBBER ASSOCIATION OF CANADA
Mississauga, Ontario

SAINT JOHN, CITY OF
St. John, New Brunswick

SAINT MARY'S UNIVERSITY
Halifax, Nova Scotia

SASKATCHEWAN, GOVERNMENT OF
Regina, Saskatchewan

SILL, STREUBER, FISKE & COMPANY
Winnipeg, Manitoba

SMITH, FLYNN, STALEY
Burnaby, British Columbia

SPIRO, MR. SOLOMON
Toronto, Ontario

STERN, COHEN, WEINSTEIN, BAINES & MASCHING
Toronto, Ontario

STEWART, MRS. GAIL
Ottawa, Ontario

SUN LIFE ASSURANCE COMPANY OF CANADA
Toronto, Ontario

TAX EXECUTIVES INSTITUTE, INC.
Calgary, Alberta

TÉLÉBEC LTÉE
Dorval, Quebec

TELESAT CANADA
Ottawa, Ontario

THORNE ERNST & WHINNEY INC.
Toronto, Ontario

TOURISM INDUSTRY ASSOCIATION OF CANADA
Ottawa, Ontario

TRUST COMPANIES ASSOCIATION OF CANADA
Toronto, Ontario

VANIER INSTITUTE OF THE FAMILY
Ottawa, Ontario

VERMEULEN & ASSOCIATES
Tsawwassen, British Columbia

WEIR & FOULDS
Toronto, Ontario

WINNIPEG JETS
Winnipeg, Manitoba

YUKON, GOVERNMENT OF
Whitehorse, Yukon

Respectfully submitted,

IAN SINCLAIR
Chairman