REPORT ON THE WHITE PAPER ON TAX REFORM (Stage 1)

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The Standing Committee on Finance and Economic Affairs

November 1987

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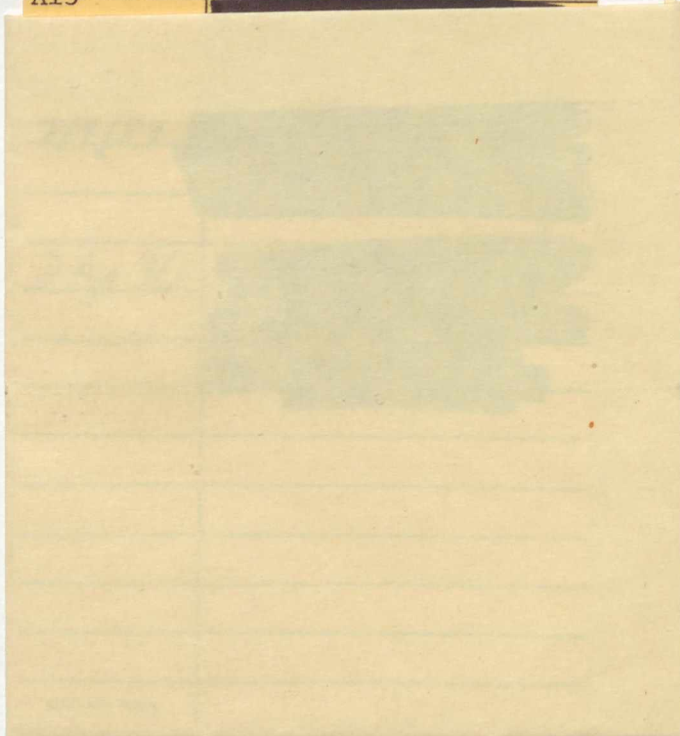

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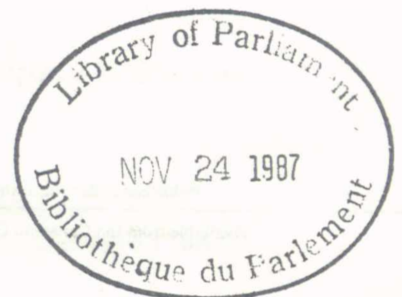

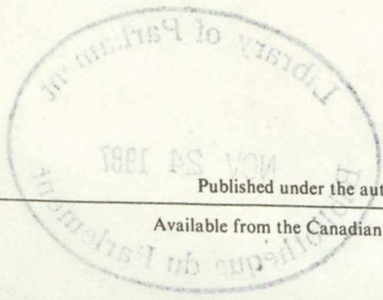

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HOUSE OF COMMONS

CHAMBRE DES COMMUNES

Issue No. 125

Tuesday, June 23, 1987
Monday, August 24, 1987
Tuesday, September 15, 1987
Tuesday, October 6, 1987
Thursday, October 8, 1987
Tuesday, October 13, 1987
Wednesday, October 14, 1987
Thursday, October 15, 1987
Tuesday, October 20, 1987
Wednesday, October 21, 1987
Thursday, October 22, 1987
Monday, October 26, 1987
Tuesday, October 27, 1987
Wednesday, October 28, 1987
Thursday, October 29, 1987
Monday, November 2, 1987
Tuesday, November 3, 1987

Fascicule nº 125

Le mardi 23 juin 1987
Le lundi 24 août 1987
Le mardi 15 septembre 1987
Le mardi 6 octobre 1987
Le jeudi 8 octobre 1987
Le mardi 13 octobre 1987
Le mercredi 14 octobre 1987
Le jeudi 15 octobre 1987
Le mardi 20 octobre 1987
Le mercredi 21 octobre 1987
Le jeudi 22 octobre 1987
Le lundi 26 octobre 1987
Le mardi 27 octobre 1987
Le mercredi 28 octobre 1987
Le jeudi 29 octobre 1987
Le lundi 2 novembre 1987
Le mardi 3 novembre 1987

Chairman: Don Blenkarn

Président: Don Blenkarn

Minutes of Proceedings and Evidence of the Standing Committee on

Finance and Economic Affairs

Procès-verbaux et témoignages du Comité permanent des

Finances et des Affaires Économiques

RESPECTING:

Pursuant to Standing Order 96(2), consideration of the White Paper and other related documents on Tax Reform

CONCERNANT:

En vertu de l'article 96(2) du Règlement, étude du Livre blanc et autres documents connexes, ayant trait à la réforme fiscale

INCLUDING:

The Eleventh Report to the House

Y COMPRIS

Le Onzième Rapport à la Chambre

Second Session of the Thirty-Third Parliament 1986-87

Deuxième session de la trente-troisième législature 1986-87

STANDING COMMITTEE ON FINANCE AND ECONOMIC AFFAIRS

In accordance with the Order of Reference from the House of Commons dated Friday, October 2, 1987:

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Vice-Chairman: Robert E. J. Layton

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Suzanne Blais-Grenier
Michael Cassidy
Mary Collins
Simon de Jong
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Aideen Nicholson
Norman Warner

In accordance with the Order of Reference from the House of Commons dated Wednesday, October 15 1986:

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Norman Warner
Geoff Wilson

(Quorum 7)

Marie Carrière
Clerk of the Committee

COMITÉ PERMANENT DES FINANCES ET DES AFFAIRES ÉCONOMIQUES

Conformément à l'ordre de renvoi de la Chambre des communes et date du lundi 2 octobre 1987:

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Vice-président: Robert E.J. Layton

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Michael Cassidy
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George Minaker
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Norman Warner

Conformément à l'ordre de renvoi de la Chambre des communes en date du mercredi 15 october 1986.

Président: Don Blenkarn

Vice-président: André Plourde

Membres

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Michael Cassidy
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W. Paul McCrossan
George Minaker
Aideen Nicholson
Norman Warner
Geoff Wilson

(Quorum 7)

Le greffier du Comité
Marie Carrière

ORDERS OF REFERENCE

Tuesday, June 30, 1987

ORDERED,— That the Standing Committee on Finance and Economic Affairs be empowered to travel

(1) to Vancouver, Edmonton, Regina and Winnipeg from September 20 to September 25, 1987;

(2) to Quebec City, Fredericton, Charlottetown, Halifax and St. John's (Newfoundland) from September 27 to 30, 1987;

(3) to Mont Ste-Marie (Quebec) on October 13, 14 and 15, 1987 for the purpose of drafting its report to the House; and

that the necessary staff do accompany the Committee.

ATTEST

Michael B. Kirby
Clerk of the House of Commons

The Standing Committee on Finance and Economic Affairs

has the honour to present its

ELEVENTH REPORT

In accordance with its mandate under Standing Order 96(2), your Committee has examined the White Paper and other related documents on Tax Reform (Stage 1 of the proposals) tabled in the House of Commons on Thursday, June 18, 1987.

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Acknowledgement

This Report would be remiss if it did not acknowledge the hard work, the effort and the organization of the Committee's deliberation by C. David Weyman, F.C.A., who has been working with the Committee as a resource person since the Committee first contemplated becoming involved in tax reform in November of 1986.

In order to coordinate the Committee's work in dealing with the hundreds of submissions and the very complex issues that came before the Committee with reference to the White Paper, Mr. Weyman brought to the Committee as consultants R. Geoffrey Fisher, C.A., Senior Manager-Tax of the firm Peat, Marwick in Ottawa; Barbara J. Mackay, C.A., tax specialist with the firm Clarkson, Gordon in London, Ontario; France Castonguay, tax specialist with the accounting firm of Samson, Bélair in Montreal; Edwin G. Kroft, tax specialist with the law firm of Ladner, Downs in Vancouver.

The particular expertise brought to the Committee by these people substantially assisted in getting at the difficult issues raised in the White Paper. In addition, the Committee was fortunate to have on its staff Dr. H. Bert Waslander as its general Research Director, who was accompanied by Dr. Terrence J. Thomas, from the Library of Parliament.

In addition, the committee was able to secure the services of Sean Aylward, an Ontario lawyer with some tax expertise, Kirk Falconer, from the New Democratic Party, and Mr. Anthony Knill from the Liberal Party.

Without the very extensive background work done by the staff, it would not have been possible to put this Report together.

In that respect it is exceptionally important to review the extensive business experience and advice that was available to the Committee from the Members of Parliament who form the Committee and who worked extensively on the Report. In that respect it is important to note the efforts of Raymond Garneau, Member of Parliament for Laval-des-Rapides, former Minister of Finance for the Province of Quebec and former Chief Executive Officer of the Montreal City and District Savings Bank; and Aideen Nicholson, Member of Parliament for Trinity, a Member with a great deal of experience and presently the Chairperson of the House of Commons Public Accounts Committee.

The Committee was also privileged to be able to have the extensive experience of Michael Cassidy, Member of Parliament for Ottawa Centre and the Finance Critic for

the New Democratic Party. Mr. Cassidy was able to bring his particular financial experience as a journalist together with his experience as the former leader of the New Democratic Party in Ontario. Also from the New Democratic Party, a long time member of the Committee from the riding of Regina, East, Simon de Jong, who has a great deal of small business experience.

From the Progressive Conservative Party, the Committee was privileged to have the experience of Paul McCrossan, Member of Parliament for York Scarborough. Prior to his election he was a leading actuary and was particularly valuable to the Committee in dealing with problems in connection with financial intermediaries and other matters of like nature in the Report.

William Attewell, Member of Parliament for Don Valley East and former Vice-President, Corporate Planning of the Guaranty Trust Company, and a long time member of the Committee, was of considerable help. In addition, the Committee had the help of Norman Warner, Member of Parliament for Stormont Dundas, who has extensive experience in the general real estate and insurance business.

From Western Canada the Committee had the assistance of Murray Dorin, Member of Parliament for Edmonton West and a chartered accountant with extensive business experience, and Geoff Wilson, Member of Parliament for Swift Current-Maple Creek, with extensive legal experience. Mr. Wilson is Chairman of the Standing Committee on Agriculture. The Committee also had the assistance of George Minaker, Member of Parliament for Winnipeg-St. James. Mr. Minaker is a former Minister in the Government of Manitoba.

The Committee's Vice-Chairman is the Honourable Robert E.J. Layton, Member of Parliament for Lachine and the former Minister of State (Mines). He had extensive experience in the engineering field before being elected to Parliament.

We must further acknowledge that without the dedication and organization capacity of Marie Carrière, the Clerk of the Committee, who together with a superb support staff comprised of Diane Lefebvre, Administrative Assistant, Lise Tierney, Secretary, Francine Brewin, Clerk/Receptionist, Margot Maguire from Humphreys Public Affairs, media interviews, Nancy Clairmont and Susan Lafontaine, Micom operators, Beth Ediger, English Editor, Georges Royer, French Editor, and Claude Beaudry, Messenger, the extensive work in connection with putting the Report together could not have been possible.

The work of the Committee involved rather difficult arrangements for witnesses and very comprehensive arrangements needed for the trips away from Ottawa involving transportation, accommODAtion, translation of briefs and documents, distribution of material and arrangements for witnesses coming to Ottawa and a whole host of other matters including preparation of briefing books for Members and making sure that Members were fully familiar with the issues being brought to them.

As Chairman of the Committee, I must say how appreciative I am of the work done by the staff and by my colleagues in Parliament in such a dedicated fashion and working the many long hours that were required to put this Report together.

Don Blenkarn, M.P.
Mississauga South
Chairman

List of Recommendations

Chapter 2: Background to Tax Reform and to this Report

1. That the Canadian income tax system be reformed along the lines proposed in the White Paper on Tax Reform, and in particular that the proposed base-broadening measures, conversion to credits and rate structures for the corporate and personal income tax be implemented, and that the other measures under Stage One of tax reform be adopted, subject to the recommendations that follow.
2. That the tax system be amended less frequently following reform, and that it be kept as stable and simple as possible.

Chapter 4: Personal Income Tax Reform

Child Benefits

3. That for the third and each subsequent child under age 19 a tax payer claims as a dependant:

   a) the taxpayer be given an additional exemption credit of $65;

   b) this additional credit be made refundable in the form of a top-up of the federal refundable child tax credit of up to $100 per child. This top-up is reduced by the portion of the additional exemption credit that is used to reduce federal tax as payable to zero;

   c) that the government negotiate with the province of Quebec to provide an equivalent tax reduction to taxpayers with eligible children in that province.

4. That a parent be permitted to elect to report a child of 19 to 21 years of age as a dependant and claim a dependant tax credit of $130 or, if he or she otherwise qualifies, the equivalent-to-married credit, and that by this election the child would lose the right to transfer to a supporting relative the unused portion of the tuition and education credit he or she may claim.
5. That the turning point net income level for the refundable child tax credit be increased by $1,500 from $24,000 to $25,500.
6. That the parent with the higher income be required to include family allowances in income.

7. That a spouse or dependant can report up to $1,000 in net income before the full value of the tax credit available to the supporting taxpayer begins to be reduced.

Medical Expenses and the Disabled

8. That as a matter of urgency the federal government, in conjunction with the other levels of government, examine the tax and welfare systems to ensure that they do not act as a deterrent or barrier to the disabled who are or who wish to become members of the workforce.

CPP/QPP and UI Contributions

9. That self-employed individuals receive a 17-per-cent non-refundable federal tax credit for their total CPP/QPP contributions in lieu of a partial deduction and a partial credit.

Education Tax Credits

10. That the proposed federal education tax credit should be made available to all full-time students enrolled in designated institutions for post-secondary education.

Capital Gains Inclusion Rate

11. That, as an interim measure only, the proportion of a capital gain or capital loss required to be included in computing an individual's taxable capital gain or allowable capital loss be increased from one-half to two-thirds for gains and losses realized in 1988 and 1989.

12. That in 1990, following a review of the subject of indexation of capital gains, the full amount of capital gains be included in income and the full amount of capital losses be deductible, provided such gains and losses are adjusted for inflation from the later of the date of ownership or January 1, 1972.

Lifetime Capital Gains Exemption

Qualified Farm Property and the Farm Exemption

13. That the definition of "qualified farm property" be amended so that it include only real property that is: (a) owned by the individual; (b) used prior to the year of disposition for a minimum of five years which need not be consecutive; and (c) used by the individual, his spouse, or any of his children actively engaged in carrying on the business of farming in Canada or by a "family farm corporation" or a "family farm partnership."

14. That the definition of "qualified farm property" be amended so that it include a share of capital stock of a "family farm corporation" or an interest in a "family farm partnership": (a) owned by the individual; and (b) in which the

individual, his spouse or any of his children was actively engaged in the business of farming carried on by the family farm corporation or family farm partnership for a minimum of five years, which need not be consecutive prior to the year of disposition.

Small Business Share Exemption

15. That a gain realized on the disposition of shares of a small business corporation qualify for the $500,000 lifetime capital gains exemption only if: (a) the individual, who disposes of the shares, or the deceased spouse was actively engaged in the business, (whether prior to incorporation as a proprietor, partner or employee, or after incorporation) for a minimum of five years prior to the year of disposition which need not be consecutive; (b) the small business corporation was not engaged in the business of farming; and (c) the total assets of the small business corporation and all corporations associated therewith (determined in accordance with generally accepted accounting principles on a consolidated or combined basis, where applicable) do not exceed $35,000,000, the limit to which statutory deferred income plans are subject when seeking to increase their foreign property holdings by investing in small business securities.

Cumulative Net Investment Losses

16. That, as proposed by the White Paper, after 1987, net taxable capital gains eligible for the lifetime capital gains exemption be reduced by other investment losses calculated through a cumulative net investment losses formula and deducted by the taxpayer in computing income for tax purposes.

17. That the definition of investment expenses in the cumulative net investment losses formula: (a) exclude any expense incurred before 1988 and amortized after 1987 as a result of property acquisitions made before 1988, such as a Canadian development expense, Canadian oil and gas property expense and capital cost allowance claimed on a multiple unit residential building; and (b) include terminal losses realized on the disposition of depreciable property acquired after 1987.

18. That the definition of investment income in the cumulative net investment losses formula include capital cost allowance recaptured into income in respect of depreciable property acquired after 1987.

Automobile Expenses

19. That the proposed 20-90 per cent rule not be adopted, and in its place the taxpayer may claim as a deduction the proportion of allowable expenses that represents business use less $500. Allowable expenses include capital cost allowance and interest on money borrowed to acquire the vehicle, or lease costs, up to the maximum amounts proposed in the White Paper; and the actual cost of insurance, licensing, parking and all other operating costs.

20. That the $20,000 limit on the cost of a passenger vehicle for claiming capital cost allowance or lease costs be increased by the amount of the relevant provincial retail sales tax on a $20,000 vehicle and that there be a regular review of the limit.

21. That the current system of allowing a reduced standby charge for an employee who drives an employer-provided automobile less than 1,000 kilometers per month for personal use be retained.

Business Meals and Entertainment Expenses

22. That the proposed 80 per cent limitation on the deductibility of business meals and entertainment expenses be adopted but that the cost of meals while attending a convention, conference or seminar or while travelling overnight and out of town be fully deductible.

Certified Canadian Productions (Films)

23. That the capital cost allowance rate for certified Canadian productions be set at 50 per cent on a straight-line basis and subject to the half-year rule. It is further recommended that the put-in-use rule not apply to certified Canadian productions.

Multiple Unit Residential Buildings

24. That owners of multiple unit residential buildings on June 17, 1987 be allowed to continue indefinitely to claim capital cost allowance at a 5 per cent rate to create or increase tax-deductible losses.

25. That the first purchaser of a multiple unit residential building after June 17, 1987 be allowed to claim capital cost allowance at a rate of 4 per cent to create or increase a tax-deductible loss, provided the purchase price is less than the vendor's original cost.

Averaging

26. That block averaging be retained for farmers and fishermen.

27. That an appropriate averaging system be implemented to protect low-income earners from losing the benefit of personal tax credits as a result of fluctuations in income.

Taxation of Farmers

28. That farmers continue to have the option of choosing either cash accounting or accrual accounting for income tax purposes.

29. That the Minister of National Revenue consider establishing peer review committees that include farm operators, assessors and auditors. These committees would be used to review the operations and plans of farmers to

determine whether a farm operation has a reasonable expectation of profit, and the taxpayer can be deemed to be a farmer.

30. That Revenue Canada ensure that personnel with experience in farming assist in the review and audit of farmers' tax returns.

31. That individuals who qualify as being in the business of farming and use cash accounting for their farm business may deduct up to $10,000 of farm losses against other income, subject to a claw-back of this deduction. For example, those with off-farm income of up to $30,000 may have the full deduction; those with off-farm income greater than $30,000 will have the allowable deduction reduced by $1 for every $2 of income above $30,000.

32. That individuals who qualify as being in the business of farming and use accrual accounting may deduct all farm losses against other income.

33. That the White Paper proposals for modified accrual accounting, a profit test and a gross revenue test be dropped.

Chapter 5: Corporate Income Tax Reform

Manufacturing and Processing

34. That the rate of capital cost allowance for manufacturing machinery and equipment (Class 29) be set at 30 per cent on a declining balance basis and not at 25 per cent as proposed in the White Paper.

Put-in-Use Rule

35. That in determining eligibility for claiming capital cost allowances and investment tax credits in respect of any eligible property, the put-in-use rule be changed to a put-in-place rule.

36. That for the purpose of either a put-in-use or put-in-place rule, an asset be deemed to be put in use or in place, as the case may be, 24 months after it is acquired if it has not in fact been put in use or in place by that time.

Investment Tax Credits

37. That the investment tax credit for scientific research and experimental development expenditures that may be claimed in a year not be limited to one-half of federal tax payable.

38. That the refundability of R&D investment tax credits should depend on a "needs test" based on a corporation's income and not on whether a taxpayer is a public or private corporation.

Flow-Through Shares

39. That the rate at which the earned depletion allowance can be earned be reduced from 33 1/3 per cent to 16 2/3 per cent for eligible expenditures incurred after the end of 1988, and that the allowance be abolished for eligible expenditures incurred after 1989.

Eligible Capital Property

40. That eligible capital property be treated as a separate class of depreciable property with a deemed cost equal to the applicable percentage of its actual cost, and any proceeds of disposition be deemed to be the applicable percentage of the actual proceeds.

41. That the "applicable percentage" in respect of eligible capital property be increased from one-half to two-thirds.

42. That on the implementation of these recommendations the balance of existing cumulative eligible capital pools be increased by one-third, and the depreciation rate for eligible capital property be reduced from 10 per cent to 8 per cent.

43. That any proceeds of disposition of eligible capital property in excess of original cost be treated as a capital gain eligible for the $100,000 lifetime capital gains exemption.

44. That the existing rules in relation to recaptured depreciation and taxable capital gains apply to the recognition of the proceeds of disposition of eligible capital property that are not receivable until a later year.

Real Estate

45. That carrying costs on vacant land continue to be deductible as a current expense by real estate development companies.

46. That the proposals requiring the capitalization of soft costs incurred during construction are appropriate and should be implemented, but the amounts should be capitalized totally to the building.

47. That the government implement an alternative minimum tax on the real estate industry. The tax would be established at a low rate and on an appropriately broad base with a *de minimis* rule. Furthermore, this tax would be payable, only to the extent that it was greater than regular corporate income tax but would be limited to 28 per cent of the Canadian portion of reported accounting income.

48. That while the White Paper proposals requiring the reduction in the rate of capital cost allowance for buildings from 5 per cent to 4 per cent should be adopted, an assessment should be made by the Department of Finance to determine whether a preferential rate of capital cost allowance should be available to taxpayers who renovate buildings that are over 50 years old.

Expenses of Issuing Securities

49. That, as proposed in the White Paper, expenses relating to the issue of shares, partnership interests and trust units be amortized over a five-year period; but that expenses relating to borrowing funds be amortized over the term of the debt obligation including any renewal periods, with a maximum of five years. Any unamortized costs should be deductible in the year in which the borrowings are repaid.

Chapter 6: Preferred Share Financing and Dividend Distributions

Preferred Share Financing

50. That the $500,000 exemption of preferred share dividends for any group of corporations be reduced to a lower level of exempted dividends or be available only to non-taxable firms of a specific size.

51. That the government take steps immediately to introduce a comprehensive advance corporation tax on common and preferred share dividend distributions.

Chapter 7: Financial Intermediaries

52. That, to ensure taxable income reasonably reflects business income, bond and mortgage trading profits and losses be amortized over the remaining lifetime of the security for all financial intermediaries.

Financial Reinsurance

53. That in calculating required Canadian assets, the calculation be made monthly, or at least quarterly.

54. That the calculation of the Canadian investment fund be made in such a manner that an increase or decrease in foreign policy loans does not affect the Canadian investment fund.

55. That the use of financial arrangements, including reinsurance contracts, between financial intermediaries be blocked by a specific anti-avoidance rule similar to section 845 of the U.S. Internal Revenue Code.

General Loan Loss Reserves

56. That authorized general loan loss reserves continue to be set by formula but that the level of the reserves be reduced to one-half of its current level over five years.

57. That the Superintendent of Financial Institutions be allowed to require additional specific loan loss reserves because of factors such as geographical, industrial or sovereign concentration of risk and that these reserves be tax-deductible.

58. That methods be developed to allocate loan loss reserves by country for income tax purposes.

Claims Reserves

59. That the principle of requiring property and casualty claims reserves to be established using interest be accepted.

60. That structured settlement claims reserves be required to use interest immediately.

61. That property and casualty claims reserves for existing but unsettled claims be allowed to run off as settled.

62. That future claims reserves be required to be established using interest as soon as the Superintendent of Financial Institutions is satisfied that appropriate standards have been established by the Canadian Institute of Actuaries to ensure adequacy of reserves.

63. That increases in claims reserves or actuarial reserves required by the Superintendent of Financial Institutions for solvency purposes be tax-deductible.

Alternative Minimum Margin Tax

64. That effective January 1, 1988, the government institute a minimum corporate tax on the Canadian earnings of banks, trust companies and life insurance companies to be called the "alternative minimum margin tax" and that this tax be based on the margins of such financial intermediaries.

65. That the limits on equity and real estate investment recommended in the White Paper be eliminated.

66. That the 10 per cent/5 per cent/2 per cent ownership limitations on certain listed preferred shares and taxable SFI shares be reviewed to assess whether they would still be required given the adoption of the alternative minimum margin tax.

Investment Income Tax

67. That the proposed investment income tax on life insurance companies not be introduced.

Credit Union Shares

68. That to the extent that "accumulation unit" shares are permitted in the future by the provinces, capital gains treatment be available in respect of credit union shares.

Blue Cross

69. That the Department of Finance reconsider whether Blue Cross should continue to be exempt from income tax.

Chapter 8: Federal Sales Tax Reform

70. That parliament enact a law in 1988 to reform the existing federal sales tax system, such law to become effective as soon as possible thereafter.

Related Marketing Companies and the Shift to the Wholesale Trade Level

71. That the proposals to apply the federal sales tax to marketing companies related to the manufacturer and to shift the tax to the wholesale level for a limited range of products not proceed; and that in their place a temporary federal sales tax surcharge of three per cent of taxes payable be introduced, but that this federal sales tax surcharge not be levied on the proposed tax on telecommunication services.

72. That a specific anti-avoidance rule be enacted with respect to related marketing companies.

Tax on Telecommunication Services

73. That the residential Touch-tone feature be exempted from the proposed 10-per-cent telecommunications sales tax.

74. That all telephone subscribers in the "Remote North", all of the Northwest Territories, Yukon, and other remote locations in Canada where year-round road, rail or boat links do not exist be subject to the proposed 10 per cent telecommunications sales tax on long-distance calls to a maximum of $3 per month.

Chapter 9: Accelerated Remittances

75. That a formal system, financed by the government, should be established to allow for members of the Canadian Payments Association to be recognized as authorized tax collection agents of the government.

76. That payments made by taxpayers to the Receiver General for Canada should be deemed to be received when paid to a member of the Canadian Payments Association.

Chapter 10: Tax Avoidance and Compliance

77. That the form of the general anti-avoidance rule proposed by the White Paper not be adopted and the following substituted therefor:

General Anti-Avoidance Provision

"245(1) The Minister may ignore the consequences of an avoidance transaction and may reasonably determine the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act, having concluded that such amount had been determined as a consequence of an avoidance transaction.

Avoidance Transaction

(2) An avoidance transaction means:

(a) any transaction that results in an artificial or undue reduction, deferral or refund of tax or other amount payable under this Act; or

(b) any transaction that is part of a series of transactions or events, which series results in an artificial or undue reduction, deferral or refund of tax or other amount payable under this Act.

Interpretation

(3) For the purposes of this section, "transaction" includes an arrangement, scheme, or event.

Adjustments in the course of a Ministerial Determination

(4) To make a reasonable determination under subsection (1) of the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act, the Minister may:

(a) disallow in whole or in part any deduction in computing income, taxable income, or tax payable or any part thereof;

(b) allocate any deduction or any income, loss or other amount or part thereof to any other person; and

(c) recharacterize the nature of any payment or other amount.

Adjustments by the Minister to Prevent Double Taxation

(5) The Minister, in order to eliminate double taxation, shall make any adjustment to income, taxable income, tax payable, or other amount payable or refundable under this Act of any person other than a person referred to in subsection (4), and the Minister shall notify the other person of the adjustment within 90 days of the day of mailing of any notice of assessment to the person referred to in subsection (4) for the year in which the avoidance transaction occurred.

78. That no specific penalties be applied to taxpayers who participate in an avoidance transaction as defined in proposed section 245.

Penalties

79. That the 50 per cent penalty on interest on late or deficient installments not be implemented.

Chapter 11: Tax Reform and Tax Simplification

80. That, as a pilot project, the relevant government departments form a group to follow the recommendations of the report Tax Simplification and simplify the sections of the tax system dealing with attribution rules.

Alternative Minimum Tax

81. That once the tax system as outlined in this Report is put in place and enough time has passed for the reform to be fully phased in, the Minister of Finance should review the need for the Alternative Minimum Tax.

78. That no specific penalties be applied to taxpayers who participate in an avoidance transaction as defined in proposed section 245.

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Chapter 11: Tax Reform and Tax Simplification

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Alternative Minimum Tax

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CHAPTER 1

Revenue Neutrality: The Impact of the Committee's Proposals on Federal Revenues

The Committee acknowledges that many of the recommendations in this Report will have an impact on federal tax revenues. Some of the recommendations reduce revenues, others aim to increase them. In keeping with the approach of the White Paper, the Committee has adopted the principle of revenue-neutrality as a constraint and, taken together, the recommendations of this report are revenue-neutral.

Measuring the revenue impact of each recommendation was not an easy task, although the Committee did what it could in the short time available to obtain detailed revenue impact estimates. In some cases this was straightforward, and precise calculations could be done from publicly available data, but in others the implications for revenue impact were difficult to determine. The Committee did consult with the Department of Finance to obtain detailed and precise revenue impact estimates, and it is satisfied that the package of proposals in this Report is approximately revenue-neutral.

An overview of the revenue impact of the Committee's recommendations is given in Table 1. For this purpose, the recommendations have been combined into small groups. No estimates were made of the proposed overhaul of capital gains taxation and the advance corporation tax, which can be implemented in conjunction with Stage Two in a way that is revenue-neutral. Furthermore, the estimates presented indicate the *average* annual revenue impact for the next several years. Presenting detailed annual impact estimates for the next five years, as in the White Paper, would suggest a degree of precision that was not possible.

The table indicates how much revenue is gained or forgone for each group of the Committee's amendments to the White Paper package. For instance, the revenue impact of the changes in taxation of financial intermediaries and the minimum tax on real estate companies is estimated as the total revenue from the Committee's proposals net of the revenue forgone by not implementing the investment income tax proposed in the White Paper, and net of an allowance for reduced tax revenues outside the financial sector due to trading-away of tax-free financial instruments. By the same token, the estimate of revenue from the surtax on the federal sales tax is net of the $300 million the White Paper projected could be raised by moving the tax to related marketing companies and the wholesale level.

These revenue estimates represent the net impact of the Committee's major recommendations on federal revenues. The recommendations of the Committee can be said to be both balanced and revenue-neutral.

Table 1

Revenue Neutrality of the Committee's Recommendations: Estimated Annual Impact on Federal Revenues

	(millions of dollars)
Enhanced child benefits, taxation of family allowances and increase in dependants' net income threshold	– 225
Capital gains and eligible capital property	0
Automobile and other expenses, averaging, farm income	– 100
Enhanced write-offs for manufacturing and processing, not restricting investment tax credits, and other smaller corporate tax changes	– 200
Changes in taxes on financial intermediaries, including the alternative minimum margin tax, and the alternative minimum tax on real estate companies	400
Net interim sales tax changes	125
Estimated net impact on revenue	0

CHAPTER 2

Background to Tax Reform and to this Report

If taxes are inevitable, as most people agree they are, then so is tax reform. Throughout history, tax reform has been activated by many events, from wars and revolutions to royal commissions and legislative changes. On June 18, 1987 the Honourable Michael H. Wilson, Canada's Minister of Finance, presented to Parliament a White Paper on tax reform. According to the White Paper, reform is to take part in two stages. Stage One includes reform of personal and corporate income taxes, to take effect generally in the 1988 tax year, and several interim measures affecting the federal sales tax that will be in place until implementation of the second stage of tax reform. Stage Two will deal with reform of the sales tax system; the White Paper provides three options for reform, but does not give a timetable for implementation. Revenue from sales tax reform will replace revenue from the current federal sales tax and allow removal of the personal and corporate surtaxes, further reductions in personal income taxes for middle-income individuals and families, and increases to the refundable sales tax credit. (Incidentally, the term White Paper is used in a general sense to mean both the actual White Paper, which is a relatively brief statement by the Minister of Finance, and the related documents on tax reform released by him on June 18, 1987.)

The White Paper proposals were referred to the Standing Committee on Finance and Economic Affairs. In this report, the Committee discusses the proposals included in Stage One of tax reform. Stage Two will be the subject of further hearings of the Committee and a subsequent report.

The Objectives of Reform

In a sophisticated economy the tax system is constantly evolving, and the evolution in Canada has produced what the Minister recognized as "a crazy quilt of special incentives, special deductions and special write-offs." Each special measure benefits someone (or some corporation) but, as the measures increase in number, those not receiving benefits begin to see the tax system as unfair. Moreover, such special measures often have indirect effects which, if large enough, lead to countermeasures. The result is the complicated and inefficient tax system that the White Paper proposes to reform.

According to the White Paper, its tax reform proposals have been designed to meet five broad objectives: fairness, competitiveness, simplicity, consistency, and reliability. The first three are fairly standard goals of tax reform, although "competitiveness" is often replaced by, and considered part of, the efficiency objective. Consistency refers to the need for the personal, corporate and sales tax structures to be well-integrated and internally consistent and for the entire tax system to be externally consistent with other government policies and programs. Reliability means that revenues raised are predictable and based on a fair, broad and secure tax base, and that rules can be relied on to stay the same over time.

Balancing these objectives is the challenge of tax reform. The White Paper attempts to balance them by reducing tax rates and the number of tax brackets, broadening the tax base, and shifting some of the tax burden from the personal income tax to other sources of revenue. On the whole, it achieved its aim, although the objective of simplicity appears to have been overlooked or given less emphasis than other objectives. There were expectations that tax reform would address the problem because of general concern over the growing complexity of the tax system. However, although the White Paper introduced some modest simplifications, the problem remains. This is taken up in Chapter 11.

In addition to attempting to balance the five objectives, tax reform had to be designed so as to be revenue-neutral; that is, revenues to government from taxes should be the same after reform as before, Moreover, reform in Canada was to be consistent with recent tax reform in the United States. Consistency in this case does not mean that tax reform must be the same here as in the United States, but that, for competitive reasons, reform of personal and corporate income taxation must not be too far out of line with what has taken place in the United States. As the White Paper put it: "In an increasingly interdependent world, it is important not to allow Canada's tax system to put our traders, businesses, investors and highly skilled individuals at a competitive disadvantage with other countries." Of special concern was the widening gap between statutory corporate tax rates in Canada and in the United States. This issue will be discussed below.

Overview of Government Tax Revenue

Income tax is probably the most visible tax to most Canadians. Its visibility, however, tends to obscure the contribution to revenue of the rest of the tax system. The breakdown of total government tax revenue in Table 2 provides some needed perspective.

In the table, federal personal income taxes do stand out as the largest component of tax revenue, representing over 50 per cent of federal revenues. Large as this component is, however, tens of billions of dollars are raised from other sources. Because most provinces tie their income taxes to the federal income tax, reform by the federal government has repercussions for provincial fiscal policy. And a change in provincial fiscal policy can affect other revenue items — from provincial sales tax rates to local property taxes. Thus federal-provincial interrelationships, which can be direct or indirect, emphasize the importance of the consistency objective.

Table 2

Total Government Tax Revenue, 1986

	Federal	Provincial and Local
	(millions of dollars)	
Total tax revenue	70,882	66,913
Total income taxes	50,145	28,248
Personal	38,321	24,072
Corporation	10,724	4,176
On payments to non-residents	1,100	0
Property and related taxes	0	16,840
Total consumption taxes	19,427	19,197
General sales	10,850	13,081
Motive fuel	1,297	3,389
Alcoholic beverates and tobacco	2,616	2,000
Customs duties	4,205	0
Other	459	727
Miscellaneous taxes	1,310	2,628

Source: Based on data from Statistics Canada, CANSIM Division.

By focussing on a single year, the table of course misses the changes in relative importance of revenue sources over time. The most important change, and an important stimulus to the current reform proposals, has been the relatively greater contribution to revenues by the personal income tax. In the 1950s, personal income tax produced about one-quarter of total federal tax revenue; by 1986 this tax produced more than one-half of federal tax revenues. The shift has also been apparent in more recent years. As the White Paper puts it:

> The relative importance of personal income taxes has increased markedly, while the shares of both the corporate income tax and sales tax have declined significantly. This shift in the balance of federal tax revenues reflected a combination of policy actions undertaken in the 1970s and early 1980s, and the uneven impact of economic conditions in the late 1970s and early 1980s on the composition and size of the underlying tax bases.

The White Paper concludes that a rebalancing of federal tax revenue shares is needed.

> In the absence of tax reform, increasing reliance on personal income taxes would have continued. The tax measures in the first stage of tax reform will lower the share of personal income taxes and increase the shares of both corporate income and sales taxes.

The Issue of Tax Expenditures

What an individual or company pays in taxes, the government receives in tax revenue. To these two sides of any tax system must be added another, namely tax expenditures. Tax expenditures, which are also called tax incentives, tax preferences or selective tax measures, arise when the government introduces a measure that allows an individual or corporation to pay less tax than would be paid without the measure. Examples include the deduction of tuition fees and investment tax credits. These measures may be based on the finest motives — stimulating higher education or promoting investment in less developed regions — but they narrow the tax base.

Concern about tax expenditures has been growing in recent years, and the Department of Finance has responded by publishing documents about these measures in 1979, 1980 and 1985. The most recent, *Account of the Cost of Selective Tax Measures*, provided estimates for personal and commodity tax measures for 1979 to 1983 and for corporate income tax provisions for 1979 to 1982. The Department of Finance documents are very cautious in presenting estimates of individual selective tax measures and warn that simply totalling the estimates will not produce a valuation of all the measures in the Canadian tax system. Nevertheless, the total value is in the tens of billions of dollars.

One tax expenditure that has received a great deal of attention is not covered in the Department of Finance documents — namely, the scientific research and development tax credit (SRTC), which was implemented in January 1984 and terminated in May 1985. The experience of the SRTC, especially one type of transaction that became known as the "quick flip", has been called a fiasco. In his 1984 Annual Report the Auditor General highlighted problems with the SRTC and the quick-flip transactions; his 1985 Annual Report included a chapter on income tax expenditures in general. In June 1986, the House of Commons Standing Committee on Public Accounts issued a more comprehensive report dealing with the problems of the SRTC.

Given this experience of the SRTC, eliminating tax preferences would seem a desirable way to broaden the tax base. Tax preferences, however, do recognize the importance and special problems of specific groups, of which Canadian artists are a good example. As the Canadian Conference of the Arts put it during an earlier appearance before the Finance Committee:

> Although we recognize the government intends its tax reform to be beneficial to Canadians in general . . . we caution that such a global and general approach will drown out yet again the recognition we have been striving to achieve for artists and arts organizations within the tax system.

This Committee recognizes the special place of artists in Canadian society and would like to see them supported in as efficient a way as possible, because Canada cannot afford to neglect its culture or the artists who contribute to it. Other special interest groups, however, could similarly argue that their special circumstances merit special treatment in the tax system. An important part of tax reform is the rebalancing of the tax system to give more weight to the goals of equity and simplification than to the arguments of special interest groups.

Thus, although the White Paper attempts to broaden the tax base by removing some tax preferences, it recognizes limits to this process: "The tax reform proposals put forth in this White Paper strike a balance between removing specific preferences and recognizing Canadian priorities and needs." One of the tasks of the Finance Committee is to see how the balance was struck.

U.S. Tax Reform

Tax reform in the United States has provided a stimulus to reform in Canada. In fact, the U.S. *Tax Reform Act* of 1986 put pressure on all industrialized countries in the West to examine and reform their tax systems. The most prominent features of U.S. tax reform are a reduction in top tax rates for individuals and corporations, a broadening of the tax base by reducing or eliminating numerous tax benefits, and a shifting of the tax burden from individuals to corporations.

In 1988, personal income tax in the United States will have a two-tier structure — 15 per cent for taxable income below US$29,750, and 28 per cent for taxable income above that level. Prior to tax reform, there were 15 personal tax brackets, with the top one at 50 per cent for taxable income greater than US$175,250. The top corporate tax rate in the United States drops from 46 per cent to 34 per cent.

Capital gains will be taxed as income, and individuals will no longer be able to deduct the interest charges on car loans, credit card purchases and other consumer loans. Corporations will also be affected by the new treatment of capital gains and, in addition, they face restrictions on business meals and entertainment expenses, less generous depreciation deductions, and a minimum tax based on a broadened definition of income. The net effect is estimated to be an increase in corporate taxes of US$120 billion over five years.

To provide competitive conditions, the tax system in Canada should not get too far out of line with that in the United States. Canada should not, however, simply copy the U.S. reforms. For one thing, there is an important provincial dimension to federal tax reform in Canada because of the way most provinces link their tax systems to that of the federal government. Links between the states and the federal government are weaker in the United states. Moreover, the United States had much greater opportunity for broadening the tax base before reform than Canada has now. Social benefits and medical programs are more extensive in Canada than in the U.S., so income taxes have been higher here, and they will continue to be higher as long as Canada enjoys more extensive social benefits.

Other Influences on Tax Reform

Recent reform of the U.S. tax system is not the only influence on tax reform in Canada. As is the case in most sophisticated economies, Canada has had periodic reviews of its tax system. The most sweeping review was the Royal Commission on Taxation appointed in 1962. The Commission, called the Carter Commission after its Chairman Kenneth E. Carter, finished its report in December 1966. The report, which

was tabled in the House of Commons in February 1967, comprised six volumes and an index. In addition, there were about thirty volumes of related studies.

The Commission focussed on personal and corporate taxation and proposed comprehensive changes to the tax system that were based on several popular objectives of taxation with equity given the greatest weight. The first conclusion of the report sounds a note that is familiar and relevant 20 years later:

> The present system does not afford fair treatment for all Canadians. People in essentially similar circumstances do not bear the same taxes. People in essentially different circumstances do not bear appropriately different tax burdens.

The changes proposed also have a familiar ring, because of the issues they raised and the solutions they offered to perceived flaws in the tax system. Among the proposed changes were a comprehensive concept of income (the principle that "a buck is a buck", so gifts, bequests, capital gains and other forms of income should be treated the same); a new schedule of progressive tax rates that would lower top marginal tax rates; recognition of the family or the unattached individual as the basic tax-paying unit; integration of corporate and personal income taxes; and replacement of the manufacturers' sales tax by a more comprehensive retail tax.

The Report of the Carter Commission was followed in 1969 by a White Paper which in turn was followed by Reports of Committees in the House of Commons and Senate. The government finally enacted tax reform legislation in the budget of June 18, 1971, and tax reform was implemented effective January 11, 1972. The tax reform measures were not as sweeping as those put forward by the Commission, but they did include broadening the tax base, integrating personal and corporate income taxes, lowering the top marginal rates, increasing personal exemptions and making one-half of capital gains taxable.

Subsequent budgets introduced large changes to the tax system, and their partial reforms and tinkering — found in most budgets — eventually led to the complicated tax system we have today.

Work of the Committee

By its nature, the Committee often deals with tax-related issues, regularly examining ways and means motions and analyzing specific proposals that would require changes to Canadian tax laws. In early 1986, the Committee reviewed the issue of tax simplification and in June 1986 issued the Report *Tax Simplification*, which concentrated on the personal income tax system.

In his speech to the House of Commons on October 23, 1986, the Minister of Finance presented guidelines for the then forthcoming tax reform. He asked the Standing Committee on Finance and Economic Affairs to review the guidelines and "make recommendations on how the government's goal for tax reform can best be achieved, while maintaining a system that suits Canada's needs."

There were nine guidelines set out in the Minister's speech to the House:

fairness,
simplicity and compliance,
balance,
stability (of revenue),
international competitiveness,
economic growth,
Canadian priorities,
transitional implementation, and
consultation.

The list of guidelines can be considered an extension of the three characteristics usually considered important to an ideal tax system — fairness, simplicity and efficiency — or an extension of the five objectives given in the White Paper.

The Committee held public hearings with more than 20 groups from November 1986 to April 1987. In addition to these sessions, the Committee met several times with representatives of the Department of Finance. Although certain of these sessions were *in camera* hearings about tax reform, the Department did not divulge the specifics of forthcoming tax reform. Other sessions with the Department of Finance were concerned with the ways and means motion in October 1986 implementing the February 1986 budget measures. All of these hearings touched upon issues important to tax reform, as did the appearance of the Department to discuss its Main Estimates for the 1987-88 fiscal year.

With only a general outline of the prospective tax reform, the Committee developed what could be viewed as an investigative role during its early hearings. Instead of probing to discover how a witness reacted to a specific proposal, the Committee let each witness establish the ground to be covered. Some witnesses presented comprehensive tax reform proposals; others focussed on one or two specific issues (such as tax credits for low-income Canadians or capital cost allowances for manufacturers). Several discussed the implications of replacing the existing federal sales tax with a business transfer tax (BTT), although no specific proposal was before the Finance Committee. Nevertheless, these early hearings provided an excellent preview of the work that would follow the White Paper.

The Minister of Finance presented the White Paper on Thursday evening, June 18, 1987, and the Committee began hearings on tax reform the following Monday. The initial sessions were with officials from the Department of Finance who surveyed the White Paper for the Committee and reviewed specific issues.

Even before the White Paper was presented, the Finance Committee had begun assembling a staff of accountants, lawyers, economists and other researchers. Over the summer, this research staff met several times with officials from the Department of Finance, and these meetings led to further inquiries for information and interpretation as the critical issues of tax reform emerged and while the Report was being prepared.

Also during the summer, briefs from interested Canadians — individuals and groups — began arriving, in a trickle at first and then in a flood around the August 18 deadline. Over 550 briefs were sent to the Committee, and they were analyzed according to the issue or issues addressed, with the information stored by computer. After review by Committee members and the researchers, the briefs formed the basis for inviting witnesses to appear before the Committee, and in turn as preparation for the hearings.

The Committee held hearings with 174 witnesses. (The Departments of Finance and National Revenue are each counted once although they appeared several times.) These hearings were held in Ottawa and, during the last two weeks in September, in cities in the west and east. In addition to the public hearings, the Committee held numerous *in camera* working meetings to discuss issues raised by the White Paper, and the briefs submitted to review the testimony of the witnesses. In the middle of October, the Committee spent three days at Mont Ste.-Marie, Quebec, to concentrate on its Report.

The Committee's mandate was to examine the proposals for Stage One of the tax reform as presented in the White Paper. Specifically, this Report examines issues raised in the White Paper document *Income Tax Reform* as well as the issues having to do with transitional measures proposed in the White Paper.

The perceived importance of the issues raised in the White Paper documents changed as the Committee reviewed briefs and progressed with the hearings and discussions of tax reform. The structure of this Report is based loosely on the structure of the *Income Tax Reform* document, with the addition of chapters on Stage One federal sales tax changes and simplification.

In a report of this nature the emphasis given specific topics depends on several factors, including the complexity of the topic, the emphasis given the topic in briefs and hearings, and whether the Committee agreed substantially with the White Paper — in which case a topic is treated briefly or not at all. In some cases, the discussion of a topic in one section covers related topics that are then not treated in the other relevant sections.

In general, the Committee agrees with the stated objectives and thrust of tax reform. The shift from deductions and exemptions to credits, the lowering of tax rates, and the broadening of the tax base make the system fairer and more progressive, and the Committee welcomes these moves. As the "List of Recommendations" shows, however, the Committee does not accept many of the details found in the White Paper. The reasons for disagreement and the Committee's analysis of the recommendations are set out in the text of the Report.

Therefore, the Committee recommends:

1. **That the Canadian income tax system be reformed along the lines proposed in the White Paper on Tax Reform, and in particular that the proposed base-broadening measures, conversion to credits and rate structures for the corporate and personal income tax be implemented, and that the other measures under Stage One of tax reform be adopted, subject to the recommendations that follow.**

2. **That the tax system be amended less frequently following reform, and that it be kept as stable and simple as possible.**

CHAPTER 3

The Effects of Tax Reform on the Economy

One of the objectives of tax reform is encouraging competitiveness, growth and jobs. The White Paper argues that reducing subsidization of particular types of investment through the tax system makes the economy more efficient; that lower tax rates are the best way to reward success and will stimulate economic activity; and that the tax system should not place Canadians at a competitive disadvantage in international and domestic markets.

While examining the effects of the White Paper proposals on the economy, the Committee invited some economic policy research organizations to present their analyses. There was general agreement that the proposed tax reforms would have some impact on the macroeconomy in the next few years. Personal tax reform should give a boost to consumer spending in late 1988 and 1989.

Reform will also have some lasting structural consequences. These will be positive if sales tax reform under Stage Two goes ahead. The witnesses agreed that the Canadian tax system will remain competitive with the U.S. system. No analysis was offered of regional economic impacts, but witnesses did indicate that differences were likely to be very minor.

Macro-Economic Impact

As the White Paper proposals are revenue-neutral and involve only a limited restructuring of revenue sources, their short-term impact on the economy will be modest. The timing of the elements of the package has an influence on the short-term impact. Stage One provides for a personal income tax reduction in 1988 and particularly in 1989 (through refunds), which will boost consumer spending. The tax cut is financed in part by acceleration of revenue collections, which has very little effect on the economy. Increases in sales and corporate taxes will temper the stimulative effect of higher disposable incomes of consumers, the more so after 1989 since the corporate tax changes are phased in gradually.

A temporary boost to economic activity results. According to several independent studies presented to the Committee, production in 1989 may be as much as 0.5 per cent higher than without tax reform. There could be 30,000 to 100,000 more jobs, and the

unemployment rate would drop by 0.2 to 0.4 per cent. By 1991 the change in employment would be higher still. The annual change in the Consumer Price Index would be 0.1 to 0.2 per cent higher over the period 1988-91 because of higher sales and corporate taxes and higher activity levels.

Several witnesses noted with approval the more even taxation of all types of investment, observing that this will improve quality of investment over the longer haul by reducing tax-induced distortions. However, some warned that in spite of this Stage One alone may well be a drag on the economy in the longer term, because the increase in taxation of investment it imposes could slow down economic growth.

The economic experts all called for early implementation of Stage Two. Although sales tax reform would have transitory inflationary effects when introduced, it is expected to have lasting economic benefits. Replacing the current federal sales tax reduces distortions, removes taxes on business inputs, and enhances the competitive position of Canadian products and services. Insofar as Stage Two would include income tax cuts, it might also stimulate saving and investment, work effort and enterprise, and thus offset any lasting negative effect of Stage One on economic growth.

Competitiveness

The macro-economic analyses presented to the Committee implicitly assume that Canada's tax system would remain internationally competitive under the White Paper proposals, especially compared to the tax system in the United States. The testimony heard by the Committee suggested that on the whole the tax system does remain competitive, and an analysis by the Conference Board of Canada showed that the corporate tax system continues to give Canadian manufacturers a slight if somewhat reduced edge. These matters are examined in more detail in other parts of this report. The point to be made here is that, in the absence of reform, the Canadian tax system would lose that competitive edge. Tax revenues, investment and jobs would be lost to the United States. Preventing such a situation surely is one of the economic benefits of reform, one that may well outweigh the other effects discussed earlier, and it certainly lends urgency to tax reform.

The Deficit

As the White Paper indicates, the Stage One proposals have virtually no effect on the federal deficit in the medium term. Insofar as Stage One stimulates economic activity in the next few years, some extra revenue will be generated.

Some economic policy research groups expressed the view that reform should have contributed to deficit reduction and not merely be revenue-neutral. They were concerned that the economic projections presented in the White Paper may be too optimistic, and that the deficit could turn out to be larger if the economy performs worse than projected. It was noted that the yield from base-broadening measures is uncertain, and could be lower than projected. The concern about the projected size of the federal deficit was shared by a number of representatives of the business community.

The Committee, however, feels that tax reform is a worthwhile endeavour on its own merits, and that combining tax reform with a change in fiscal strategy would complicate matters greatly and make the enterprise more risky.

As for the uncertainty attached to yield estimates of base-broadening measures, it may be recalled that the existence of many generous tax preferences has led to unanticipated revenue shortfalls in the past. By closing down or tightening these preferences, base-broadening reduces the risk of revenue shortfalls in future. Many of the measures directly stem the ongoing erosion of the revenue base and prevent future such erosion. Although the yield of individual base-broadening measures may be impossible to estimate with precision, taken together they are sure to make revenue projections more accurate by providing a more reliable revenue base. Therefore, the Committee endorses this thrust of tax reform. It has thoroughly reviewed the proposals to ascertain whether they do indeed ensure a reliable revenue base, and through many of its recommendations contributes to this objective.

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CHAPTER 4

Personal Income Tax Reform

Impact and Review

In the White Paper proposals for personal income tax reform, three broad sets of changes are envisaged that reduce federal revenues from personal income taxes by $2-$2.4 billion per year over the next five years:

- lower tax rates and reduction of the current ten tax brackets to three;
- conversion of personal exemptions and certain deductions into tax credits; and
- base broadening.

In its examination of personal income tax reform, the Committee was aided by comments from many briefs and from a large number of witnesses. Naturally the comments focussed on the fairness of the reformed system. The introduction of tax credits and the base broadening thrust received high marks. Yet the overall impact of the changes on progressivity, many witnesses noted, is rather neutral, and they expressed disappointment that the White Paper did not propose full indexation of brackets and credits.

The Tax Credit Proposals

Almost all briefs and witnesses welcomed the conversion of personal exemptions and certain deductions into tax credits. By providing the same tax reduction to all qualifying taxpayers irrespective of income, tax credits help to make the tax system fairer and more progressive.

Two general questions were raised in the Committee's hearings. A number of witnesses wondered why some deductions are to be replaced by the tax credits and others are not. Many also observed that conversion to credits is not an isolated step and that it needs to be evaluated in the context of reform as a whole. These questions are addressed in turn.

The Committee has spent many hours discussing the scope of the conversion to credits with officials of the Department of Finance and witnesses. All personal exemptions are converted, making for a coherent, well-integrated set of reform

measures that enhance fairness and may actually simplify tax filing to some extent. The Committee is not in full agreement with the proposed changes in the tax treatment of dependent children, but it agrees with the basic thrust of the introduction of tax credits that replace personal exemptions.

As regards deductions, the White Paper proposes that tuition fees and education expenses, CPP/QPP and UI contributions by employees, charitable donations and medical expenses be treated through credits. Pension and RRSP contributions, union and professional dues, child care expenses and the CPP/QPP contribution payable on self-employed earnings will continue to be treated as deductions.

The reasoning behind why some deductions are converted and others are not is based on the general principle that expenses incurred to earn income should be deductible. By contrast, tax incentives and recognition of special circumstances of the taxpayer, in line with the treatment of dependants, are fairer when they are in the form of credits. In the view of the Committee the new credits for tuition and education expenses, charitable donations and medical expenses are justified on this basis. As for the deductions that remain, the Committee has examined CPP/QPP contributions on self-employed earnings and concludes that these ought to be treated as credits in the interest of tax simplification. The White Paper indicates that the government will deal with child care expenses in the context of its review of the policy on child care. Union and professional dues may be regarded as employment expenses that should be treated as a deduction.

Officials of the Department of Finance explained to the Committee why deductions for retirement savings are not converted to credits. A tax credit at the 17 per cent federal rate would reduce tax assistance for employee contributions to RPPs and for RRSP contributions out of incomes in the middle and upper brackets. This would discriminate against contributory plans and RRSPs, and create a tax incentive to shift to greater employer contributions. High-income contributors approaching retirement would prefer to drop out of their plans instead of saving federal taxes at 17 per cent on contributions towards benefits a few years later that would be taxed at 26 or 29 per cent. In other words a tax credit for contributions could not be introduced without re-examining how benefits should be taxed. Clearly there are practical obstacles to a tax credit for private retirement savings plans.

No such obstacles stand in the way of a tax credit for CPP/QPP contributions, since the contributions are mandated by the government. The same applies to UI contributions. Comparing the fairness of a tax credit and a deduction is not simple, however, because the tax treatment of benefits is an important factor. For social insurance plans it can be argued with some justification that they provide an income floor, and that the plans operate almost entirely in the lowest income brackets. The switch to a tax credit raises a large amount of revenue, and by taking it from middle and upper incomes a contribution is made to keeping the personal income tax system progressive.

Progressivity

It is clear that the White Paper proposals will not redistribute the tax burden among different income groups in a major way. The average tax reduction per household is 0.9 per cent of income. Households with incomes in the $15,000 to $30,000

range experience reductions of 1.4 per cent, those in the $50,000 to $100,000 range a 0.6 per cent reduction; the other groups are very close to the average of 0.9 per cent (Table 3). The share of federal taxes payable is somewhat reduced for incomes under $30,000 and increased for incomes above this level (Table 4).

Table 3

Overall Impact of Tax Reform for all Households Affected

Average Change in Federal/Provincial Personal Income Tax Due to Tax Reform Measures, 1988

Income range	Number affected	Average change	Change as a per cent of tax	Change as a per cent of income
($000)	(000)	($)	(%)	(%)
Under 15	2,860	−90	−15.5	−0.8
15-30	3,310	−320	−10.2	−1.4
30-50	2,575	−310	−4.1	−0.8
50-100	1,740	−395	−2.6	−0.6
100 and over	235	−1,615	−3.2	−1.0
Total	10,720	−295	−4.5	−0.9

Source: Department of Finance, *Tax Reform 1987: Income Tax Reform*, Table 2, p. 33.

Table 4

Share of Federal Income Taxes Paid by Individuals by Income Group, 1988

Income range	Share of taxfilers	Share of federal tax payable: Before tax reform	Share of federal tax payable: After tax reform
($000)	(%)	(%)	(%)
Under 15	46.7	1.6	1.3
15-30	28.7	25.2	24.0
30-50	18.2	38.3	38.5
50-100	5.5	22.8	23.8
+100	0.8	12.1	12.4
Total	100.0	100.0	100.0

Source: Department of Finance. *Tax Reform 1987: Income Tax Reform*. Table 4.4, p. 37.

These figures show the combined result of base broadening, conversion to tax credits, and rate reductions. Base broadening involves eliminating or restricting a variety of tax preferences that are most attractive to and therefore used mainly by high-income people. Thus, as shown by impact data in the White Paper, the proportion of households that experience an increase in taxes as a result of reform rises with income. Although tax preferences are curtailed, however, the share of taxes borne by high-income people remains almost the same, partly because of the sharp reduction in the top marginal federal rate from 34 to 29 per cent, and partly because of the modest nature of a number of the base-broadening measures.

As pointed out earlier, the conversion of exemptions and deductions into tax credits in itself makes taxes more progressive, since the value of a deduction is greater the higher the income tax bracket, whereas a credit gives the same amount of tax reduction to all. But the progressivity of the tax system changes little when the rate cuts are taken into account. Thus two powerful mechanisms for making the tax system more progressive — base broadening and replacing exemptions and deductions with credits — have been used to accommodate a shift to a less progressive rate structure in a way that leaves the distribution of the tax burden by income class virtually unchanged.

Partial Indexation

Many witnesses appearing before the Committee deplored the fact that the White Paper did not propose full indexation of the personal tax system. The Committee has carefully reviewed this matter with the help of analyses of the impact of partial indexation from some of the briefs.

If prices and incomes are rising as they currently are in Canada, the absence of full indexation means that the revenue from personal income taxes increases faster than incomes. The tax burden rises, and this happens not evenly across the income scale, but most rapidly for those with incomes in the lower ranges of each tax bracket, including low taxable incomes. The income threshold at which people begin to pay income tax falls in real terms.

What the witnesses and briefs that addressed partial indexing suggested was that the gains from personal income tax reform are transitory, as several years without full indexation will raise the tax burden on incomes back to the level where it would be in 1988 without tax reform. This is obviously a valid point if the annual inflation rate equals or exceeds the maximum indexation factor of 3 per cent per year. The White Paper projects that the rate will be 3 per cent on average for the years 1989-92. Calculations made for the Committee indicate that, after three years of partial indexation when inflation is at or above 3 per cent, personal income tax revenue will reach approximately the same level in relation to income as in 1988 before reform.

This led the Committee to compare the impact of tax reform and of three years of partial indexation. The question the Committee asked was whether a taxpayer in 1991 would pay less tax in relation to income than in 1988 without reform. It is recognized that tax reform reduces the tax burden in 1988 and subsequent years. The comparison is between the personal income tax burden in 1991 — after reform and three years of partial indexation — and in 1988 without reform.

It was found that a single taxpayer with only income from employment will still be better off in 1991 than he would have been in 1988, irrespective of his income. A one-earner family of four with income in the low or high bracket will also still be better off in 1991. However if the earner in this family has income in the middle bracket, the family will be worse off by 1991. Partial indexation erodes the value of the refundable child tax credit, especially for families who receive a partial credit, and of the new child exemption credit. The tax benefits for parents of dependent children are also reduced under tax reform. Hence tax reform does not correct for the erosion of child benefits through partial indexation, and it reduces child benefits for middle income families still further. For larger families these effects will be more severe. This matter is addressed in the section "Child Benefits".

It can also be shown that the White Paper proposals would raise the income threshold at which a one-earner family of four starts paying tax by an amount that offsets the effect of three years of partial indexation. For most other taxpayers the threshold is raised by even more through tax reform. In this way the White Paper proposals reduce to zero the taxes of 850,000 people who would otherwise pay taxes. Families with incomes below the threshold are not affected by tax reform, but they experience a reduction in the real value of their tax refunds as a result of partial indexation. However it should also be noted that the refundable child tax credit has been increased substantially since 1985.

The Committee is of the view that the fiscal situation of the federal government rules out full indexation. It has considered full indexation of the basic personal credit and other personal credits as a way to automatically update the taxable threshold and offset the effect of partial indexation on low taxable incomes, but has had to reject it because of its high cost and inadequate targeting. The Committee notes with approval that tax reform corrects for the effects of several years of partial indexation on incomes in the low bracket and on the income threshold above which people pay federal income tax, and urges the government to continue to make such corrections at regular intervals.

A Competitive Rate Structure

Commentary on the competitiveness of the Canadian personal income tax system tends to focus on a comparison of the top marginal rate with that in the U.S. The importance to Canadian well-being of highly-paid professionals, entrepreneurs and investors and the idea that these individuals have a high degree of geographic mobility underlies this concern.

The top federal rate of 29 per cent is close to the top U.S. rate of 28 per cent. When provincial and state taxes are brought into the equation, however, the comparison is substantially less equal. On the other hand, the U.S. federal rate exceeds 28 per cent over a wide range of income because of the recapture of the benefit of the 15 per cent rate and the phase-out of the personal exemption. Thus, a rate of 33 per cent applies from $43,150 to $101,760 for single taxpayers and from $71,900 to $171,650 for joint filers.

Certain witnesses wondered how critical the top personal marginal rate is for competitiveness. It was argued that all Canadians enjoy the benefit of a larger public sector role, and that the choice of location depends on quality of life and many other

factors besides taxes. Other witnesses however stressed the mobility of the movers and shakers who are so vital to the Canadian economy. Some also made the point that in the U.S. recently high incomes contributed more tax revenues after the top marginal rate was reduced.

The Committee concludes that the White Paper proposals for personal income tax reform have been carefully crafted so as to effect an acceptable compromise among the criteria of fairness, efficiency and competitiveness. This is only a global assessment, of course, and the Committee is proposing amendments to some specific White Paper proposals. For instance, the Committee proposes some improvements in child tax benefits. However the overall impact of the package is appropriate and the Committee endorses the new rate structure along with the thrusts of base broadening and conversion to credits.

Specific Tax Credits

Child Benefits

The tax recognition of children is an integral part of the family benefit system, which is currently undergoing substantial changes that are augmented by the White Paper proposals. Many briefs, as well as the witnesses at the Committee hearings, addressed the changes in child benefits, and they did not confine their comments to the White Paper proposals. All expressed concern about the sweeping restructuring of family benefits and the sharp erosion of benefits for middle- and upper-income families.

Evidence presented to the Committee indicates that, over a span of seven years from 1984 to 1991, real child benefits will be cut by half or more for upper- and middle-income families, whereas real benefits for low-income families will end up being at the same level in 1991 as in 1984, if the government does nothing to change the effects of partial indexing and the White Paper proposals. However, the government has made commitments with respect to the child benefits area, and, although the government may choose to focus exclusively on a new national child care policy, it would be unreasonable to take the projected level and structure of benefits in 1991 as a starting point for policy recommendations.

Thus the Committee is faced with a dilemma. Its task is to examine the White Paper; yet larger changes are occurring, and it is these the Committee was urged to address. In the end, the Committee has decided to confine its recommendations more or less to the White Paper proposals and to the tax recognition of children. Elsewhere in this report some comments are offered in respect of partial indexation, which pertain also to child benefits, and the Committee feels that there will be other opportunities to address family benefits in future.

The White Paper proposals contain five sets of changes to child benefits, which are discussed below:

1. Converting the child tax exemption into a tax credit. This follows upon the steps taken in the May 1985 Budget to reduce the child tax exemption. The Committee is concerned about the effect of this proposal on large families.

2. Removal of the tax recognition of dependent children over 18 except for those who are infirm, and introduction of a tuition and education credit. The Committee feels these changes go too far.

3. A reduction in the "turning point" family income level above which the existing child tax credit is phased out. This is a byproduct of conversion of several tax deductions to tax credits, and the Committee regards it as undesirable.

4. A progressive tax on family allowances because the exemption is replaced by a tax credit. The question arises as to which parent should report children as dependants.

5. The net income allowed a dependant without a reduction in the tax credit for the supporting relative is set at $500 for all dependants. This threshold is too low.

The Child Tax Exemption Credit

The conversion of the child exemption to a credit has been welcomed by all as a progressive step. However there has been concern about the level of the credit, at $65 per child. This level represents a confirmation of the policy of the May 1985 Budget which reduced the child exemption to the same level as family allowances, thus offsetting income taxes on the allowances. The credit goes further, however, in that it does not offset the tax on family allowances for a parent with income taxable at the 26 or 29 per cent federal rate.

The Committee feels that such changes would be too great and too rapid for large families. It therefore proposes that the federal child exemption credit be doubled for the third child and subsequent children, providing approximately $100 more per child, if the provinces followed the federal lead.

Such an increase in the proposed tax credit would provide some relief to large middle-income families who could otherwise experience a reduction (or complete loss) of the refundable child tax credit, and whose gains from personal income tax reform would be relatively small. It would also provide relief to large families with relatively low taxable income. However, its effect in alleviating poverty would be restricted if the increase in benefits were not extended to families with no taxable income.

The Committee proposes that the government make the increase in the credit refundable. The refund, to be made by the federal government, would be $100 per eligible child to reflect the value of the credit for federal and provincial taxes combined. As a mechanism, a top-up in the refundable child tax credit for third and subsequent children in families with incomes below the taxable threshold is suggested. This minor complication in the tax system would aid in concentrating benefits where they are most needed.

The cost of such a measure would be moderate, in the order of $55 million for the federal government, including the refundable portion. The cost to be provinces (excluding Quebec) would be $17 million. About 600,000 families would benefit.

Therefore, the Committee recommends:

3. That for the third and each subsequent child under age 19 a taxpayer claims as a dependant:

a) the taxpayer be given an additional exemption credit of $65;

b) this additional credit be made refundable in the form of a top-up of the federal refundable child tax credit of up to $100 per child. This top-up is reduced by the portion of the additional exemption credit that is used to reduce federal tax payable to zero;

c) that the government negotiate with the province of Quebec to provide an equivalent tax reduction to taxpayers with eligible children in that province.

Dependent Children of 19 Years of Age and Over

The White Paper proposes drastic changes in tax support for dependent children and students over 18 years of age. Those over 18 will be regarded as adults who can be claimed as dependants by others only if they are infirm. A credit of $250 for infirm dependent children over 18 years of age will replace the current exemption.

The exemption for dependent children aged from 18 to 21 will be eliminated, as well as the exemption for children over 21 who are studying full-time at colleges or universities. This exemption was projected to have a value of $1,000 in 1988. A single parent, however, will lose the equivalent-to-married exemption for a dependent child over 18, unless he or she has another dependant eligible for the new equivalent-to-married credit.

To replace these exemptions, the White Paper proposes a new credit for tuition fees and education expenses that can be transferred to a supporting spouse, parent or grandparent. The credit will be $10 per month of full-time attendance at a designated educational institution, plus 17 per cent of tuition fees paid in the calendar year, up to a combined maximum of $600 per year. The ample transferability feature makes it highly likely that the full cost of tuition fees and allowed education expenses will be credited against federal taxes.

In addition, persons over 18 years of age qualify as adults for the federal sales tax credit. This credit, introduced in 1986 with a rate of $50 per adult with a net income under $15,000, will be raised to $70.

The combined effect of these changes is a shift away from tax assistance based on age and dependency status to tax assistance for the cost of post-secondary education. It is by no means simple to work out the impact on the group affected, since so many changes are made at once. This may well be a major reason why the Committee has received few representations on these matters.

Very early in its examination of the White Paper, the Committee observed that many children are still in high school in the year in which they reach the age of 18 and according to the White Paper proposals these children would not be recognized as dependants. Depending on the family situation this could mean a sharp reduction in benefits at a time when the child is evidently still a dependant. An announcement by

the Department of Finance dated August 31, 1987, indicates that in the year in which a person turns 18 he or she is still regarded as a child under 18 for the refundable child and sales tax credits and the dependant and equivalent-to-married tax credits. In the view of the Committee, this announcement deals with the problem in a satisfactory manner.

The Committee feels, however, that tax assistance is too drastically curtailed for those at ages 19 to 21 who for whatever reason are not self-supporting nor in post-secondary schools. Lack of opportunity in high-unemployment areas, or difficulty in choosing or adjusting to full participation in the labour market may force people to remain dependent on parental support after their high school years. Single parents could suffer a major setback because of the elimination of the equivalent-to-married exemption for a child over 18.

To assist these young people and their supporting parents, and to mitigate the negative effects of tax reform on this group, the Committee proposes that a dependant tax credit be made available as an option for children until and including the year they become 21 years of age. The amount of the tax credit should be $130, as it replaces the current exemption which is twice as large as the exemption for children under 18. The equivalent-to-married credit should also be available for dependants up to age 21. According to another proposal by the Committee, these credits should be reduced by 17 per cent of income of the dependant in excess of $1,000.

The Committee recognizes that transferability of the tuition and education credit will provide tax assistance to many students that is generous compared to that under current rules. Therefore the Committee does not want to extend the dependant tax credit to students who elect to transfer the unused portion of their tuition and education credit to a supporting parent. The student has a choice, and the Committee estimates that most students paying normal tuition fees will prefer to avail themselves of the transfer of the tuition and eduction credit and forgo the dependant tax credit. The Committee feels that all persons over 18 years of age, including those who elect to use the dependant tax credit, should be treated as adults for the purpose of the sales tax credit.

This proposal provides targeted assistance to a group that would lose tax assistance under the White Paper proposals.

Therefore, the Committee recommends:

4. That a parent be permitted to elect to report a child of 19 to 21 years of age as a dependant and claim a dependant tax credit of $130 or, if he or she otherwise qualifies, the equivalent-to-married credit, and that by this election the child would lose the right to transfer to a supporting relative the unused portion of the tuition and education credit he or she may claim.

The Refundable Child Tax Credit

The federal child tax credit will reach a value of $524 per child by 1988. It is refundable, and it is reduced by 5 per cent of net family income in excess of a threshold

level which will reach approximately $24,000 in 1988. The White Paper proposes no changes to the credit, but rather changes to the definition of net income. After reform, employment expenses, tuition fees and CPP/QPP and UI contributions are no longer deductible in calculating net income. Therefore families will have higher income on paper after reform, and those with net family income in excess of $24,000 will receive a lower child tax credit.

The amount by which the credit is reduced depends on family income. Single-earner families claiming no tuition fees may have a maximum increase in net income of $1,684, the sum of the maximum current deductions for employment expenses, CPP/QPP contributions, and UI contributions. Two-earner families may face an increase of twice this amount if their income is high. In any event they lose the $500 employment expense deduction for both earners. Since the credit is reduced by 5 per cent of net income above the $24,000 threshold, a single-earner family may lose up to $84 in tax assistance for children. Two-earner families lose more than $100, on average.

The Committee notes that the turning point above which the tax credit is phased out is partially indexed, so that the credit for families with income above the turning point is eroded more rapidly than other child benefits. The erosion of the partial child tax credit and the change in net income affect many families in widely varying circumstances. The group affected includes single-earner families with incomes of $25,000 to $30,000, for whom the overall impact of income tax reform is rather favourable. But it also includes families with somewhat higher incomes whose gains from personal income tax reform are small.

The Committee wishes to provide a one-time increase in the turning point to slow down the erosion of the child tax credit for families with incomes near and above the turning point. A sum of $1,500 per family would roughly offset the effect of tax reform on single-income families, and go a long way towards neutralizing the effect on two-earner families. The cost of this measure is in the order of $90 million.

Therefore the Committee recommends:

5. That the turning point net income level for the refundable child tax credit be increased by $1,500 from $24,000 to $25,500.

Taxation of Family Allowances

The new child tax credit of $65 will be equivalent to a 17 per cent tax on the family allowance. The credit will offset taxes on family allowances for incomes in the 17 per cent bracket, but not for the higher income brackets. Thus the White Paper introduces progressive taxation of family benefits.

The Income Tax Act requires that the parent who claims the child tax exemption report the allowance. Generally the parent with the higher income will elect to do so because this income is subject to higher marginal rates than that of the spouse. After tax reform, evidently, it will generally be to the advantage of families to have the spouse with the lower income report the children.

To examine this more closely, assume a parent has income over $55,000. If this parent reports family allowances, the allowances are taxed at 29 per cent. This rate

applies for a single parent or a couple with two incomes over $55,000. If the spouse earned $20,000, however, he or she would report the children and avoid the 29 per cent tax. If the spouse earned $3,000 and reported family allowances, no tax would apply and the child tax credit would not be used, but the married credit claimed by the other spouse would be reduced by 17 per cent. Hence this couple will decide to have the high-income spouse report the allowance. These examples show that, under the new rules, family allowances will not be progresively taxed based on family income. Some couples will be able to engage in a limited form of income splitting which is largely prohibited for other forms of income.

Taxation of family benefits based on family income would probably be the fairest method, as already is done with respect to the child tax credit. However, extending the method to family allowances would require a new regime with its own brackets if not rates, this would be unacceptably complex. The Committee feels that fairness would be enhanced by making the spouse with the higher income report the children as dependants.

Therefore the Committee recommends:

6. That the parent with the higher income be required to include family allowances in income.

The Income of Dependants

The White Paper proposes an income threshold of $500 for all dependants. In the case of the married credit, the equivalent-to-married credit and the credit for dependants, the spouse or dependant would be able to report up to $500 in net income. The credit is reduced by 17 per cent of net income in excess of $500.

In 1986, the thresholds were $520 for a spouse, $2,760 for a child under 18 years old, and $1,340 for a dependant over 18 other than an infirm child. The married exemption was reduced by income above the threshold, and the credit for dependent children was phased out by one half of income over the threshold. Clearly the White Paper proposes very little change in the treatment of income of spouses, and restricts drastically the income allowed dependent children.

The Committee regards a $500 threshold for a dependant's income as unrealistic. Income just over $500 should not be subject to a 17 per cent federal tax rate, as it effectively will be when the dependant tax credit is clawed back at this rate. A net income of only $900 for a dependent child under age 18 should not completely eliminate the child tax credit.

The Committee proposes that the net income threshold for all dependants be raised to $1,000. By raising the threshold for all dependants by the same amount, the simplicity achieved in tax reform of having one common income threshold is maintained. As well, in the case of the married and equivalent-to-married credits, the credit is reduced to zero at $6,000, the income level corresponding to the basic personal tax credit.

Many dependants report income, and this measure has a greater cost in revenue forgone than any other recommendation in respect of dependants. Nonetheless the

Committee judges that the measure is justified. It is fair and provides a greater incentive to dependants to contribute to family income.

Therefore, the Committee recommends:

7. That a spouse or dependant can report up to $1,000 in net income before the full value of the tax credit available to the supporting taxpayer begins to be reduced.

Medical Expenses and the Disabled

The White Paper proposes to replace the special deduction for disabled persons by a federal tax credit of $550 commencing in 1988. Also, the medical expense deduction will be replaced by a non-refundable federal tax credit of 17 per cent of allowable medical expenses that exceed 3 per cent of a taxpayer's net income.

The Committee welcomes tax credits generally because they provide the same amount of tax assistance irrespective of the income of the taxpayer. The impact on a taxpayer of the conversion of a particular exemption or deduction into a tax credit is limited by the size of the exemption that is replaced, and generally the impacts are modest. However, the credit for medical expenses can have great impact when expenses are very high. The Committee recognizes that there are some for whom the effects of tax reform are dominated by this element of the package. Those who have chronic, high medical expenses for care and appliances not covered by medicare or other insurance, and with incomes of their own or of supporting relaives in the middle or upper tax brackets, will experience a sharp loss in tax assistance. However the Committee is inclined to accept this and to approach the tax treatment of the disabled in a different way.

The Committee is impressed by the arguments for making it easier for the disabled to become full and equal members of the Canadian workforce. The Committee strongly supports the aspirations of the Coalition of Provincial Organizations of the Handicapped (COPOH) when they stated that "as disabled people we collectively aspire to be independent and to participate in the mainstream of society."

After examining the testimony respecting both the taxation and welfare systems as they affect the disabled, the Committee believes that greater efforts must be made by all levels of government, working in co-operation, to give the disabled the opportunity of becoming increasingly independent by helping them integrate more fully into the workforce. As pointed out by COPOH, "an unnecessarily dependent disabled person is a person who could have been a taxpaying citizen."

Among the problems identified by the witnesses is the fact that the disabled may have special expenses needed to make them employable, and that these are not tax-deductible. The option of granting the disabled the opportunity to deduct expenses needed to make them employable has a lot of appeal, but the Committee realizes that this will not be simple to develop and manage, because of the diverse needs of the disabled and the different provincial regimes of support for them.

The Committee was also made aware by such groups as COPOH that "the working poor" are disadvantaged by the interaction of the present tax and welfare systems. It

was noted that people with no income are entitled to full welfare benefits, which can include full assistance for the payment of such items as prosthetic devices and wheelchairs. On the other hand, a person with taxable income will be able to obtain some relief through tax credits. However, "the working poor" who do not earn sufficient to pay taxes are situated in a no-man's-land between these two groups, and cannot receive either the full benefits of "the welfare system", or those of the "income tax system". They are thus unduly penalized for working. The Committee was advised that the effective marginal tax on the first dollars earned by the "working poor" is 50 per cent as a result of the social assistance claw-back. Feeling that this is counter-productive, the Committee believes that welfare payments and related benefits for paid care, medicine and disability-related devices should be phased out more gradually with earned income.

The Committee also considered the question of enhancing employment opportunities for the disabled by encouraging small businesses to make their premises more accessible to the disabled. COPOH recommends that "a one-time-only" reasonable accommodation deduction of $45,000 should be allowed to businesses that make capital expenditures to accommodate disabled employees, consumers or tenants. COPOH also noted that the 1986 United States tax reform package included such an "accommodation expense" of US$35,000. The Committee is attracted to this recommendation but notes that comparable provincial grant programmes may exist, as for example in Ontario.

The Committee endorses the aspirations of the disabled to become more independent and participate fully in the workforce, and wishes to draw attention to the ideas that were put forward for reducing the obstacles that stand in the way. Without necessarily endorsing any of these suggestions without further examination, the Committee recommends:

8. **That as a matter of urgency the federal government, in conjunction with the other levels of government, examine the tax and welfare systems to ensure that they do not act as a deterrent or barrier to the disabled who are or who wish to become members of the workforce.**

Charitable Contributions

For charitable contributions, the White Paper proposes a two-tier non-refundable federal tax credit. Contributions up to $250 annually will give rise to a 17 per cent credit; a 29 per cent credit will apply to donations in excess of $250.

Many witnesses expressed disappointment with the complexity of the proposal. Some of the briefs submitted to the Committee misinterpreted the proposal, and also expressed concern about the adequacy of tax support for charitable institutions after reform. The Committee has examined these submissions with care, and has finally decided to endorse the proposed credit.

Making the amount of tax assistance dependent only on the amount donated to charities and not on the income of the taxpayer certainly is an improvement in fairness. No longer will the tax system subsidize giving by the rich more than giving by middle- and low-income people. No longer will the government show a preference for one donor over another, apart from a preference for donors who give more!

Some witnesses expressed concern that the credit will reduce the tax incentive for charitable giving, but the Committee has concluded that this concern is not well-founded. In fact, the reduction in tax rates would reduce the tax assistance for charitable giving if contributions continued to be deductible. The new credit offsets the rate reduction and gives far more people than currently tax assistance at 29 per cent. According to calculations in the White Paper, the credit will cost $50 million in forgone federal revenue, which means more tax support for charities.

The credit has little impact on people in the top income bracket. For them the 17 per cent credit for charitable contributions up to $250 is lower than the value of a deduction, but for annual contributions in excess of $250 there is no difference between a credit and a deduction. But for people with incomes in the bottom bracket, the 29 per cent rate for the credit means a substantial enrichment. Currently, there are some three-quarters of a million individuals in this bracket who give more than $250 a year to charities for an average of close to $1,000, and these people will see their taxes reduced. They and many others may be tempted to give more to charities as they find their cost of giving reduced. Taxpayers in the bottom bracket contribute more than one-third of total donations. By contrast, although there are proportionately more donors in the top bracket, their number is smaller and they contribute only one-quarter of the total. Indeed, charities in Canada are not very dependent on donations out of high incomes. The new credit reflects this reality by providing an equal incentive for giving across the entire income spectrum.

The $250 threshold is arbitrary, and it has been suggested that it be lowered to $100 or removed. Removal would be attractive as a simplification measure and would also help charities in fundraising, as tax assistance would be easier to explain. However, such a step has a cost to the government; moreover, the limited evidence available suggests that giving is not very sensitive to the rate of tax assistance so that charities would gain less than the government would lose. In the view of the Committee, giving is motivated primarily by concern for the cause.

A two-tier credit requires an extra calculation in tax filing for those who donate more than $250. A single credit at an intermediate rate, say, 26 per cent, might be simpler but still requires a separate calculation. As it turns out, the two-tier structure can be integrated with the calculation of credits by grossing up the amount in excess of $250 by 70 per cent, after which the 17-per-cent credit rate can be applied (29 is 170 per cent of 17). Thus, the added complexity seems manageable.

In their fundraising, charities naturally like to stress the tax advantage of giving. Currently, they advertise the fact that donations are tax-deductible, and after reform they might want to advertise the rate of tax assistance. Doing so will be complicated by the two-tier structure and provincial income taxes. Not everyone has immediately understood that the credit rates of 17 and 29 per cent reflect only federal taxes, and that tax assistance is much more generous when provincial taxes are factored in. Roughly speaking, the combined federal-provincial credit for charitable donations will be 25 cents per dollar up to $250, and 45 cents beyond $250. Thus a more precise indication of tax assistance can be given than was possible before reform.

CPP/QPP and UI Contributions

The White Paper extends the conversion of exemptions into credits to CPP/QPP and UI contributions. A non-refundable federal tax credit of 17 per cent will apply to contributions and premiums for all employees and self-employed taxpayers. The employer portion of contributions, including that of self-employed individuals on their own behalf, will continue to be treated as a deduction.

The Committee agrees that the conversion to credits is fair, since credits provide the same tax relief to all taxpayers. However, the Committee has concluded that the requirement for the self-employed to claim a partial deduction and a partial credit for their CPP/QPP contributions will lead to unwarranted complexity in the design of the T1 individual income tax return, and will make the preparation of the T1 particularly confusing for those self-employed individuals who also make CPP/QPP contributions in respect of employment during the year. Therefore, the Committee recommends:

9. That self-employed individuals receive a 17-per-cent non-refundable federal tax credit for their total CPP/QPP contributions in lieu of a partial deduction and a partial credit.

Education Tax Credits

The White Paper has proposed that tuition fees will no longer be deductible, but will be replaced by a transferable tax credit equal to 17 per cent of fees. Furthermore, the $50 per month education deduction will be replaced by a $10 per month transferable credit.

The Federation of Independent Schools in Canada and the Ontario Association of Alternative and Independent Schools noted that the tax credits available for education exclude costs related to elementary and secondary schools. Although the Committee sympathizes with the concerns of those providing alternative forms of elementary and secondary schooling, the issue of school funding is within the realm of the provincial governments. Accordingly, it is not within the scope of the federal government's tax reform proposals to extend incentives to those taxpayers who wish to fund elementary or secondary school education privately.

The Canadian Association for Distance Education appeared before the Committee and addressed the issue that only students who are physically in attendance at classes on campus receive the education deduction of $50 per month of study. Therefore, students who enroll full-time in correspondence courses are not eligible for the deduction. These students might be disabled or located in remote regions. The Canadian Association for Distance Education estimated that 200-300 full-time students enrol for correspondence courses. The Association remarked in its brief: ". . . the current regulations . . . are antiquated and do not recognize the changing patterns of education in Canada today."

The Committee heard testimony from representatives of two universities, Athabasca University and the University of Waterloo, who stressed the growing practice of long-distance education in Canada. To be equitable, they said, the proposed federal education tax credit should be available to all full-time students, and the criterion should be whether the student studies full-time, not whether the student

attends classes. The Committee also heard testimony requesting that the proposed federal education tax credit be extended to part-time students. However, part-time students are currently allowed a tax credit for tuition fees paid, and the Committee was not convinced that the education tax credit need be extended. Therefore the Committee recommends:

10. That the proposed federal education tax credit should be made available to all full-time students enrolled in designated institutions for post-secondary education.

Base-Broadening Measures

The Capital Gains Inclusion Rate and Dividend Income

The changes to the taxation of capital gains and losses proposed by the White Paper affect both the proportion of a capital gain included in income and the amount and calculation of the lifetime capital gains exemption. Proposed changes to the taxation of dividend income are also discussed in this section to show the relative merits of earning dividends and capital gains.

The *Income Tax Act* now requires a taxpayer to compute income by including one-half of capital gains and deducting one-half of capital losses. The gains or losses arise only when a taxpayer disposes of "capital property" as defined in the *Income Tax Act*.

The White Paper Proposals

Under the White Paper proposals, a taxpayer will be required to include two-thirds of net capital gains in income in 1988, with the proportion increasing to three-quarters in 1990. The higher inclusion rate is projected to raise the top effective federal tax rate on an individual's capital gain in excess of the lifetime capital gains exemption from approximately 17 per cent in 1987 to 19 per cent in 1988 and 1989 and 22 per cent in 1990 and subsequent years. The federal-provincial tax rates on capital gains will be higher and will vary from province to province as seen in Table 5, which is taken from one prepared by Clarkson Gordon, chartered accountants, for its publication, *Tax Reform in Canada*.

The timing would be a little different for most corporations, which will be required to include two-thirds of net capital gains income for taxation years commencing after June 30, 1988 and 75 per cent for taxation years commencing after 1989. These changes will increase the effective federal tax rate on gains from the current rate of 18 per cent to 18 2/3 per cent in 1988 and to 21 per cent in 1990 and subsequent taxation years. For taxation years that straddle July 1, 1988 or January 1, 1990, the appropriate proportion will be prorated based on the number of days in the year that fall on either side of the effective date. For Canadian-controlled private corporations that realize capital gains, the July 1, 1988 effective date will be advanced to January 1, 1988 to correspond with both the personal and corporate tax rate reductions on such income which are effective on that date. For such corporations with taxation years that straddle January 1, 1988, the inclusion rate will be determined by prorating the one-half and two-thirds inclusion rate based on the number of days in the taxation years on either side of that date.

Table 5

Top Marginal Federal-Provincial Tax Rates on Capital Gains

Province	Top Rate on Capital Gains[1]		
	1987	1988-89	1990
		(per cent)	
Ontario	26.27	29.87	33.60
Quebec[2]	28.29	34.83	39.18
British Columbia	26.27	29.87	33.60
Alberta	26.55	30.29	34.08
Saskatchewan	27.87	31.86	35.84
Manitoba	29.03	33.02	37.15
Newfoundland	27.71	31.51	35.45
Northwest Territories	24.82	28.23	31.76
Yukon	25.16	28.61	32.19
New Brunswick	27.37	31.13	35.02
Nova Scotia	27.12	30.84	34.69
Prince Edward Island	26.86	30.55	34.37

[1] All years include surtaxes and other provincial taxes on income in effect or proposed at June 18, 1987.

[2] Rates for 1988 and future years assume that Quebec parallels federal capital gains changes.

Taxation of Dividend Income

The dividend gross-up and tax credit assist in the integration of corporate and personal taxes and attempt to prevent double taxation. Their object is to ensure that business and investment income earned by a Canadian-controlled private corporation bear approximately the same total tax as if the income had been earned directly by the shareholders. A taxpayer now grosses-up taxable dividends from taxable Canadian corporations by one-third and claims a dividend tax credit of 16 2/3 per cent of the grossed-up dividend.

The White Paper proposes to reduce the dividend gross-up to one-quarter. This change will in turn reduce the dividend tax credit to 13 1/3 per cent of the grossed-up dividend, because the credit will remain at two-thirds of the gross-up. The dividend tax credit will adequately compensate a shareholder of a Canadian-controlled private corporation for a federal (12 per cent) and provincial (8 per cent) tax rate of 20 per cent on active business income.

Testimony of the Witnesses

Officials from the Department of Finance testified that it was "really a judgment call as to the appropriate inclusion rate" for capital gains and that a variety of considerations led them to an inclusion rate "somewhere between two-thirds and three-quarters." They in turn rejected the American approach of taxing capital gains in full

for three reasons: (a) the need to reward risk associated with holding capital property; (b) the reluctance to create too much of a difference between the effective rate of tax on dividends and capital gains, and (c) the need for some allowance for the fact that property was held for long periods of time, recognizing that some of the gain may be due to inflation. Mr. David Dodge, the Assistant Deputy Minister, Tax Policy and Legislation Branch, stressed that there was "no real magic" about the three-quarters as opposed to 70 per cent or two-thirds and that the three-quarters figure was chosen to "keep the tax rates as low as possible". The move from two-thirds to three-quarters was expected to yield $135 million in 1990 and was estimated to be worth "approximately half a point of rate reduction on the corporate side to prevent major revenue drains to the U.S. treasury." The inclusion rate was also based on the Department's belief in integration at the small business rate and that this number would result from the adoption of a 25-per-cent dividend tax credit and a 12-per-cent small business rate with an allowance for provincial tax.

Comments in various briefs on this subject and the testimony of witnesses were both laudatory and critical of the White Paper proposal on the capital gains inclusion rate. The Joint Securities Industry Committee on Tax Reform, for example, advocated limiting the increase to two-thirds. Mr. Donald Huggett, F.C.A., a consultant with Coopers & Lybrand, argued for maintaining the existing dividend gross-up and tax credit mechanism but conceded that the inclusion rate for capital gains could be advanced to two-thirds provided it was reduced by some inflation factor. There were also more extreme views. The Canadian Gift and Tableware Association argued for retention of the 50 per cent rate while the Consumers Association of Canada, for example, demanded the taxation of the entire amount of capital gains. The reasons put forward by the various groups for their differing views might be summarized as follows:

- The full taxation of capital gains will introduce simplicity and fairness into the tax system;
- The full or increased taxation of capital gains will distort debt-equity ratios and discourage investors from investing in new equity capital; and
- The full or increased taxation of capital gains is retroactive and taxes accrued gains that were previously only subject to a possible 50 per cent inclusion and moreover may be the product of inflation rather than real growth.

A number of witnesses supported the full taxation of capital gains only if these amounts were adjusted for inflation. Other witnesses such as the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants expressed concern about the proposed increase in the tax burden on realized capital gains, and urged the government to give serious consideration to provisions allowing for inflation adjustments to the cost base of assets. The Department of Finance officials cited various arguments for not indexing capital gains and expressed a reluctance to treat other types of yields such as interest differently from capital gains, even though in 1982, the United Kingdom adopted a system of taxing the non-inflationary component of a capital gain.

Finance officials also indicated that they had examined other concepts when considering increasing the capital gains inclusion rate to two-thirds. For example, they rejected the introduction of another Valuation Day concept to provide transitional relief and thus favoured simplicity at the expense of retroactivity and fairness. They also

declined to use an arbitrary holding period such as five years as a means of determining whether an asset is "capital property" based on their assessment of the difficulties with this method in the United States. American taxpayers have apparently recognized losses within the holding period to take advantage of fully deductible losses, and have held property beyond this time limit to ensure they will obtain capital gains treatment.

Observations of the Committee

The Committee recognizes the importance of base broadening in lowering tax rates, and it supports the proposed increase in the capital gains inclusion rate to two-thirds to ensure that there is little difference between the marginal rates at which dividends and capital gains are taxed. Projected top marginal rates for dividends and capital gains under the White Paper proposals are contained in Table 6, which was prepared by Clarkson Gordon, chartered accountants, for its publication *Tax Reform in Canada*.

Table 6

Top Marginal Federal Provincial Tax Rates on Dividends and Capital Gains

	Top Rate on Dividends[1]		Top Rate on Capital Gains[1]		
Province	1987	1988	1987	1988/89	1990
Ontario	35.71	30.26	26.27	29.87	33.60
Quebec[2]	41.87	38.82	28.29	34.83	39.18
British Columbia	35.71	30.26	26.27	29.87	33.60
Alberta	36.74	31.26	26.55	30.29	34.08
Saskatchewan	38.99	33.24	27.87	31.86	35.84
Manitoba	40.1	35.75	29.03	33.02	37.15
Newfoundland	37.67	31.92	27.71	31.51	35.45
Northwest Territories	33.74	28.59	24.82	28.23	31.76
Yukon	34.20	28.98	25.16	28.61	32.19
New Brunswick	37.21	31.53	27.37	31.13	35.02
Nova Scotia	36.86	31.24	27.12	30.84	34.69
Prince Edward Island	36.52	30.94	26.86	30.55	34.37

[1] All years include surtaxes and other provincial taxes on income in effect or proposed at June 18, 1987.

[2] Rates for 1988 and future years assume Quebec parallels federal capital gains changes, but not the dividend gross-up and credit changes.

The two-thirds inclusion rate will also assist the government in simplifying the *Income Tax Act*. It will contribute to narrowing the difference in the tax base between capital gains and dividends and may eliminate the need for some 15 pages of complex anti-avoidance rules, which would be necessary to prevent the exploitation of such differences in the tax base.

The rates for various income tax brackets are set out in Table 7, which was prepared by Touche Ross, chartered accountants for its publication *Understanding Tax Reform - 1987 - Personal Tax Planning*.

Table 7

Combined Federal and Provincial[1] Tax Rates on Investment Income including Federal Surtax

Taxable Income	1987	1988	1989	1990
		(per cent)		
$27,501 to 36,952				
Dividends	17.0	24.2	24.2	24.2
Capital gains	19.1	26.5	26.5	29.8
$36,953 to 55,000				
Dividends	27.2	24.2	24.2	24.2
Capital gains	23.0	26.5	26.5	29.8
$55,001 to 63,347				
Dividends	27.2	30.0	30.0	30.0
Capital gains	23.0	29.6	29.6	33.3
$63,348 and over				
Dividends	35.4	30.0	30.0	30.0
Capital gains	26.0	29.6	29.6	33.3

[1] Assumes a 50% provincial tax rate.

The Committee has concluded that the increase in the capital gains inclusion rate to two-thirds should be an interim measure only. Moving to an inclusion rate of three-quarters rather than 100 per cent is considered to be inappropriate because, as the previous tables show, the gap between the taxation of dividends and capital gains widens in 1990. The Committee also urges the government to reconsider the conclusions of the Department of Finance found in the November 1980 paper *A Review of the Taxation of Capital Gains in Canada*. In that paper, the Department concluded that various factors had prompted "no industrialized country" to provide a comprehensive inflation adjustment of capital gains or other investment or business incomes. The Committee appreciates that full inflation adjustments are difficult to justify when only partial indexation is found elsewhere in the *Income Tax Act*. However, although inflation adjustments may lead to some complexities and inequities, the Committee advocates taking another look at indexation as an alternative means of taxing capital gains, in view of the use and apparent success of this approach in the United Kingdom since 1982. Consequently, the Committee would advocate that the full amount of capital gains be included in income and the full amount of capital losses be deductible, and recommends:

11. That, as an interim measure only, the proportion of a capital gain or capital loss required to be included in computing an individual's taxable capital gain or allowable capital loss be increased from one-half to two-thirds for gains and losses realized in 1988 and 1989.

12. That in 1990, following a review of the subject of indexation of capital gains, the full amount of capital gains be included in income and the full amount of capital losses be deductible, provided such gains and losses are adjusted for inflation from the later of the date of ownership or January 1, 1972.

The Lifetime Capital Gains Exemption

Until the May 23, 1985 federal Budget, taxable capital gains were exempt from the income tax base only in limited circumstances. For example, gains from the disposition of a principal residence were not included in income. Furthermore, in its 1980 paper *A Review of the Taxation of Capital Gains in Canada*, the Department of Finance rejected the non-taxation of capital gains for a variety of reasons.

Nevertheless, in his May 23, 1985 Budget Speech, the Minister of Finance heralded the introduction of the lifetime capital gains exemption:

> Individual Canadians will be granted a lifetime capital gains exemption of half a million dollars. All capital property will qualify for the exemption. The lifetime exemption limit will be phased in over six years beginning this year.
>
> The full exemption will be available immediately for capital gains realized on the sale of farm property. Based on my consultations with the farming community, I believe this to be the most effective way to provide the necessary assistance to this vital sector of the economy.
>
> This measure will encourage more Canadians to invest in small and large businesses. It will help Canadian companies to accelerate their return to a healthy financial position by attracting new equity investment. It will assist small businesses in raising capital to pursue new ideas and new directions. It will help raise capital for research and development.

Existing Quantitative Limits

Current legislation provides for a $500,000 lifetime capital gains exemption limit for individuals resident in Canada throughout the year. For gains on qualified farm property, the full $500,000 lifetime capital gains exemption limit commenced in 1985. For gains on all other capital property, the $500,000 limit was to be phased in over six years and was scheduled to reach the $500,000 level in 1990. The cumulative phase-in limits for net capital gains are as follows: 1987 - $100,000; 1988 - $200,000; 1989 - $300,000; and 1990 - $500,000.

One-half of capital gains net of capital losses in excess of the exemption limit are currently included in income. The alternative minimum tax calculation also requires the addition back into taxable income of the non-taxable half of a capital gain. Capital gains reserves claimed in respect of properties disposed of after 1984 are not eligible for the higher phase-in limits for the taxation years in which the reserves are included in income.

Existing Qualitative Restrictions

Gains realized on all capital property, as defined in the *Income Tax Act*, are eligible for the lifetime capital gains exemption. "Qualified farm property", as defined in the *Income Tax Act*, is eligible for the immediate use of the $500,000 lifetime capital gains exemption. Qualified farm property is defined to apply to real property used by the individual taxpayer, his spouse or any of his children in the course of carrying on the business of farming in Canada. It also applies to property used by a corporation or partnership which is a "family farm corporation" or "family farm partnership". Real property is deemed to be used by an individual in the course of carrying on the business of farming in Canada if such property was used in the carrying on of the business in the year of disposition or in at least five years during which the property was owned by the individual, his spouse or child. Qualified farm property also includes a share of a "family farm corporation" or an interest in a "family farm partnership," which must use all or substantially all of its property to carry on the business of farming in Canada, and the individual owning shares of the corporation or an interest in the partnership must be actively engaged in the business. This test is also satisfied if the spouse or child of the individual has been actively engaged. The "actively engaged" test has no stipulated time frame, so that an individual could be actively engaged in the business for a short period to qualify for the lifetime capital gains exemption. An individual is also not required to own or hold the real property, shares or partnership for any stipulated period before qualifying to claim the lifetime capital gains exemption.

The White Paper Proposals on the Lifetime Capital Gains Exemption

The White Paper aims to impose additional quantitative and qualitative restrictions on the lifetime capital gains exemption. These proposed rules will reduce the maximum lifetime capital gains exemption to $100,000 for all capital assets other than "qualified farm property" and shares of a "small business corporation," and will delay an individual's utilization of the lifetime capital gains exemption until cumulative net investment losses realized after 1987 have been offset. The $500,000 lifetime capital gains exemption limit will be available for shares of small business corporations beginning in 1988. Yet capital gains from dispositions of shares of small business corporations that are being included in income after 1987 through the capital gains reserve mechanism will be eligible for the $500,000 lifetime capital gains exemption where the shares have been disposed of after June 17, 1987.

Qualified Farm Property

Qualified farm property still remains eligible for the $500,000 lifetime capital gains exemption, which is also referred to for convenience as the farm exemption. The definition becomes more restrictive for real property acquired by an individual *after* June 17, 1987 for it contains additional tests. Real property will not qualify *unless*:

(a) it was owned by an individual, his spouse or child for at least 24 months prior to disposition; and

(b) in at least two calendar years during which the property was owned, the gross revenues from the farming business for a fiscal period ending in the year in which the property was used exceed the net income of the taxpayer, his spouse or child from all other sources.

Real property owned by an individual and used by a "family farm corporation" or "family farm partnership" of which the individual, his spouse or child was a member will qualify only if the corporation or partnership used the property in the course of carrying on the business of farming in Canada for at least 24 months before disposition.

No changes are proposed to the rules dealing with the shares of family farm corporations or the interests in a family farm partnership.

Small Business Corporations

A capital gain on the disposition of a share of a "small business corporation" will be eligible for the $500,000 (not $100,000) exemption only where:

(a) the corporation is a small business corporation at the time of disposition;

(b) the shares are not held by anyone other than the taxpayer or persons related to the taxpayer throughout the 24 months immediately preceding disposition; and

(c) more than 50 per cent of the value of the assets of the corporation have been used in an active business carried on by it primarily in Canada throughout the holding period.

For convenience, this Report refers to this $500,000 exemption as the "small business share exemption". Additional technical rules are proposed to deal with circumstances in which shares of one corporation are held by a holding company and the shares of the holding company are sold.

As defined in the *Income Tax Act*, a "small business corporation" at any particular time means a particular corporation that is a Canadian-controlled corporation all or substantially all of the assets of which were at that time:

(a) used in an active business carried on primarily in Canada by the particular corporation or by a corporation related to it,

(b) shares of the capital stock of one or more small business corporations that were at that time connected with the particular corporation (within the meaning of subsection 186(4) on the assumption that such small business corporation was at that time a "payer corporation" within the meaning of that subsection) or a bond, debenture, bill, note, mortgage, hypothec or similar obligation issued by such a connected corporation, or

(c) assets described in paragraphs (a) and (b),

and, for the purposes of paragraph 39(1)(c), includes a corporation that was at any time in the 12 months preceding that time a small business corporation.

Cumulative Net Investment Losses

Under the White Paper proposals, individuals will be required to postpone claims for lifetime capital gains exemption until they have earned sufficient investment income to offset investment losses suffered through direct or indirect ownership of property. It would appear that the rationale for this cumulative net investment losses rule is that

individuals are required to pay taxes on all investment income to the point where there are no net tax subsidies for their investments before they can become entitled to the use of a lifetime capital gains exemption, another tax preference, to offset the gain resulting from the disposition of an investment.

After 1987, net taxable capital gains eligible for the exemption will be reduced in respect of other net investment losses deducted by the taxpayer in computing income for tax purposes. Investment losses are calculated on a cumulative basis. Cumulative net investment losses incurred after 1987 will reduce the portion of the capital gains eligible for the lifetime capital gains exemption for 1988 and subsequent years. At the end of the year, cumulative net investment losses are composed of the difference between the taxpayer's Investment Expenses for the year and prior years commencing after 1987 and the taxpayer's investment income for those years.

Investment expenses consist of the following items that are deducted in computing income for the year:

(a) deductions, including interest, with respect to property that will yield interest, dividends, rent or other income from property;

(b) carrying charges, including interest, with respect to an interest in, or a contribution to, a limited partnership or any other partnership or ownership arrangement where the individual is not actively engaged in the business;

(c) the individual's share of deductions attributed to a resource flow-through share or relating to Canadian exploration and other resource expenses of a partnership or co-ownership arrangement where the individual is not actively engaged in the business; and

(d) any loss for the year from the renting or leasing of real property owned by the individual or a partnership not otherwise included in investment expenses.

Excluded from investment expenses will be capital cost allowance claimed in 1988 in respect of a certified film production acquired in 1987.

Investment income consists of the following items included in income:

(a) interest, taxable dividends and other income from property;

(b) the individual's share of the income from a limited partnership or any other partnership or co-ownership arrangement where the individual is not actively engaged in the business; and

(c) income for the year from the renting or leasing of real property owned by the individual or a partnership not otherwise included.

Summary of the Testimony and Briefs

Qualified Farm Property and the Farm Exemption

Various farming groups commented on the restrictions placed on the definition of "qualified farm property". For example, both the Saskatchewan Wheat Pool and the

Canadian Federation of Agriculture expressed concern that the property must be owned for at least two years preceding the disposition by the taxpayer, his spouse or child and that during this period, the owner must be a bona fide farmer. Therefore, these groups recommended that the Farm Exemption be available to a bona fide farm operator or a farmer who has operated the farm unit for any five years prior to disposition regardless of whether the farm unit is later rented to and farmed by persons other than family members.

The Small Business Share Exemption

Some groups, such as the Canadian Organization of Small Business, criticized the scope of the small business share exemption and the consequent lack of neutrality that will exist between incorporated and unincorporated small businesses. Although most sales of small business involve the disposition of assets rather than shares, a vendor will only be permitted to sell shares rather than assets used in an unincorporated business to take advantage of the small business share exemption or the $100,000 lifetime capital gains exemption. Incorporation of a business would first be required to enable an individual to effectively sell the assets of a proprietorship or partnership.

Cumulative Net Investment Loss Rules

Of the changes affecting the calculation of the lifetime capital gains exemption, the cumulative net investment losses rules attracted the most criticism. The adverse comments came principally from interest groups involved in certain sectors of the economy (e.g., resources and film) who concluded that the after-tax return from an investment in such tax-favoured instruments as flow-through shares or films would decline significantly if investors were unable to utilize the lifetime capital gains exemption.

The Lifetime Capital Gains Exemption Limit

A number of social policy groups such as the National Anti-Poverty Organization and the National Council of Welfare advocated the elimination of the lifetime capital gains exemption because of the perceived advantage it affords wealthier Canadians. Professional groups also supported such views. For example, the Institute of Chartered Accountants of British Columbia stated that the lifetime capital gains exemption is "poor tax policy" because "the potential deduction is not a material influence on investors making new investments (with the exception of flow-through shares)" and "has resulted in a significantly more complex tax system with the addition of anti-avoidance measures required to block perceived abuses of the deductions". In contrast, the Joint Securities Industry Committee on Tax Reform recommended that the $500,000 ceiling also be retained for the shares of listed Canadian companies because the lifetime capital gains exemption "has been an important factor in encouraging Canadians to purchase record amounts of equity capital of Canadian business" which has "contributed importantly to growth and job creation in the Canadian economy".

Adequacy of the White Paper Proposals

The Committee recognizes that the lifetime capital gains exemption has contributed significant complexity to the tax system and has necessitated the

introduction of many anti-avoidance rules. Nevertheless, on balance, the Committee has concluded at this stage that the lifetime capital gains exemption does provide an inducement for Canadians to be entrepreneurial and to invest their capital in new and risky ventures and should be maintained. Yet, to prevent the misuse of the lifetime capital gains exemption, the Committee endorses the White Paper proposal to cap the lifetime capital gains exemption limit at $100,000 of cumulative net capital gains arising on the disposition of most forms of capital property.

The Committee also agrees with the comments of Mr. Allan Short, Assistant Director Legislation of the Department of Finance, to the effect that the $500,000 lifetime capital gains exemption limit provides "a fairly sizeable recognition of the importance the government attaches to the small business and agricultural sectors." Subject to further comments on the adequacy of the proposed rules dealing with qualified farm property and small business corporations, the Committee recommends that the the farm exemption and the small business share exemption limit of $500,000 be available at this stage for cumulative net capital gains arising on the disposition of these types of capital property.

Bearing in mind that the purpose of the small business share exemption is to afford relief to small business corporations, the Committee rejects the suggestion that a $500,000 lifetime capital gains exemption limit should extend to shares of all corporations because of the potential revenue loss to the government.

The Farm Exemption and Rules for Qualified Farm Property

The Committee is of the view the proposed changes do not go far enough to prevent the abuse of the farm exemption. If the proposed rules were enacted, individuals could carry on the business of farming for a limited two-year period before selling real property. Consistent with the stated purpose of the rule to restrict the farm exemption to bona fide gains with respect to farm real property and preclude speculators from farming for one year and then taking the exemption, the Committee suggests changes that will require the active participation of an individual or an immediate family member in the Canadian farming business. These suggested changes should ensure that it should be irrelevant whether the farming business is owned directly or indirectly, provided the ownership interest is held for any five-year period immediately before the year of disposition, and the business is actively carried on at any time before disposition for a total of five years, which need not be consecutive. Accordingly, the Committee also advocates changes to the existing rules dealing with the characterization of shares of family farm corporations or family farm partnerships to ensure that gains resulting from the ownership of a direct or indirect interest in a farming business are treated equally.

The Committee also recognizes that a taxpayer may be able to multiply the use of the farm exemption within a family unit by having the taxpayer first transfer a direct or indirect ownership in the farm property or farming business to his children on a tax deferred or rollover basis in anticipation of a sale of the whole property or business to a third party. The Committee suggests that it may be appropriate for the government to review whether the rollovers permitting the inter vivos transfer of direct or indirect interests in the farm property or farming business should be available if the principal purpose of the rollover is to enable the transferor's family to obtain the benefit of farm exemption when the transferor could not have obtained the same benefit.

Small Business Corporations and the Small Business Share Exemption

The Committee has concluded that the proposed rules affecting the small business share exemption are too broad because they reward passive ownership of an enterprise. They also extend the exemption to shareholders of large Canadian-controlled private corporations who do not require the $500,000 lifetime capital gains exemption limit to risk their capital. Consequently the Committee has determined that the small business share exemption limit should only be available for the owner manager who is "actively engaged or employed" in a business carried on by a corporation that meets a particular size test. The Committee recognizes that there are many different size tests or caps that may be appropriate. The size test of $35,000,000 of assets suggested by the Committee is found in the Income Tax Regulations and is now used as a benchmark in connection with investments in small businesses by statutory deferred income plans as a means of also increasing their foreign property holdings. Other size standards exist in the provincial stock savings and venture capital legislation as well. Although the Department of Finance officials criticized "size caps" in their testimony because they encourage corporations to "stop growing", the Committee has concluded that the small business share exemption is intended to induce persons to invest in risky ventures and that an incentive as generous as $500,000 should not be awarded once a corporation has reached a certain size. The Committee therefore recommends the adoption of rules that stress the active involvement of the owner manager in an active business for a minimum of five years prior to the disposition of shares of the corporation that carries on such a business. The Committee recognizes that some businesses may be carried on in an unincorporated form either as a proprietorship or partnership prior to incorporation and believes that the vehicle for carrying on business should not disentitle the owner manager from claiming the small business share exemption. Accordingly, the Committee believes that the period during which the owner manager was actively engaged in carrying on the business in its unincorporated form should count towards determining the five-year period. The Committee is also concerned about the need for rules that would prevent a corporation from qualifying as a small business corporation if it also could not be characterized as a family farm corporation. Consequently, the Committee advocates the specific exclusion of a corporation from carrying on the business of farming in Canada from the definition of small business corporation for purposes of determining an individual's entitlement to the small business share exemption.

The Committee also acknowledges that the small business share exemption will create a bias towards selling shares rather than assets even though the purchaser in many cases would prefer to acquire the assets for tax and commercial reasons. Nevertheless, the Committee recognizes that the small business share exemption will enable proprietors or partners of unincorporated businesses to gain access to an exemption limit of $500,000 rather than $100,000 or perhaps nil, in some cases, by first transferring the assets on a tax-deferred basis to the corporation prior to selling the shares. The Committee believes that the costs associated with the incorporation of the business will not impair the vendor's desire to incorporate. Nonetheless, the Committee shares the concerns of witnesses such as the Canadian Organization of Small Business that certain asset sales should also be subject to the lifetime capital gains exemption. It also urges officials of the Department of Finance to attempt to formulate solutions in this area and suggests that, as a start, eligible capital property should be treated as depreciable property to at least enable resident Canadian individuals to gain access to

the $100,000 lifetime capital gains exemption on assets that most likely appreciate in value such as goodwill. This topic is canvassed further in the Report in the section on eligible capital property.

The Cumulative Net Investment Loss Rules

The lifetime capital gains exemption is deductible from taxable income. The deduction enables a taxpayer to reduce cumulative net taxable gains once the taxpayer has also deducted any available capital loss carry-over and any allowable business investment losses claimed in the taxation year. The White Paper proposes to further reduce a taxpayer's claim for the lifetime capital gains exemption by the amount of cumulative net investment losses claimed after 1987 for tax purposes. Its stated purpose is "to reduce tax shelter possibilities and to better match deductions with tax-exempt income." Consequently, a person without investment income who deducts interest expenses on money borrowed to buy shares will be required to delay a claim for the lifetime capital gains exemption on the sale of the shares or other capital property until an equal amount of taxable income is earned from all other investments. The calculation of the cumulative net investment losses is done in two stages. The first requires a calculation of various elements within the definitions of investment income and investment expenses. The second involves the determination as of December 31 whether the investment expenses exceed the investment income.

The Committee endorses the cumulative net investment losses concept because it prevents an individual from deriving a net economic benefit through the tax system. This could occur because interest expenses are deductible in full even though capital gains derived from the use of these borrowed funds may be exempt from taxation through claims for the lifetime capital gains exemption. The Committee appreciates the role that the cumulative net investment loss provision should play in limiting the proliferation of tax shelters.

The Committee is sensitive to representations made about the adverse impact of the cumulative net investment losses on the after-tax return of certain investments. Nevertheless, it considers that the availability to investors of other tax incentives such as unrestricted capital cost allowance (for MURBS) or current deductions (Canadian exploration expenses), sufficiently enhances the attraction of an investment without unduly distorting the economics of the investment. To the extent that the Committee does recommend the elimination of certain tax incentives from the cumulative net investment losses rule, it does so only as a means of affording transitional relief to certain taxpayers or correcting structural flaws within the cumulative net investment losses formula resulting from the adoption of the "pooling" concept. Nevertheless, the Committee believes that certain elements within the cumulative net investment losses formula may lead to a retroactive denial of the lifetime capital gains exemption. Assets acquired in 1987 prior to the proposal of the cumulative net investment losses formula were not expected to affect the lifetime capital gains exemption available upon the disposition of another capital asset.

The Committee is of the view that the deduction of certain costs in 1988 and subsequent years that relate to the costs incurred for acquisition of property in 1987 and previous years should be excluded from the calculation of cumulative net investment losses. To the extent that the exclusion of these amounts would prove too

awkward and would unduly complicate the *Income Tax Act*, the amounts might then remain in the calculation. Ideally, all capital cost allowance relating to capital assets that were acquired prior to June 18, 1987 should be excluded from the cumulative net investment losses calculation. Yet, for simplicity, the Committee restricts its remarks on exclusion from the cumulative net investment losses exclusively to certain resource expenses such as Canadian development expenses and to capital cost allowance relating to MURBS and Canadian certified productions that can contribute to investment expenses. The income from these investments might also then be excluded from investment income.

The Committee also urges the Department of Finance to consider other technical matters such as the need to include the recapture of capital cost allowance and terminal losses in cumulative net investment losses and the ability of taxpayers to readjust their cumulative net investment losses balance created in statute-barred taxation years. This latter adjustment would be required in the event that Revenue Canada later determined that an investment should have been classified as a business asset.

The Committee recognizes that, ideally, the cumulative net investment losses concept should be calculated with reference only to the asset to which it relates. Consequently, the deduction of a lifetime capital gains exemption with respect to a particular asset would only be deferred until the cumulative net investment losses created from the acquisition, ownership, use and disposition of that asset is exhausted. Nevertheless, the Committee appreciates that to "quarantine" or "ring fence" an investment would only increase the complexity of the tax system and could prove difficult for Revenue Canada to administer. Therefore, by broadening the cumulative net investment losses calculation to embrace flows from the direct and indirect ownership of all investments, the Department of Finance is demonstrating that equity has been sacrificed for simplicity.

The Committee, however, realizes some of the problems inherent in the pooled calculation of investment income and expenses and that the cumulative net investment losses formula, as presently designed, leads to some arbitrary results and to some inequities. As the following example illustrates, the cumulative net investment losses rule, as drafted, may force taxpayers to order their investment affairs in a tax-driven fashion, contrary to one of the White Paper's precepts to prevent distortions in economic decisions. For example, a taxpayer may have acquired real estate in 1988 that has appreciated substantially in value by 1990. In 1989, the taxpayer may have borrowed funds to acquire shares that reflect an accrued loss in 1990. A sale of the real estate may not entitle the taxpayer to claim the lifetime capital gains exemption in 1990 because the debt service costs related to another asset, the shares, will have created cumulative net investment losses at the end of 1989. Had the taxpayer sold the real estate before acquiring the shares, he would have been able to claim lifetime capital gains exemption with respect to the gains realized on the sale. Although this example shows that cumulative net investment losses should be calculated by "quarantining" or "ringfencing" investments, the Committee agrees with the Department of Finance's adoption of the simpler approach to the calculation of cumulative net investment losses at the expense of fairness and "rough justice."

Recommendations on the Lifetime Capital Gains Exemption Proposals

Qualified Farm Property and the Farm Exemption

13. That the definition of "qualified farm property" be amended so that it include only real property that is: (a) owned by the individual; (b) used prior to the year of disposition for a minimum of five years which need not be consecutive; and (c) used by the individual, his spouse, or any of his children actively engaged in carrying on the business of farming in Canada or by a "family farm corporation" or a "family farm partnership."

14. That the definition of "qualified farm property" be amended so that it include a share of capital stock of a "family farm corporation" or an interest in a "family farm partnership": (a) owned by the individual; and (b) in which the individual, his spouse or any of his children was actively engaged in the business of farming carried on by the family farm corporation or family farm partnership for a minimum of five years, which need not be consecutive prior to the year of disposition.

Small Business Corporations and the Small Business Share Exemption

15. That a gain realized on the disposition of shares of a small business corporation qualify for the $500,000 lifetime capital gains exemption only if: (a) the individual, who disposes of the shares, or the deceased spouse was actively engaged in the business, (whether prior to incorporation as a proprietor, partner or employee, or after incorporation) for a minimum of five years prior to the year of disposition which need not be consecutive; (b) the Small Business Corporation was not engaged in the business of farming; and (c) the total assets of the Small Business Corporation and all corporations associated therewith (determined in accordance with generally accepted accounting principles on a consolidated or combined basis, where applicable) do not exceed $35,000,000, the limit to which statutory deferred income plans are subject when seeking to increase their foreign property holdings by investing in small business securities.

Cumulative Net Investment Losses

16. That, as proposed by the White Paper, after 1987, net taxable capital gains eligible for the lifetime capital gains exemption be reduced by other investment losses calculated through a cumulative net investment losses formula and deducted by the taxpayer in computing income for tax purposes.

17. That the definition of investment expenses in the cumulative net investment losses formula: (a) exclude any expense incurred before 1988 and amortized after 1987 as a result of property acquisitions made before 1988, such as a Canadian development expense, Canadian oil and gas property expense and capital cost allowance claimed on a multiple

unit residential building; and (b) include terminal losses realized on the disposition of depreciable property acquired after 1987.

18. That the definition of investment income in the cumulative net investment losses formula include capital cost allowance recaptured into income in respect of depreciable property acquired after 1987.

The Investment Income Deduction and the Elderly

The Committee heard from a number of witnesses representing the senior citizen community. Their major concerns were the removal of the $1,000 investment income deduction, taxation of capital gains and indexation. Many expressed the view that senior citizens will not be better off after tax reform.

The Committee has examined the specific points raised in the context of the impact of the personal income tax reform proposals as a whole. The elimination of the investment income deduction is not an isolated move and, placed in the context of other proposals, it proves to be not a serious loss to the elderly.

As over 70 per cent of taxfilers aged 65 and over will have income in the bottom bracket in 1988, the level of the new tax credits and the replacement of several rates by a common 17 per cent rate is of particular concern. The proposed personal basic tax credit of $1,020 is set at a level so as to offset the elimination of the 6 per cent and 16 per cent lowest federal tax rates, and provides a cushion for the loss of the employment deduction and the investment income deduction. The large majority of taxpayers in this income range will therefore see their income taxes reduced as a result of the White Paper proposals.

As for the elderly, few are affected by the elimination of the employment expense deduction. Seniors in the bottom tax bracket will also benefit from the new age credit of $550 that compares favourably with the current exemption, whose value would be $455 at the 17 per cent rate. The pension income deduction is also continued, in the form of a credit of 17 percent for income up to $1,000, roughly equivalent to the current deduction. The combined effect is that lower income seniors will pay less tax as a result of reform.

A number of seniors with low incomes will see their taxes reduced to zero. With the enhanced personal credits, the taxable income threshold is increased, especially for seniors. Before tax reform the typical single senior with public pension benefits and bank interest could earn $7,900 (ignoring guaranteed income supplements) before paying federal tax. After reform income up to $9,300 will be tax-free. Similarly, a married senior couple could earn $14,200 tax-free before tax reform compared to $17,500 post-reform. For those with eligible pension income the thresholds are higher both before and after reform.

Senior citizen representatives advocated full indexation of the tax system and social program benefits. While full indexation may be desirable, seniors are less affected than some other groups of taxpayers, because the benefits most of them receive outside the tax system (OAS and CPP) are fully indexed. The issue of full indexation is discussed in more detail elsewhere in this report, as is capital gains taxation.

To sum up, the Committee judges that personal income tax reform will not increase taxes for low-income elderly. The Committee accepts the claim of the White Paper that personal income tax will be reduced for almost 9 out of 10 Canadians over age 65.

Automobile Expenses

Revenue Canada and the Department of Finance have long been concerned that some expenses deducted as a cost of business actually represent personal consumption. Automobile expenses present an obvious problem for tax treatment. The same car that is used by a professional to visit clients or by a salesperson for business purposes can also be used for a family vacation. And while on the way to visit a client or to sell a piece of real estate or an insurance contract, the professional or salesperson may run a personal errand, so that it is difficult to disentangle the business and personal use of an automobile. Rules are now in place that attempt to exclude some personal use from the allowable deductions for automobile expenses, but the problem remains.

The White Paper, therefore, proposes tightening up these rules:

> Deductions for depreciation and lease costs on automobiles will be limited to the first $20,000 of the cost of the car, and limits will apply to deductible financing charges. Further reductions in allowable claims by employed and self-employed individuals will apply unless the automobile is used all or substantially all (i.e., at least 90 percent) for business purposes.

At the hearings before the Finance Committee, officials from the Department of Finance suggested that the proposed rules for automobile expenses would add approximately $150 million to federal government revenue in 1988. (The White Paper estimates that the revenue gain in 1988 from reduced deductions for home offices, business meals and entertainment, and automobile expenses would be $230 million.)

The proposed change in the treatment of automobile expenses attracted more complaints from those submitting briefs to the Finance Committee than any other aspect of tax reform. More than 90 briefs addressed the issue. The two areas of greatest concern were the definition of what constitutes "substantial use for business purposes" and the $20,000 limit on capital cost allowance or leasing costs.

Those who use their automobiles 20 per cent to 89 per cent of the time for business purposes face the greatest changes in the handling of automobile expenses. For this group, only one-fifth of the maximum capital cost allowance, lease costs and interest charges may be claimed. In addition, this group may deduct none of the ordinary charges for insurance, licensing and parking (at the regular place of business). This group may, however, deduct their full business percentage of all other operating costs (fuel, maintenance and repairs).

In contrast, those with business use equal to or greater than 90 per cent, may claim as a deduction the proportion of the maximum capital cost allowance, lease costs and interest charges as well as the costs of insurance, licensing and parking and all other operating costs that represents the business use. Those with business use less than 20 percent may also deduct the proportion of the maximum capital cost allowance, lease

costs and interest charges, as well as all other operating costs that represents business use, but may not claim any deduction for the costs of insurance, licensing and parking.

The Finance Committee agrees that expenditures on personal consumption should not be included in a business deduction. The 90 percent rule and other restrictions on allowable automobile expense deductions, however, appear to go to the other extreme and disallow some legitimate business expenses. The Canadian Real Estate Association presented the basic argument against the new rules:

> The automobile is a necessity to a real estate agent. The capital cost or lease payments, financing costs and insurance are as much a business expense as office rent is to an employer who provides office accommodation.

As an alternative the Committee suggests that allowable automobile expense deductions continue to be based in all cases on the proportion that represents business use. However, the Committee has concluded that a fairer and simpler way to address the issue of personal consumption in automobile expense claims is to reduce the calculated amount of the deduction by a specified sum. The Committee suggests that the reduction should be $500 for a full year. Therefore, the Committee recommends:

19. That the proposed 20-90 per cent rule not be adopted, and in its place the taxpayer may claim as a deduction the proportion of allowable expenses that represents business use less $500. Allowable expenses include capital cost allowance and interest on money borrowed to acquire the vehicle, or lease costs, up to the maximum amounts proposed in the White Paper; and the actual cost of insurance, licensing, parking and all other operating costs.

The second major criticism of the treatment of automobile expenses concerned the $20,000 limit on the cost of an automobile for claiming capital cost allowance or lease costs. Several briefs and witnesses before the Committee claimed the limit was arbitrary and inadequate and suggested raising it to $30,000 or $35,000. The Committee considered the arguments for a higher limit but was not convinced by them. A limit in the order of $20,000 ensures that ordinary taxpayers are not helping to foot the bill for the business use of a luxury automobile.

The Canadian Automotive Leasing Association (CALA) provided estimates of the current cost of suitable business automobiles. For fleet cars, CALA concluded: "Replacement costs for suitably equipped mid-size business cars will average $19,657 for the 1988 model year." The sample of cars included the Chrysler New Yorker, Ford Taurus GL, Pontiac 6000 and Ford Aerostar Passenger Van; the suitable equipment included air conditioning, AM/FM radio, cruise control, four doors and a six-cylinder engine. The CALA survey showed costs close to the $20,000 limit for fleet purchases. Individuals, of course, generally pay more for an automobile than a company buying a fleet of cars. The average "non-fleet price" for the CALA sample was $21,157, a price that included freight, pre-delivery inspection, dealer mark-up, sales tax and license fee.

Several briefs brought up the problem of regional variations in automobile costs, and the Federation of Automobile Dealer Associations suggested that "the $20,000 limit is really a vehicle price limit of about $18,000 when freight, pre-delivery expenses and provincial sales tax are taken into account." The issue of freight is not considered a

problem, however, given the equalization policy followed by most automobile manufacturers in Canada. Many briefs also expressed concern that the limit was not indexed. The Committee concluded that the regional disparities resulting from different provincial sales taxes across Canada are a valid concern.

Considering all these factors, the Committee recommends:

20. That the $20,000 limit on the cost of a passenger vehicle for claiming capital cost allowance or lease costs be increased by the amount of the relevant provincial retail sales tax on a $20,000 vehicle and that there be a regular review of the limit.

Corporations and employees who drive an employer-provided automobile are also affected by the proposed changes. Corporations are subject to the $20,000 cost limit and the related limit of $250 per month for carrying charges. They must calculate the capital cost allowance separately for each vehicle instead of on a pooled basis as generally applies to the tax system. As pointed out in Chapter 11 of this Report, businesses face increasing complexity in the tax system as a result of the changing requirements for the tax treatment of automobile expenses.

Employees who drive an employer-provided automobile may face an increase in their taxable benefits because of the removal of the permitted reduction in the standby charge in respect of personal use of the vehicle. The standby charge is generally two per cent per month of the original cost of the automobile or two-thirds of the lease costs. Under the current system, this charge can be reduced if personal use is less than 1,000 kilometers per month — the extent of the reduction depends on the proportion of the 1,000-kilometre limit actually driven for personal use.

The White Paper proposes to eliminate entirely the ability of an employee to recognize a reduced standby charge when there is only incidental personal use of an employer-provided automobile. Considering that the annual standby charge is calculated essentially as 24 per cent of the original cost of the automobile with no adjustment for depreciation, the Committee has concluded that the proposed change goes too far and treats some legitimate business use as personal consumption. Therefore, the Committee recommends:

21. That the current system of allowing a reduced standby charge for an employee who drives an employer-provided automobile less than 1,000 kilometres per month for personal use be retained.

Business Meals and Entertainment Expenses

Currently, business meals and entertainment expenses incurred for business purposes can be deducted in full, subject to their being reasonable in amount. However, in theory, if not in practice, every business meal or entertainment has an element of personal consumption. To that extent, there is an element of personal expense that should not be deductible.

The White Paper proposes to reflect the fact that there is a personal consumption benefit to a business meal or entertainment by limiting the deduction for business meals and entertainment expenses to 80 per cent of their cost. The limitation will also apply to

gratuities, cover charges, room rentals at a hotel or a resort to provide entertainment, and to the cost of private boxes at sports facilities. As well, it will apply to the cost of meals while travelling or attending a convention, conference, seminar or similar function. Similar rules have been adopted in Britain, Australia and the United States.

The Committee heard representatives from a large number of business groups on this issue, who felt that any personal consumption benefit to a businessperson in a meal or entertainment could be sufficiently addressed by existing provisions in the *Income Tax Act*. The Committee also heard from the Canadian Food & Restaurant Association which proposed that meals be deductible in full where the expense was incurred while travelling out of town, at a seminar or convention, or at a business meeting where the taxpayer was accompanied by a client or colleague.

The Committee agrees that there is an element of personal consumption in a deduction for business meals and entertainment expenses. Indeed, the Committee believes that a deduction of 80 per cent for certain entertainment expenses such as private boxes at sports events or room rentals at resorts is generous.

However, the Committee recognizes that where a meal expense is incurred at a convention, conference or seminar, or while travelling away from home overnight, there is no such personal consumption benefit since the taxpayer must consume a restaurant meal. Therefore, the Committee recommends:

22. That the proposed 80 per cent limitation on the deductibility of business meals and entertainment expenses be adopted but that the cost of meals while attending a convention, conference or seminar or while travelling overnight and out of town be fully deductible.

Home Office Expenses

Under the current tax system, self-employed individuals may deduct from business income all expenses related to a home office used for business purposes. As part of the broadening of the tax base, the White Paper introduces restrictions on the home office deductions:

A self-employed person will be allowed to claim a prorated portion of expenses (such as rent, capital cost allowances and mortgage interest or operating costs such as heating, electricity or insurance) relating to his or her home office only if the space is used exclusively on a regular and continuous basis for the purpose of earning business income. To qualify, the home office must also either be the taxpayer's principal place of business, or be used on a regular basis for meeting clients, customers or patients.

The problem addressed by the White Paper on this issue is similar to the problem faced in the treatment of automobile expenses. Taxpayers should not be allowed to deduct as a business expense an expense for personal consumption. In general, the same groups that commented on automobile expenses also commented on home office expenses. Most of the concern of these groups, however, was directed at the change in treatment of automobile expenses.

Those affected by the restrictions, not surprisingly, would like to see the current treatment of home office expenses retained. There were two frequently expressed

objections to the proposed treatment. The first was that it would treat differently two taxpayers who have almost identical jobs and require identical office space and supplies — say, two insurance agents or two interior designers, one an employee and the other self-employed. The second is that the proposed rules do not allow for the vast distances that may have to be travelled by someone for business purposes. On this second point, the president of the Canadian Real Estate Association appeared before the Committee and explained:

> The geographic make-up of Canada does not allow everyone in Canada to live within a reasonable distance of his main place of employment, and the way Canadians sell real estate it could mean that your main office could be 50 miles away.

One group that is certainly affected by Canada's geography are farmers, and they are of special concern to the Committee. Farms can be small, family-run operations in rural communities; although the house on such a farm may have no space devoted exclusively to earning business income, without the farmhouse there would be no farm.

The example of farmhouses highlights the need for clarification of the rules and definitions behind the new proposals. The White Paper attempts to ensure that the home office deduction will be allowed only where the home office is necessary to the conduct of business. Under current rules, some expenses for home offices that are incidental to the conduct of business can be deducted as a business expense.

The problem of the seemingly different treatment of individuals who perform almost identical work remains. As was brought out during the meeting with the Life Underwriters Association of Canada, there are important differences between employees and the self-employed, even when they appear to be doing the same work. The tax system should recognize these differences.

The White Paper gives examples of those who will be affected by the new treatment of home office expenses. Unfortunately, the examples do not cover several of the problems raised in the briefs or hearings (for example, those affecting farmers, authors, artists and interior designers). What the examples do bring out is that business people and professionals who use home offices for convenience will not be allowed a business deduction for these offices. If, however, a home office is the principal office or used on a regular basis for meeting clients, customers or patients the deduction will be allowed.

The Committee is in general agreement with the proposed change in the treatment of home office expenses. For the reasons given above, however, the rules and definitions need clarification.

Certified Canadian Productions (Films)

The White Paper proposes three changes that will reduce the special tax treatment of investment in films that are certified Canadian productions. First, the existing accelerated capital cost allowance would be reduced from 100 per cent to 30 per cent (calculated on a declining balance basis and subject to the half-year rule), but this capital cost allowance would remain available to offset income from all sources. Second, an additional capital cost allowance would be introduced to permit the

unrestricted deduction of the undepreciated capital cost of certified Canadian productions from the net income from such productions after claiming the regular rate of capital cost allowance. The additional capital cost allowance would be calculated without regard either to the half-year rule or to the proposed put-in-use rule. Third, the capital cost allowance claimed in respect of an investment in a film would be included in the calculation of the cumulative net investment loss which serves to postpone the ability of an individual to use the lifetime capital gains exemption.

The original transition period for implementing these changes was amended on August 31, 1987 by a Department of Finance press release (#87-128) which noted that the nature of film productions is not uniform across the industry. Hence, series productions will enjoy the benefits of the current capital cost allowance provisions provided certain conditions are met, as will other certified productions acquired in 1987 if principal photography is complete before July 1, 1988. Furthermore, investments in those productions will not trigger an inclusion in the proposed cumulative net investment loss provisions in 1988.

The public hearings held by the Committee provided a forum for representatives and employees of the industry and raised concerns about the reduction of the capital cost allowance rate. The press release of August 31, 1987 seems to have adequately addressed the industry's concerns for a longer transition period. Moreover, the proposed additional allowance, to increase the capital cost allowance which may be deducted against film income, was acceptable to the industry's representatives.

Industry representatives did, however, express concerns about the reduced capital cost allowance. First, the witnesses indicated that private investment would be reduced, as the investors' initial perception of a film investment would not compare favourably with other risky investment opportunities. Next, they noted that private Canadian funding is critically important in developing Canadian productions that are not controlled by the government through grants or by U.S. distributors through their investment. Third, the Committee heard that the industry is still in its infancy and continues to require government support, and that, in the industry's view, tax assistance for individuals is less of a burden on the government than direct grants. Finally, the industry believes that it contributes significantly to job creation in Canada. In summary, the industry argued for continuation of the current tax assistance for Canadian productions.

The Committee generally agrees with the tightening of the rules for film investors. It believes, however, that several changes are necessary to avoid an adverse effect on film investment and to be consistent with the government's policy of promoting an indigenous industry. A 30 per cent declining balance regime is too strict and does not reflect the reality of the film business.

At the risk of oversimplification, the life cycle of a film may be sketched as follows. Typically, major expenditures for a film are made in the first year of production. Editing and release of the film take place in the second year, and most of the film income from distribution in theatres and through video is earned before the end of the third year. There is normally very little income after the fourth year. A 50 per cent straight-line regime, subject to the half-year rule but without the put-in-use rule, approximates economic depreciation and better reflects the short life of a film. With

the 30 per cent declining balance regime, on the other hand, it would take eight years to write off 93 per cent of the cost of a film.

Therefore, the Committee recommends:

23. That the capital cost allowance rate for certified Canadian productions be set at 50 per cent on a straight-line basis and subject to the half-year rule. It is further recommended that the put-in-use rule not apply to certified Canadian productions.

The White Paper also proposes that no limit be imposed on the deduction of capital cost allowance against income from certified Canadian productions. The Committee believes that this proposal is an appropriate incentive for the industry and should be adopted.

The Committee was concerned about the tax treatment of the income realized upon the disposition of an interest in a film or a unit in a partnership owning a film. The Committee heard evidence of taxpayers who invested in a film through a limited partnership, and deducted the cost of their investment by way of a partnership loss allocated to them, subsequently sold their partnership interest and were treated as having realized a capital gain. The Committee considers that an investor in a film intends to exploit the film in any practical manner and therefore the sale of the investor's interest in the film should give rise to taxable income, whether this is done directly or by selling a partnership interest. The Committee considers that capital gains treatment is not appropriate for a film investment. As a consequence, capital cost allowance claimed on a film should not be included in the calculation of the cumulative net investment loss.

Multiple Unit Residential Buildings

As an element of its general base-broadening thrust, the White Paper proposes to eliminate the tax incentive benefits of owning a multiple unit residential building, or MURB. The MURB program was introduced in 1974 by the government of the day to provide a direct incentive through the income tax system for taxpayers to invest in a particular type of residential housing. Although beneficial tax treatment ceased for multiple unit residential buildings in 1981, the tax status and related tax benefits of existing MURBs continued to be available to purchasers.

Under the current tax system, a taxpayer has the advantage of being able to create or increase the rental loss from a multiple unit residential building by claiming the maximum allowable amount of capital cost allowance.

The White Paper proposes to eliminate the status of a multiple unit residential building in the following manner:

- After June 17, 1987, a multiple unit residential building will cease to qualify as a multiple unit residential building on resale.
- The ability to claim capital cost allowance so as to create or increase the rental loss on existing multiple unit residential buildings will continue but will expire at the end of 1990 for taxpayers who owned the multiple unit residential buildings on June 17, 1987.

Rental losses from a multiple unit residential building resulting from claiming both regular operating expenses and capital cost allowance will be included in an individual's cumulative net investment loss, which may restrict the amount of lifetime capital gains exemption that can be claimed on a subsequent sale of an investment.

A number of briefs have argued that there is a significant problem with the changes to the MURB program, in that the White Paper proposes to change the rules retroactively. The old rules were relied on by taxpayers who purchased multiple unit residential buildings on the basis that they would be entitled to the related tax benefits, and the economics of investment in MURBs were determined accordingly.

The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants summarized this situation as follows:

> However, where an incentive exists and taxpayers, in good faith, have invested based upon the government's representations, a resulting retroactive denial of the tax treatment can only lead to disrespect and cynicism about incentive measures and other aspects of our income tax system.

Therefore, the Committee recommends:

24. That owners of multiple unit residential buildings on June 17, 1987 be allowed to continue indefinitely to claim capital cost allowance at a 5 per cent rate to create or increase tax-deductible losses.

Multiple unit residential buildings have been built and purchased across Canada. However, investors in some regions of the country face substantial negative cash flow and losses on their investment because of adverse economic conditions, and this situation is unlikely to change in the foreseeable future. The White Paper proposal to eliminate MURB benefits to purchasers after June 17, 1987 will impose an additional hardship on existing owners of multiple unit residential buildings.

The Canadian Institute of Public Real Estate Companies (CIPREC) summarized this situation as follows:

> CIPREC is concerned with the adverse implications of retroactively changing the rules of an incentive program in which individuals were encouraged to invest to enable governments to meet affordable housing objectives. As a result of the White Paper proposals, many investors will incur further cash losses and in some cases lose their original investment. The proposals in this regard are also difficult to understand in light of the minimum tax provisions that now limit the tax benefits an individual investor can obtain from claiming capital cost allowance on a multiple unit residential building investment.

The Committee has concluded that where an existing owner holds a multiple unit residential building worth less than its original cost, the tax benefits should be allowed to be passed on to a subsequent investor. Maximum capital cost allowance at the new 4 per cent rate should be deductible from total income if the purchaser is paying less than the original cost of the multiple unit residential building to the vendor. To ensure that MURB benefits are not extended unreasonably, this provision could be limited to the first purchaser of existing multiple unit residential buildings after June 17, 1987. The Committee considers it to be unnecessary to extend this concession to taxpayers who

sell multiple unit residential buildings after June 17, 1987 for more than the original cost.

To put this amendment in place, some administrative procedures would be required. For example, a purchaser could be required to file with Revenue Canada a prescribed declaration signed by the vendor, which would acknowledge that the purchase price of the multiple unit residential building is less than the vendor's original cost.

Therefore, the Committee recommends:

25. That the first purchaser of a multiple unit residential building after June 17, 1987 be allowed to claim capital cost allowance at a rate of 4 per cent to create or increase a tax-deductible loss, provided the purchase price is less than the vendor's original cost.

The Committee views its two recommendations as a more reasonable approach to phasing out preferential treatment for investment in multiple unit residential buildings. The phase-out period would not be as abrupt as proposed in the White Paper, and taxpayers who relied in good faith on an existing set of tax incentive rules when they purchased a multiple unit residential building in the past will not be affected retroactively.

Averaging

The White Paper proposes to eliminate both the forward averaging available to all individual taxpayers and the block averaging for farmers and fishermen.

Both forms of averaging, which require relatively complex calculations, are intended to allow taxpayers to spread the incidence of tax over a number of years. Forward averaging allows qualifying income to be averaged into the future provided that the tax is paid currently at the maximum rate. Benefits can then be realized in future years should income levels drop and the forward-averaged income is taxed at a lower than maximum rate. Block averaging provides a mechanism whereby farmers or fishermen could average their fluctuating income over a specified five-year period, thereby benefitting as much as possible from the graduated marginal tax rate structure. Alternative minimum tax is not payable when block averaging is used.

The Department of Finance argues that averaging is no longer necessary, as there are fewer tax brackets and narrower rate differentials between tax brackets. Nevertheless, some witnesses advocated its retention. For example, farmers called for the retention of block averaging on the grounds that their income can fluctuate dramatically for reasons beyond their control, such as the weather and changes in crop and livestock prices.

A number of submissions have identified the need for averaging for those taxpayers who have a relatively short, but high-income-earning career, followed by a lifetime of moderate earnings, such as professional athletes. In their situation an averaging system will be of limited value because the tax bracket structure will be compressed by reform. The same applies to those taxpayers who have one year of unusually high income among years of steady income. However, the Committee agrees with the proposal that forward averaging be eliminated.

In contrast, there is no averaging for those who in any one year earn little or no income among years of steady but modest income. This group includes authors and artists, and individuals who go in and out of the workforce. For these people, all or part of their personal tax credits in a low-income year, cannot be used, nor can they be recovered later. Thus the savings from an averaging system which allowed carry-forward of the unused part of personal tax credits could be significant.

The Committee believes that a fair tax system should assist low-income individuals with irregular income patterns, but not compensate middle- and high-income earners. Consequently, it believes that an averaging system should have the following characteristics:

- Compensate for fluctuations in earnings, particularly years with nil earnings.
- Apply only to those whose annual income is relatively low.
- Provide compensation primarily for the value of lost personal tax credits.
- Not apply to years in which an individual is enrolled at an educational institution, or is claimed as a dependant of another individual.
- Limit the time frame over which benefits could be derived to, say, five years.
- Be designed so that ideally the benefits of averaging would be calculated automatically by Revenue Canada.

Furthermore, the unique aspects of the farming and fishing industry justify the retention of five-year block averaging. The alternative minimum tax should also continue not to apply in years of block averaging.

For other people, a similar block averaging system should be available to enable them to recover any personal tax credits they lose in years in which they have little or no income. Table 8 illustrates how such a system could work. As is shown, even at relatively modest income levels significant tax savings in percentage terms would result from averaging.

Table 8

Tax Savings under an Averaging System

	Year				
	1	2	3	4	5
Taxable income	$10,000	$12,000	$1,000	$3,000	$15,000
Tax - no averaging	1,020	1,530	0	0	2,295
Total tax (5 years)	$4,845				
Taxable income - averaged over 5 years	$8,200	8,200	8,200	8,200	8,200
Tax with averaging	560	560	560	560	560
Total tax (5 years)	$2,800				
Tax reduction	$2,045				

Note: Calculations are for a single taxpayer. Indexing over years is ignored, and the provincial tax is 50 per cent of the federal tax.

An averaging system of this type would be an effective method to compensate low-income earners for periods of unemployment and would encourage them to rejoin the workforce so that they could benefit from prior years' personal tax credits.

Therefore, the Committee recommends:

26. That block averaging be retained for farmers and fishermen.

27. That an appropriate averaging system be implemented to protect low-income earners from losing the benefit of personal tax credits as a result of fluctuations in income.

Taxation of Farmers

The proposed changes in the White Paper may affect farmers more than any other group. To the farm groups that sent briefs and appeared before the Committee the greatest concern was about at the changing treatment of farm income and losses. The most important changes are:

- Replacement of cash accounting with modified accrual accounting;
- Use of an objective profit test (net income of at least $1 in three of seven years) to determine who is in the business of farming;
- Use of a gross revenue test (gross revenue from farming greater than net income from other sources in three of seven years) to determine who is a full-time farmer.

These three changes are related to each other and should be treated as a package. Additional changes are related to them — for example, the increase from $5,000 to $15,000 in the allowable deduction of farm losses against other income for part-time farmers, the change in the allowable write-off of the cost of race horses and show animals, the new treatment of start-up farmers, and the transitional rules for the profitability requirement and gross revenue test.

In addition to proposing changes to the treatment of farm income and losses, the White Paper lists other changes that would also affect farmers. These changes include the elimination of five-year block averaging for farmers, new definitions of eligible capital property for the lifetime capital gains exemption (the exemption for farmers and certain small businesses will be $500,000, while others will have the exemption capped at $100,000), restrictions in the treatment of automobile and home office expenses, and the proposed put-in-use rules. These proposals are discussed in the relevant sections of the Report.

As mentioned, the move to modified accrual accounting, the profit test and the gross revenue test are related; the thrust of the three is to prevent taxpayers who are not full-time farmers from taking advantage of what some see as generous tax preferences. The profit test provides a supposedly objective test to separate hobby farmers from those in the business of farming. The gross revenue test provides a test for distinguishing full-time from part-time farmers.

For the profit and gross revenue tests to be objective – that is, to prevent behaviour that would render them useless – the cash accounting now used by most farmers must

be replaced with accrual accounting. With cash accounting, it is relatively easy to alter the timing of inventory purchases and thus manipulate recorded profits. The proposed accounting system is called a modified accrual system, because there is a "cash reserve adjustment" that is supposed to return profitable farmers to the taxable position they would have had under the cash system; the Ontario Federation of Agriculture, however, has argued that this equivalence will not hold over time.

Farmers have been almost unanimous in opposing the move away from the cash system. They point out that the modified accrual system is complex and costly; they fear that it is a first step towards full accrual accounting and, perhaps, the reduction or elimination of any special status under the tax system; they argue that the proposed system will lead to tax-motivated behaviour by farmers, a result at odds with the objectives of the White Paper.

The farm groups have been joined by accountants in pointing out potential problems with accrual accounting for farmers. The treatment of inventory will be a mess or a mystery, despite some attempt by the Department of Finance to address certain problems in its August 31, 1987 press release. Moreover, the transition from the existing cash system to the modified accrual system appears to be uncharted territory.

As the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants (CBA-CICA) pointed out, all farmers would be affected by the proposed changes although the problem has to do only with some part-time farmers. If this is the case — if the Department of Finance is worried that, say, someone with a high income in Toronto is "farming" on property outside Toronto and using the farm losses to shield non-farm income from tax — tax changes should be aimed at them instead of blanketing all farmers.

Table 9 draws attention to the large number of farmers who are *not* part of the problem.

Table 9

Profile of Individuals Reporting Net Farming Losses, 1981

	Full-time farmers	Part-time farmers	Total
Number of individuals in category	277,604	174,800	452,404
Number of individuals reporting a loss	48,605	124,074	172,679
Percentage of individuals in category reporting a loss	17.5%	71.0%	38.2%
Total losses ($ million)	423.1	618.8	1,041.9
Amount restricted ($ million)			86.8
Number of individuals with a restricted loss			34,471

Source: Department of Finance, *Tax Issues in Agriculture*, January 1985, p. 24, Table 10 (based on Revenue Canada taxation data).

The basic problem, of course, is that farm losses are used to shield other income from taxes. Farm losses of more than $1 billion dollars were claimed in 1981 although more than 60 per cent of all farmers did not claim losses. For full-time farmers, the proportion of those not claiming a loss jumped to over 80 percent (about 229,000 farmers). These farmers, who are not part of the problem addressed by the White Paper, will be required to switch to modified accrual accounting if they are currently reporting on a cash basis for tax purposes. According to a survey prepared for the Ontario Federation of Agriculture, 58 per cent of Ontario farmers do not prepare financial statements on an accrual basis.

If the entire amount of farm losses claimed represented tax avoidance, then a change that would plug a $1 billion leak should be warranted. But the expected revenue gain from the White Paper changes is, according to testimony by officials from the Department of Finance, ". . . probably in the order of $50 million plus per year . . . all of it from part-time or really hobby farmers."

All in all, the modified accrual accounting system would probably produce more real costs to farmers than benefits to the government. Therefore, the Committee recommends:

28. That farmers continue to have the option of choosing either cash accounting or accrual accounting for income tax purposes.

As is now the case under the *Income Tax Act*, farmers will not be able to switch back and forth between accounting methods. With the retention of the cash accounting system, the profit test and the gross revenue test should be dropped, as must the changes affecting start-up farmers, and race horse and show animal breeders. Two problems remain with respect to farmers. How does Revenue Canada determine who is in the business of farming, and how does it distinguish between full- and part-time farmers? The Finance Committee has already grappled with the issue of trying to determine who is in the business of farming (see the Finance Committee's April 1985 report *Tax Issues in Agriculture*).

The test of determining who is in the business of farming should continue to be based on whether there is reasonable expectation of profit from the farming activities. Although there is in this area established jurisprudence relating to what is a "reasonable expectation of profit", there are still disputes between Revenue Canada and taxpayers over who is in the business of farming, and uncertainty for those who would like to enter the business of farming.

Other individuals besides farmers face problems in demonstrating to Revenue Canada that they are carrying out a business instead of pursuing a hobby. Artists and authors, for example, may take a long time becoming established and profitable; determining a reasonable expectation of profit, therefore, can be tricky. To help in determining the expectation of profit, Revenue Canada has issued an interpretation bulletin (IT-504) that lists a dozen factors that should be considered. One of these factors includes "public and peer recognition".

Peer review is also used by Revenue Canada in determining whether certain activities will receive favourable treatment under the *Income Tax Act*. Those who want an activity considered under the scientific research and experimental development

refundable tax credit program must submit an application. Revenue Canada has a staff of scientific advisors who screen these applications for eligibility. "Routine engineering or routine development" activities are not eligible, but it is often a far from straightfoward task to distinguish routine activity from eligible R&D activity. In difficult cases, Revenue Canada may hire outside specialists to help determine eligibility. The Department has an inventory of almost 1,500 specialists who can be hired as consultants; these consultants and the scientific advisors on staff provide a form of peer review.

The 1985 Report of this Committee and several farm groups have suggested a peer review process. Therefore, the Committee recommends:

29. That the Minister of National Revenue consider establishing peer review committees that include farm operators, assessors and auditors. These committees would be used to review the operations and plans of farmers to determine whether a farm operation has a reasonable expectation of profit, and the taxpayer can be deemed to be a farmer.

30. That Revenue Canada ensure that personnel with experience in farming assist in the review and audit of farmers' tax returns.

These recommendations provide a way of determining who is in the business of farming but do not necessarily help distinguish full-time from part-time farmers, nor determine how the losses of part-time farmers should be treated. At present, under section 31 of the *Income Tax Act*, the deductibility of farm losses is restricted for part-time farmers, while business losses for full-time farmers are unrestricted.

The problem of trying to determine who is a full-time farmer is about as old as the *Income Tax Act*. Tests have changed over time. The most recent stems from the 1977 *Moldowan* decision of the Supreme Court of Canada: full-time farmers are those for whom farming may reasonably be expected to provide the bulk of income or the centre of work routine. This test, coupled with the restriction on deductible losses for part-time farmers, poses problems for beginning farmers and farmers in financial difficulty. At the same time, the system seems to give tax advantages to those with high non-farm income.

One possible solution to the so-called Section 31 problem is to remove the need for the distinction between part-time and full-time farmers. A way to do this is to base the allowable deduction for farm losses on the extent of non-farm income. Therefore, the Committee recommends:

31. That individuals who qualify as being in the business of farming and use cash accounting for their farm business may deduct up to $10,000 of farm losses against other income, subject to a claw-back of this deduction. For example, those with off-farm income of up to $30,000 may have the full deduction; those with off-farm income greater than $30,000 will have the allowable deduction reduced by $1 for every $2 of income above $30,000.

With the retention of cash accounting, the allowable deduction should be lowered from the figure of $15,000 proposed in the White Paper. In its 1985 report, the Finance Committee suggested doubling the $5,000 allowable deduction which had been in effect

since the 1950s; the $10,000 figure has been retained in the above recommendation, although without the complication of a full deduction for the first $5,000 loss and one-half of the next $10,000 loss.

In the example, the claw-back provision means that individuals with off-farm income above $50,000 would no longer be allowed to deduct farm losses calculated on a cash basis from their off-farm income. The policy of restricting the deduction of farm losses against off-farm income goes back to 1919. The recommendation above follows that policy and adds the new element of excluding those with high off-farm income from using farm losses determined on a cash basis to shield this income.

The example in the recommendation shows how the concept of a claw-back might work. The numbers used in the example — the allowable deduction, the maximum income at which the full deduction may be taken and the rate at which the claw-back takes place — seem reasonable. But the Committee did not have all the information needed to estimate the exact cost of the specific example presented. Some of the numbers used in the recommendation may be altered in the wake of research by the Department of Finance. The Committee believes, however, that the model provides a solution to a long-standing problem in the taxation of farmers.

Those with high off-farm incomes may choose, according to the first recommendation in this section, to use full accrual accounting. Accrual losses are equal to economic losses and are calculated in the same manner as for other businesses. It makes sense, therefore, to allow farm losses calculated on an accrual basis to be treated the same as losses for other businesses. Therefore, the Committee recommends:

32. That individuals who qualify as being in the business of farming and use accrual accounting may deduct all farm losses against other income.

The recommendations above address the problems of determining who is in the business of farming and how to treat part-time farmers with large off-farm income. These problems have been a concern in the tax system for almost 70 years; in 1985 the Finance Committee issued a report about tax issues in agriculture and, during the examination of the White Paper on tax reform, a large amount of time was spent analyzing and discussing the taxation of farmers.

The recommendations presented for peer review and the claw-back of allowable loss deductions are the result of careful consideration by the Committee. They appear reasonable and workable. If the government rejects the Committee's recommendations, it is imperative that solutions be found for the problems addressed by the recommendations.

If necessary, the Department of Finance should be prepared to begin consultations with interested parties across Canada — farm groups, accountants, tax lawyers, officials from Revenue Canada and other government departments. Finding a solution to the problems dealing with the taxation of farmers must be made a priority. The Committee has concluded, however, that the proposals in the White Paper are not a workable solution. Therefore, the Committee recommends:

33. That the White Paper proposals for modified accrual accounting, a profit test and a gross revenue test be dropped.

CHAPTER 5

Corporate Income Tax Reform

Manufacturing and Processing

The tax treatment of manufacturing and processing income has been significantly altered by the White Paper. Foremost among the changes will be the phased reduction in the federal corporate tax rate applicable to Canadian manufacturing and processing income from the present rate of 30 per cent to 23 per cent by 1991, the reduced rate of capital cost allowance available for manufacturing machinery and equipment, and the introduction of a put-in-use rule. The small business manufacturing and processing tax rate will be raised from 10 per cent to the same level as the general small business corporate tax rate, which will be 12 per cent under the tax reform proposals. Although this is the only part of the manufacturing and processing sector to face a rate increase, the Committee has taken note of the strong endorsement of the overall tax reform package by small businesspeople, including the Canadian Federation of Small Business and the Canadian Organization of Small Business.

Manufacturing Corporate Tax Rate

The Committee believes that it is important to ensure that, in the face of major reductions in corporate tax rates in the United States, Canada maintains a competitive fiscal climate for its manufacturing and processing sector. A substantial gap in tax rates between Canada and the United States would result in a large diversion of taxable income across the border and a serious erosion of the government's revenue base.

The levels of corporate tax rates in Canada and the United States before and after reform are shown in Table 10.

It is clear from the table that Canada will continue to enjoy a competitive advantage over the United States in its manufacturing and processing corporate tax rate, although somewhat less than that experienced before reform, and that the benefits of locating manufacturing and processing industries in Canada will remain. Accordingly, the Committee accepts the proposed rates of tax on Canadian manufacturing and processing income set out in the White Paper.

Table 10

Corporate Tax Rates in Canada and the United States Before and After Tax Reform

	Tax Rates Before Reform	
	Canada	United States
	(per cent)	
Federal rate	46	46
Manufacturing reduction	−6	0
Provincial/state reduction	−10	−3.7
Federal surtax	1.5	0
Average provincial/state rates	12	8
Average statutory rate	43.5	50.3

	Tax Rates After Reform	
	Canada	United States
	(per cent)	
Federal rate	38	34
Manufacturing reduction	−5	0
Provincial/state reduction	−10	−2.7
Federal surtax	0.7	0
Average provincial/state rates	12[1]	8[1]
Average statutory rate	35.7	39.3

[1] Subject to decisions by provincial/state governments

Capital Cost Allowance

There have also been substantial changes to the available write-offs for manufacturing machinery and equipment (Class 29). The White Paper has changed the treatment of such assets from a two-year straight-line write-off to a 25 per cent declining balance basis. The half-year rule continues to apply in both cases. Prior to tax reform, Canada's two-year write-off was strongly competitive with the United States' write-off of five years for similar assets.

These changes have attracted a great deal of concern from all sectors of the manufacturing and processing industry. The Committee heard from, among others, the Canadian Manufacturing Association, Canadian Chemical Producers, Council of Forest Industries of British Columbia, General Motors of Canada, Dow Chemical Canada, Bell Canada, the Canadian steel industry and the Canadian Petroleum Association.

Fairly typical of these submissions was the following comment from the steel industry brief: "The tax reform proposals to lengthen the write-off period for manufacturing assets and the introduction of the 'put-in-use' rule will have a long-term negative impact on the steel industry and on other capital-intensive industries."

These submissions drew to the Committee's attention the importance of the capital cost allowance system in maintaining a competitive position for Canada as an attractive location for new plants. As a submission by Dow Chemical stated: "Our analysis of the combined effects of both the U.S. and Canadian tax reform indicates that Canada will lose the position it has so far enjoyed as an attractive location for major plants. Under tax reform, other things being equal, a multi-national firm having the option of making a major capital investment in Canada or the U.S. could find it advantageous to build in the U.S. since depreciation is a significant cost element in the production of chemicals."

The proposed rates of depreciation for manufacturing assets will fall short of similar manufacturing depreciation in the United States. On a discounted cash flow basis the discrepancy will be more severe, as illustrated in Table 11.

It is apparent from the table that, at a 25 per cent declining balance rate, Canada may be at a disadvantage in comparison with the United States, and this disadvantage would be all the more pronounced in view of Canada's favourable position in this area prior to reform.

Accordingly, the Committee believes that the rate of depreciation for manufacturing machinery and equipment should be increased to a level that is comparable to that of the United States.

Table 11

Manufacturing Machinery and Equipment Depreciation Schedules

Year	United States 7-Year	Canada 25 per cent	Canada 30 per cent
		(per cent)	
1	14.3	12.5	15.0
2	24.5	21.9	25.5
3	17.5	16.4	17.9
4	12.5	12.3	12.5
5	8.1	9.2	8.7
6	8.1	6.9	6.1
7	8.1	5.2	4.3
8	4.5	3.9	3.0
9		2.9	2.0
10		1.6	1.5
Written off after 10 years	100.0	92.8	96.5
Discounted present value of total write-off[1]	72.1	66.2	70.0

[1] Assumes a discount rate of 10 per cent

Therefore, the Committee recommends:

34. That the rate of capital cost allowance for manufacturing machinery and equipment (Class 29) be set at 30 per cent on a declining balance basis and not at 25 per cent as proposed in the White Paper.

Put-In-Use Rule

The introduction of the put-in-use rule was a subject of concern to many witnesses from the business community who came before the Committee. The rule will defer a taxpayer's ability to claim capital cost allowances and investment tax credits to the year in which eligible assets are "put-in-use" as opposed to the year of acquisition under the current law. This rule is intended to ensure that depreciation claims and investment tax credits are not taken before the eligible assets are placed in operation.

The application of the put-in-use rule will be felt most severely by manufacturers, and real estate and resource developers who undertake large, long-term capital-intensive projects in which expenditures are made well ahead of the completion of the project. In its submission to the Committee, the Alberta Energy Company said: "The rule would have a significant negative impact on proposed capital investments causing otherwise viable projects not to be undertaken with obvious adverse consequences to regional and national economies."

While the Committee agrees with the underlying principle of a put-in-use rule to better match income and expenses, it also believes that the rule should apply on the basis of when assets are ready for service. For instance, a farmer who traditionally buys equipment in the fall cannot "use" that equipment until the following spring, yet it is nonetheless ready for service at the time of purchase. Similarly, in many new plants assets are purchased but cannot be used because their "use" depends on other assets being put into operation. The Committee is of the view that using a "put-in-place" rule for claiming capital cost allowances and investment tax credits on eligible property would alleviate these problems and allow property not "in use" but available for service to be claimed. Such a rule would reflect the economic reality of assets which are ready for service but which are not actually in use.

The Committee is also anxious to ensure that either a put-in-use or put-in-place rule does not adversely affect large capital-intensive mega-projects which by their nature have long lead times and on-site construction where assets cannot be "in place" or "in use". Such projects are particularly sensitive to international competitiveness, and the application of a put-in-use or put-in-place rule in conjunction with the proposed lower rates of capital cost allowances and investment tax credits could have a significant negative impact, causing otherwise viable projects not to proceed. Accordingly, the Committee believes that 24 months after the acquisition of an asset a taxpayer should be entitled to begin claiming capital cost allowances and investment tax credits in respect of the asset even if it has not in fact been put in use or in place.

Therefore, the Committee recommends:

35. That in determining eligibility for claiming capital cost allowances and investment tax credits in respect of any eligible property, the put-in-use rule be changed to a put-in-place rule.

36. That for the purpose of either a put-in-use or put-in-place rule, an asset be deemed to be put in use or in place, as the case may be, 24 months after it is acquired if it has not in fact been put in use or in place by that time.

Investment Tax Credits

Scientific Research and Experimental Development

Firms engaged in scientific research and experimental development (R&D) in Canada have benefitted from a favourable tax regime as the expenses are generally eligible for investment tax credits ranging from 20 per cent to 35 per cent, and the net amount is fully deductible. However, as part of the commitment to base broadening in tax reform, some R&D tax incentives are being removed or restricted, as follows:

- Buildings acquired after 1987 will no longer qualify as R&D expenditures.
- Generally, investment tax credits claimed in a taxation year ending after 1987 will be limited to one-half of federal tax payable. Special rules will allow Canadian-controlled private corporations to fully offset their tax payable on income eligible for the small business deduction, and individuals can fully offset their first $24,000 of taxes payable.
- Refundability of investment tax credits earned by large corporations will be ended for property acquired or expenditures made after 1987 — one year earlier than previously scheduled.

These changes should increase federal government revenue by $200 million for the 1988 taxation year ($20 million from buildings, $80 million from the limitation on investment tax credit claims and $100 million from eliminating the refundability provisions for large corporations a year in advance). For 1989 to 1992, the revenue gain will average $135 million a year.

This increase in federal revenue is a short-term gain and must be balanced against the long-run effects on Canada's technological position. According to the OECD, high technology will account for 25 per cent of world trade by 1995, up from the present 12-per-cent level. The Canadian Advanced Technology Association (CATA), which represents 700 companies that performed more than 80 per cent of privately funded industrial R&D in Canada last year, expressed the view that Canada is being left behind with a stagnating level of R&D of 1.35 per cent of gross domestic product (GDP) while the United States and Japan are approaching 3 per cent.

While these numbers may be influenced by special factors (for example, the large defence and space programs being undertaken in the United States), they still indicate that Canada must provide sufficient support to maintain a satisfactory percentage of GDP allocated to experimental research and development. It is especially important for adequate tax incentives to be provided since non-tax government support in Canada is weak compared to that in other countries. According to a table provided by the Canadian Manufacturers Association, non-tax government support in the United States, Germany, France and the United Kingdom for industrial R&D was on average 25.5 per cent of total R&D performed in industry, while in Canada non-tax government

support was 12 per cent of the total. Until Canada adopts a grant system or other non-tax support programs, tax incentives must remain favourable.

Since 1977, Canada has maintained a tax policy that contributes in a direct and supportive manner to the achievement of a high level of R&D. In the April 1983 federal budget, improved incentives were provided for R&D. The 50-per-cent limit for claiming investment tax credits when taxes exceeded $15,000 was also abolished. Furthermore, a special refundable investment tax credit program was introduced.

Although there is insufficient evidence to assess the precise effects of tax incentives, it seems that the tax incentive system for Canadian R&D has been efficient. There have been major increases in the number of firms performing R&D. Furthermore, the amount of R&D performed in the private sector increased after the 1977 and 1983 tax incentives were introduced.

Briefs and Testimony

The briefs submitted to the Committee and the testimony of witnesses have stressed that the White Paper proposals will have a negative effect on the amount of R&D performed in Canada. A major concern is the limit on annual investment tax credit claims. CATA has estimated that up to 40 per cent of the R&D performed by Canada's high-tech companies will no longer be supported by R&D tax incentives.

The Business Council on National Issues identified this issue in its testimony:

> I think the issue you will have to address is whether for a small group of Canadian corporations that have massive research projects, you want to give them a restriction on the tax credit that they can claim and in effect, a different type of tax treatment that is available to other people that can use the entire tax credit immediately because they are not doing that much effort and therefore their tax credit is totally absorbable within 50 per cent of their federal tax payable.

Limiting the annual investment tax credit claim to 50 per cent of the federal tax payable will make the benefits of the investment tax credit carryforward nominal for companies that perform significant R&D on a regular basis. This measure is equivalent to a reduction in the rate of the investment tax credit. The full relief for small Canadian-controlled private corporations on their federal tax on active business income and for individuals on the first $24,000 of investment tax credit will be of little help in stimulating R&D activity, because, as witnesses have testified, these taxpayers generally perform very little of the total R&D in this country.

An investment tax credit rate of 20 per cent on which only 50 per cent may be claimed to offset taxes will weaken Canada's competitive position vis-à-vis the United States. It may be true that when comparing the tax incentives in Canada and in the United States, Canada is offering a favourable package. It has to be remembered, however, that tax incentives in Canada must remain preferential to compensate for the weakness of the non-tax government support.

In the United States, the credit is 20 per cent on current expenditures only and then only on incremental expenditures above a base amount. Furthermore, the credit in

the United States is temporary and will be eliminated after 1988. However, the limit on annual claims is more generous than the proposed 50 per cent restriction in Canada. In the United States, there is no limit on claiming investment tax credits up to the first US$25,000 of taxes for any taxpayer, and the remainder can be claimed to offset 75 per cent of the tax liability.

The Committee's View

The Committee has concluded that the limit on annual investment tax credit claims of 50 per cent of federal tax payable is inadequate and does not serve its intended purpose. While this proposal was intended to ensure that profitable large corporations pay some tax, it is more likely to remove support for the R&D expenditures of the medium-size corporations that are the heavy performers of R&D.

Thus the proposed limitation on the investment tax credit has uneven impacts; companies that account for a large proportion of R&D will be most affected. The extension of the carry-forward period from seven to ten years is insufficient for these companies, especially because the reduction in corporate tax rates will also slow down the rate at which unused investment tax credits may be claimed.

Moreover, the 50 per cent limit applied to investment tax credits earned from April 19, 1983 but not yet claimed is a retroactive measure.

If the government wants to change the R&D investment tax credit policy to compensate for the reduction in corporate tax rates, it should do so directly and even-handedly by reducing the rate and not indirectly by preventing some corporations — generally heavy R&D performers — from claiming investment tax credits.

Therefore, the Committee recommends:

37. That the investment tax credit for scientific research and experimental development expenditures that may be claimed in a year not be limited to one-half of federal tax payable.

Public and large corporations active in R&D have strongly criticized another tax reform proposal, namely the one-year advancement of the termination date for providing refunds of a portion of unused investment tax credits. While the temporary refund program was supposed to end for expenditures incurred after 1988 by any taxpayer, it has been terminated one year sooner for large corporations, but extended indefinitely for other taxpayers (individuals and Canadian-controlled private corporations with taxable income of $200,000 or less.)

The large corporations include any public corporation and any other corporation that has taxable income over $200,000. Mitel Corporation appeared before the Committee as an example of a public company that is heavily involved in R&D; it has no taxable income and therefore will not benefit from its substantial investment tax credit reserve until the company becomes taxable. Under the new rules, when the refund program ends Mitel will receive no tax support although it will continue to invest substantial amounts in R&D.

The Committee questions why a public corporation should automatically be excluded from the definition of a qualified corporation that may still benefit from the refundability provisions. If a small Canadian-controlled private corporation is allowed a 100-per-cent refund of its 35-per-cent investment tax credit, then a public corporation with no taxable income should at least be eligible for a 20-per-cent refund on its 20-per-cent investment tax credit.

The Committee believes that refundability of investment tax credits should be based on "need" rather than on the status of the taxpayers. The critical level of income may remain at $200,000 of taxable income as it presently exists for private corporations. This would provide a more equitable treatment of the R&D refundable tax credit.

Therefore, the Committee recommends:

38. That the refundability of R&D investment tax credits should depend on a "needs test" based on a corporation's income and not on whether a taxpayer is a public or private corporation.

Buildings acquired after 1987 can no longer qualify as R&D expenditures (with the exception of buildings for which there was a pre-tax reform agreement that they be acquired before 1990). They will be treated like any other building; that is, they will be depreciable at a 4 per cent declining balance rate. Prior to tax reform, the purchase of a building for R&D would generate a 20 per cent investment tax credit and the net amount (purchase price less investment tax credit) would be deductible in the current year.

This measure has been proposed in order to bring the tax treatment of R&D buildings in Canada in line with that in other industrialized countries. Indirectly, it should also eliminate the significant tax avoidance that took place where taxpayers were taking a 100-per-cent write-off for buildings and then using the buildings for R&D for only a short period of time.

In the United States, only expenditures of a current nature are entitled to an investment tax credit. In Canada, any expenditure related to an R&D project is treated as an R&D expense, whether it is current or capital. Excluding buildings might appear arbitrary because other capital property, such as computers, will still be eligible for 100 per cent deductibility.

Bell Canada suggested in its brief a possible compromise of a capital cost allowance of 20 per cent for R&D buildings. However, no evidence was brought to the Committee of a possible detrimental effect caused by the exclusion of buildings as an R&D expense. Because this restriction is part of the base broadening and will not harm Canada's competitiveness, the Committee sees no reason to reject the proposal.

Investment Tax Credits For Specified Areas

The government is currently supporting regional economic development in Canada by providing an enhanced investment tax credit on property used in specific areas such as Cape Breton, Atlantic Canada (including Gaspé Peninsula) and special regional areas. Under the tax reform proposals, the investment tax credit rates will be reduced from 60 per cent to 45 per cent for Cape Breton, from 20 per cent to 15 per cent for the

Atlantic region and from 40 per cent to 30 per cent for certified property used in prescribed low-growth areas. This reduction in investment tax credit rates is in line with the general reduction in tax rates.

This proposal was addressed by business representatives in Halifax. They regard the investment tax credit as a valuable incentive even considering the reduced rates. Therefore, the Committee does not disagree with the proposed reductions in the regional investment tax credit rates.

Flow-Through Shares

Flow-through shares are used in the mining and oil and gas industries by corporations that incur exploration expenses but have insufficient taxable income to write them off. The mechanism allows the company to pass these deductions on to its investors. These investors also benefit from an earned depletion allowance at the rate of 33 1/3 per cent of eligible expenditures on exploration and development of petroleum and mineral resources. Finally, the capital gain realized upon the disposition of shares is tax free in most cases because of the lifetime capital gains exemption put in place in 1985. Thus the present measures make flow-through shares very attractive compared with other investments.

The White Paper does not propose changes in the flow-through mechanism. However, it does attempt to make investment in flow-through shares more comparable with investments in other sectors and to provide equal treatment between the mining and the oil and gas industries:

- The earned depletion allowance will be phased out by reducing the rate at which it can be earned from 33 1/3 per cent to 16 2/3 per cent for eligible expenditures incurred after June 30, 1988 and by eliminating the ability to earn depletion on expenditures made after June 30, 1989.
- The taxable part of capital gains is increased from one-half to two-thirds in 1988 and to three-quarters in 1990.
- The lifetime capital gains exemption is limited to $100,000.
- The capital gain eligible for the lifetime exemption will be reduced by cumulative net investment losses. Cumulative net investment losses includes Canadian exploration expenses and development expenses, Canadian oil and gas property expenses, mining earned depletion allowance (until it disappears) and interest on funds borrowed to acquire flow-through shares and partnership interests.
- The issuing costs are amortized over five years.
- The definition of "prescribed shares" will be broadened in order to disqualify from the flow-through treatment shares that carry any entitlement to a payment, repayment, loan or dividend or any retraction or conversion right (including a put option but excluding an arrangement that is to take place at fair market value). This definition is applicable to shares issued after June 17, 1987 unless they are issued prior to 1989 according to a prior agreement or public documents.

- The at-risk rules applicable to limited partnerships will be extended to apply to resource expenditures incurred by partnerships.
- The oil and gas exploration expenses incurred within 60 days after the end of 1987 and subsequent calendar years under a flow-through share arrangement will be treated as if they had been incurred on the last day of the preceding calendar year.

The elimination of the earned depletion allowance will produce $80 million in additional federal revenues in 1990, and $330 million from 1988 to 1992. No estimates are available of the revenue provided by the non-eligibility of capital gains for the lifetime exemption and the other measures.

Mining associations, prospectors and developers, brokers and corporations in the industries affected submitted briefs and appeared before the Committee. While accepting a need for some restrictions, they argued that the proposals went too far. They expressed the view that the proposals did not take into account the very high risk of investments in exploration.

Several witnesses emphasized the importance of the industry for employment and the economic development of remote areas. A study done by the *Association des prospecteurs du Québec*, for example, found that the flow-through mechanism and related incentives for the mining sector contributed to the realization of 71 public share issues in 1985 (38 from junior companies and 33 from flow-through shares), which resulted in 25 discoveries that in future may generate profits and 66,660 jobs, $2.8 billion of value added and $300 million of net income for federal and provincial governments. Unfortunately, it is impossible to provide accurate forecasts of the effects of the changes in the preferential tax treatment of flow-through shares on exploration activity and on the economies of remote areas.

On the other hand, a study prepared for the Economic Council of Canada in June, 1987 concluded that the flow-through share is an inefficient mechanism for raising money because of high issuing cost and high risk premiums to the investors:

> For the seven cases examined in this study, the loss in tax revenue ranges from about $1.50 of revenue loss for an additional $1.00 of tax benefits transferred to a non-taxable company, to a high of over $16.00 of revenue loss per dollar of tax benefits transferred.

The timing of the reduction of the earned depletion allowances on July 1, 1988 and their elimination after July 1, 1989 was heavily criticized. Several witnesses noted that changing the rules in the middle of the year would produce unnecessary complications. National Investment Management Ltd. also stressed that a decrease in the allowance after July 1, 1988 would have a retroactive effect since funds have already been collected for 1988 from investors who assumed they would receive a mining earned depletion allowance of 33 1/3 per cent.

The Committee agrees that the earned depletion allowance should be abolished. However, they accept the arguments in favour of deferring the phasing out by six months. Therefore, the Committee recommends:

39. That the rate at which the earned depletion allowance can be earned be reduced from 33 1/3 per cent to 16 2/3 per cent for eligible expenditures incurred after the end of 1988, and that the allowance be abolished for eligible expenditures incurred after 1989.

Many witnesses argued that the phasing out of the earned depletion allowance, combined with the increase in the inclusion rate for capital gains, the cumulative net investment losses rules and the amortization of issuing costs over five years will make investments in flow-through shares much less attractive after 1988. Some witnesses suggested that no more shares would be issued after 1989. Investors who are now willing to pay premiums of up to 35 or 50 per cent, may find that the expected return on the investment is insufficient to contemplate payment of any premium for shares issued in 1989. This is especially true for shares issued by junior companies.

The Committee considered many alternatives to the White Paper proposals. These included: (a) changing the adjusted cost base from nil to an amount equal to the after-tax cost or 50 per cent of the acquisition prices, (b) introducing an investment tax credit equivalent to the current earned depletion allowance; and (c) excluding the deductions for resource expenditures allowed under an investment in flow-through shares from the cumulative net investment losses. The Committee rejected these suggestions as being contrary to fundamental tax concepts, inequitable, inefficient or unacceptably complex.

The Committee agrees, however, that tax incentives or government subsidies may be necessary as temporary measures during periods of depressed prices or economic downturns to ensure the survival of exploration activities in Canada.

The proposals to extend the at-risk rules to resource expenditures incurred by partnerships and to extend the definition of a prescribed share so as to exclude any share offering a guaranteed amount to the investor were designed to ensure that flow-through share investment decisions are based more on real economic considerations and less on tax considerations. The argument for providing tax incentives to flow-through shares is that the investment is risky. The new rules aim to ensure that the investor in flow-through shares bears a real risk. The Committee finds itself in agreement with the proposed treatment.

It was also suggested that oil and exploration expenditures be treated in the same way as "grass roots" mining exploration expenditures, and that a flow-through investor be allowed to deduct in a given year the expenditures incurred in the first 60 days of the following year. The Committee agrees with this proposal because it recognizes the nature of the oil and gas industry and removes an unjustified difference in treatment between industries.

Eligible Capital Property

Some business-related expenditures such as goodwill, quota rights, incorporation fees, perpetual franchises and certain customer lists are neither deductible currently, because they are capital in nature, nor depreciable by way of capital cost allowance. Instead, these expenditures on what is termed "eligible capital property" are added to a separate pool of costs such that under present rules, one-half of the costs may be

claimed as a deduction on a 10 per cent declining balance basis each year. Unlike capital cost allowance, the deduction is not subject to a "half-year rule".

When an eligible capital property is sold, one-half of the proceeds are deducted from the pool, and the deduction for the year is based on the net balance. If the balance in the pool becomes negative at the end of a taxation year, the negative balance must be included in the taxpayer's income. This is similar to the treatment of recaptured depreciation except that no capital gain is recognized if the proceeds from the sale exceed the original cost of the eligible capital property — as one-half of the full amount of the proceeds has been deducted from the pool. In line with this distinction any gain realized by an individual on the sale of eligible capital property is neither eligible for the lifetime capital gains exemption nor subject to the alternative minimum tax.

The White Paper proposes a number of changes to the tax treatment of eligible capital property "... generally consistent with the proposed increases in the portion of a capital gain that is to be included in a taxpayer's income," as follows:

- The portion of an eligible capital expenditure that is added to the pool of cumulative eligible capital is to be increased from one-half to three-quarters.
- The portion of the proceeds of disposition of an eligible capital property that is deducted from the balance of the pool will also be increased to three-quarters.
- To offset the increase in the inclusion rate from one-half to three-quarters, the rate of write-off will be reduced from 10 per cent to 7 per cent on a declining basis.

These changes will apply to fiscal periods commencing after June 30, 1988 for corporations and after December 31, 1987 for individuals carrying on business as proprietors or in partnerships. To keep the system whole, the changes will be matched by an increase of one-half in the balance of a taxpayer's existing pool of unclaimed eligible capital expenditures. However, no allowance has been provided, other than through the proposed lower tax rates (10 per cent to 7 per cent) for the retroactive effect of the increased inclusion rate (three-quarters in place of one-half) applying to the accrued gain in the value of goodwill, quota rights and other eligible capital property when the tax reform proposals become applicable.

A further change in the White Paper proposals will increase the disparity between the tax treatment of eligible capital property and capital property on sale. After June 17, 1987, when eligible capital property is sold, the applicable percentage of the proceeds must be deducted from the balance of the pool of unclaimed eligible capital expenditures at the time of sale, rather than when the purchase price is required to be paid by the purchaser. The White Paper states that the proceeds represent "... in large part, the recapture of a write-off that had previously been deducted" and the proposed change would be "consistent with the treatment of depreciation recapture." However, the portion of the proceeds in excess of the original cost of the eligible capital property — equivalent to a capital gain for which no deduction had been made — will be treated the same way, whereas some of the taxable portion of a gain realized on the sale of a capital property can be deferred for up to five years if the proceeds are not due in full at the time of sale. This change will prove to be particularly harsh in respect of goodwill proceeds realized on the sale of an unincorporated business where the goodwill had been built up in the business rather than purchased originally, that is, no amount had

ever been deducted for the goodwill. This too may necessitate the incorporation of a business prior to sale, if the proceeds will be payable over time.

The Committee recognizes that the White Paper has not remedied the one major disparity between the treatment of eligible capital property and capital property. The lifetime capital gains exemption will still not be available to an individual who realizes a gain on the disposition of eligible capital property on the sale of an unincorporated business carried on as a proprietorship or partnership. This distinction prompted the *Union des Producteurs Agricoles*, for example, to recommend that the $500,000 lifetime capital gains exemption should be applied to gains realized on the sale of production quotas. Although the Committee notes that individuals who dispose of shares of a small business corporation will be entitled to a lifetime capital gains exemption of up to $500,000, the Committee has concluded that eligible capital property should be treated as depreciable property and not like shares of a small business corporation.

The Committee notes that, in principle, eligible capital property should be treated in the same manner for tax purposes as depreciable property in respect of the portion of the cost that may be claimed as a deduction, and as capital property in respect of proceeds realized on sale in excess of the original cost. Consequently, two-thirds of any capital gain would be included, like other depreciable assets, in income and would also be eligible for the $100,000 lifetime capital gains exemption. This move to a two-thirds inclusion would also necessitate a drop in the rate of deductibility to 8 per cent. The Committee has reached this conclusion because it perceives that the historical reasons for the separate treatment of eligible capital property no longer apply and that significant simplification can be achieved by combining the eligible capital property rules with those applying to depreciable property. In making this recommendation, the Committee believes that the treatment of eligible capital property under the tax reform proposals would be consistent with that of capital property, but notes that the extension of the lifetime capital gains exemption to gains realized on this type of asset may have a significant revenue impact.

Therefore, the Committee recommends:

40. That eligible capital property be treated as a separate class of depreciable property with a deemed cost equal to the applicable percentage of its actual cost, and any proceeds of disposition be deemed to be the applicable percentage of the actual proceeds.

41. That the "applicable percentage" in respect of eligible capital property be increased from one-half to two-thirds.

42. That on the implementation of these recommendations the balance of existing cumulative eligible capital pools be increased by one-third, and the depreciation rate for eligible capital property be reduced from 10 per cent to 8 per cent.

43. That any proceeds of disposition of eligible capital property in excess of original cost be treated as a capital gain eligible for the $100,000 lifetime capital gains exemption.

44. That the existing rules in relation to recaptured depreciation and taxable capital gains apply to the recognition of the proceeds of disposition of eligible capital property that are not receivable until a later year.

Real Estate

The White Paper proposes significant changes to the overall taxation of real estate developers, estimating that the changes to the treatment of real estate carrying costs and soft costs will raise $10 million in 1988 which would grow to $70 million in 1992 once the proposals had been fully implemented. No specific estimates are provided for the impact of the other changes on real estate. Table 12 compares the current and proposed systems.

The proposals put forward in the White Paper will raise revenue, but important issues remain. Will the revenue be raised equitably across the industry? Are the proposals reasonable given the nature of the industry? Are the rules consistent with taxation rules facing other industries?

The Committee received briefs and heard testimony from various members of the real estate industry, including large, medium and small developers. The general thrust of the comments received was that although the industry accepted that more tax in total should be paid by its members, the witnesses found the proposed changes excessive. Submissions were received from groups representing small real estate

Table 12

Tax Treatment of Real Estate Developers

	Before Tax Reform	After Tax Reform
Carrying costs on vancant land inventory	Currently deductible	Capitalize to land
Carrying costs on vancant land held for expansion	Currently deductible	Capitalize to land
Construction period "soft costs"	Currently deductible	Capitalize to land and building as appropriate
Capital cost allowance on building held for rent	5% declining balance	4% declining balance
Capital gains inclusion rate	50%	66 2/3% growing to 75%
Cost of obtaining financing	Currently deductible	Deductible over 5 years for share issues, or term of debt for debt issues.
General business rate of tax	36%	28%
Put-in-use rule	N/A	Applicable

developers indicating that their sector will be hit disproportionately by many of the proposed tax changes. As indicated by the Canadian Home Builders Association:

> The competitive advantage that large developers/builders have will be increased because of their ability to absorb better the increased costs and because the impact of tax reform will be felt sooner by the small companies than the larger ones. In addition the tax rate reductions will have greater benefit to large corporations than small corporations.

This position was reinforced by the Canadian Institute of Public Real Estate Companies (CIPREC) in their presentation regarding the deduction of carrying costs on land inventory.

> . . . this provision will be more prejudicial for non-CIPREC members who are small homebuilders since in many cases, these contractors will now be required to pay income tax for years in which they do not 'make money'.

There have also been concerns raised that the White Paper proposals do not properly reflect an understanding of how the real estate development industry operates. For example, the requirement to capitalize carrying costs to the value of the land may be self-defeating. That is, situations will occur where after a number of years of capitalizing carrying cost, the tax value of the land could exceed fair market value. For tax purposes, a write-down to fair market value would be required. This change would open up problems of valuation, assessment and appeal.

Furthermore, a number of witnesses indicated that there is no recognition that land must be assembled and carried for a number of years while zoning requirements and permits are obtained and financing arranged. Nor has there been any recognition that incidental revenue is earned while a project is being developed. Under the White Paper proposals, revenue will be taxed currently, while associated costs must be capitalized until the project is complete. As the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants put it:

> A dislocation of the receipt of revenues and the deduction of expenses could occur with multi-unit projects. Further, projects that as a whole produce a loss may nonetheless result in a tax liability to the developer with respect to the first sales that are made.

Many submissions argued that the real estate industry was being singled out from other industries in the treatment of certain costs. A particular complaint of many witnesses was that inventory carrying costs will not be allowed as a deduction for real estate developers. Witnesses argued that other industries with long inventory-holding periods, for example, distillers, are able to claim their carrying costs of inventory as a current deductible expense.

A primary area of concern is the capitalization of interest on vacant land. The Committee considers that these costs are an integral component of the development industry and are properly currently deductible against income provided the taxpayer is in the real estate development business. It is incorrect to attempt to derive tax by disallowing the deduction of otherwise justifiable costs.

The Committee does believe, however, that soft costs incurred during construction (for example, interest charges during construction) can justifiably be said to be capital in nature, as opposed to a currently deductible expense. These costs should be capitalized to the cost of the building and a deduction allowed in line with the appropriate capital cost allowance.

There was some evidence presented to the Committee arguing that there may be some inequities in the application of a put-in-use rule as it relates to the real estate industry. The Committee was not convinced, however, that major changes to the put-in-use rule for real estate projects were warranted, beyond those already proposed by the Committee.

Therefore, the Committee recommends:

45. That carrying costs on vacant land continue to be deductible as a current expense by real estate development companies.

46. That the proposals requiring the capitalization of soft costs incurred during construction are appropriate and should be implemented, but the amounts should be capitalized totally to the building.

A perceived problem with the industry is that many large real estate companies are profitable in an accounting or financial sense but do not have any taxable income and therefore pay little or no tax. For example, this may occur where a real estate company finances its expansion by way of mortgaging existing properties so as to extract inherent gains in value, without paying any current income tax.

The Committee advocates that the Department of Finance should review an alternative source of taxation for the real estate industry. The Committee believes that some alternative form of taxation must be devised to ensure that the real estate industry pays its fair share of tax. An asset tax based on historical cost or depreciated cost may not be appropriate because of its uneven application. Furthermore, an asset tax based on the fair market value of assets would be difficult to administer and fraught with complications regarding the ongoing valuation of real estate assets. To address the issue of taxing the fair market value of the operations of a real estate corporation, one option is a form of alternative minimum tax based on a percentage of gross rental revenue. A relatively low tax rate could be applied to non-residential rental revenues when they are greater than a specified minimum, say $1 million. Such an alternative minimum tax would be payable to the extent it exceeded regular income tax payable, but it would be limited to 28 per cent of reported Canadian accounting income. This would ensure that a company incurring accounting losses does not have to pay tax.

The intent of this relatively simple proposal is to raise a base level of taxes from those companies in the real estate industry that report accounting income, have significant rental income and pay little or no regular income tax.

Therefore, the Committee recommends:

47. That the government implement an alternative minimum tax on the real estate industry. The tax would be established at a low rate and on an appropriately broad base with a *de minimis* rule. Furthermore, this tax would be payable, only to the extent that it was greater than regular

corporate income tax but would be limited to 28 per cent of the Canadian portion of reported accounting income.

The Committee generally supports the base-broadening implication of reducing the capital cost allowance on buildings to 4 per cent, although a concern was expressed to the Committee that this rate may be too low to encourage renovation of Canadian buildings over 50 years old. In the Committee's view, the Department of Finance should undertake a study to assess whether a favourable rate of depreciation should be available to taxpayers who renovate older buildings instead of constructing new ones. For example, if capital cost allowance rates of 6 per cent were available to those taxpayers renovating qualified property versus the general rate of 4 per cent, compensation by way of a tax incentive would be provided where the cost of renovations exceeded the cost of building a new building by up to 30 per cent.

Therefore, the Committee recommends:

48. That while the White Paper proposals requiring the reduction in the rate of capital cost allowance for buildings from 5 per cent to 4 per cent should be adopted, an assessment should be made by the Department of Finance to determine whether a preferential rate of capital cost allowance should be available to taxpayers who renovate buildings that are over 50 years old.

Expenses of Issuing Securities

At present, taxpayers may deduct the costs of issuing securities or debt in the year they are incurred. These costs include underwriting commissions and sellers' fees, legal and accounting fees, registrars' and transfer agents' fees, and printing expenses and filing fees relating to an issue. The expenses of issuing trust units and partnership interests are also deductible in the year incurred, which has the effect of permitting partners in a partnership or unitholders in a trust to deduct part of their investment costs, thereby adding to "the tax advantages of tax-motivated investments."

To achieve a better matching of expenses with revenues, the White Paper proposes that applicable to issue expenses and other costs incurred after December 31, 1987 with respect to debt and other securities issued after that date:

- Expenses relating to the issue of shares, partnership interests and trust units will be amortized over a five-year period; and
- Expenses relating to borrowing funds will be amortized over the term of the debt obligation, including any renewal periods, with a minimum of five years — however, any unamortized costs will be deductible in the year in which the borrowings are repaid.

The projected federal revenue effect of these proposals will be an increase of $50 million for 1988 declining to $10 million in 1992.

Witnesses who appeared before the Committee had a number of concerns:

- The Trust Companies Association of Canada said that long-term debt issues would be discouraged.

- The Canadian Bankers' Association said that the proposals would favour equity securities over debt with a term of more than five years, and would create uncertainty as to their application to perpetual debt instruments and revolving loan facilities.
- The Joint Securities Industry Committee on Tax Reform said that the current tax treatment of expenses of issuing securities had been very effective in encouraging Canadian companies to raise equity capital and had been particularly helpful for small business. The claiming of these expenses over a period of years would make it difficult for Revenue Canada to distinguish them from those expenses that would still be deductible immediately, such as advisory costs, especially "in the event they are incorporated into the issue price of corporate financing."

The Joint Securities Industry Committee on Tax Reform also indicated that the tax reform proposals would not be effective because companies that do "regular financing and that are very sophisticated will re-design share and debt issues so as to virtually minimize any non-deductible expenses." As a result, investors would pay more for new issues of securities leaving the same net after-tax proceeds available to the issuer as would be available when the expenses were deductible currently.

The Committee recognizes that the tax treatment of the costs of issuing securities or debt should not lead to a mismatching of revenues and expenses and should not encourage tax shelter financing. Partnerships and trusts should not be used as a means of converting capital expenditures of an investor into currently deductible expenditures. However, the Committee believes that although the expenses of issuing debt should be deducted over the term of the debt, the tax treatment of the expenses of issuing debt and other securities should as far as possible be neutral.

Therefore, the Committee recommends:

49. That, as proposed in the White Paper, expenses relating to the issue of shares, partnership interests and trust units be amortized over a five-year period; but that expenses relating to borrowing funds be amortized over the term of the debt obligation including any renewal periods, with a maximum of five years. Any unamortized costs should be deductible in the year in which the borrowings are repaid.

CHAPTER 6

Preferred Share Financing and Dividend Distributions

Preferred share financing is subject to complex rules in the *Income Tax Act*. These rules, including the definition of the various types of preferred shares, have been revised on a regular basis. Since 1978, for example, the definition of "term preferred shares" has been changed nine times. The White Paper proposes additional rules that seek to limit the issue of preferred shares by non-taxpaying corporations. The co-chairmen of the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants appeared before the Finance Committee and emphasized the extraordinary complexity of the proposed rules:

> . . . the rules are becoming incomprehensible, and the preferred share rules are a prime example of that.
>
> You go through those preferred share rules, and you have to determine whether you have got a term preferred; a short-term preferred; a collateralized preferred; a taxable preferred; a taxable SFI share; or a grandfathered share. Some of them can be in two or three of those categories, and others may be in none of those categories.

If the complexity is not daunting enough, moreover, the Committee has already heard of schemes to avoid the proposed rules and doubts that these rules, even if corrected, will stop the abuse.

Reasons For After-Tax Financing

A corporation that does not pay tax often issues preferred shares as a substitute for debt financing to reduce its costs of borrowing. Lenders of funds to corporations who demand the same after-tax yield whether the funds are invested in debt or equity, usually charge the borrower a lower cost of funds because they have been able to obtain the yield as a dividend rather than as interest.

The borrowing corporation that issues debt is indifferent to any deduction for the interest expense it incurs because it is non-taxable. Whereas the lender in this transaction would pay tax on the interest income, taxable dividends, on the other hand,

are presumed to be paid out of profits that have already been subject to a tax and would be eligible for a dividend tax credit (for the individual shareholder) or an intercorporate dividend deduction (for the corporate shareholder).

This method of equity financing has increased as the number of tax preferences in the *Income Tax Act* have multiplied. The absence of any corporate loss transfer system in Canada has also aggravated the problems arising from the use of after-tax financing. In this regard, the Committee notes that although the government published a discussion paper in conjunction with the May 1985 budget putting forward a proposal that would allow the transfer of tax losses within a commonly-owned group of corporations, the White Paper is silent on this subject. The Committee believes that as an integral part of corporate tax reform there is a need for the federal and provincial governments to seek agreement on implementing a tax-loss transfer system in Canada.

The popularity of after-tax financing is, in part, revealed in the proportion of total share issues represented by preferred shares. The following comparison in Table 13 of Canadian and U.S. issues of preferred shares as a percentage of common and preferred stock issues illustrates this country's historical tax advantage regarding preferred shares:

Problems With After-Tax Financing

If the corporation that is distributing dividends on preferred shares is in a taxpaying position, the tax system works properly. For example, the dividend tax credit and the intercorporate dividend deduction provide an incentive for individuals and corporations respectively to invest in Canadian equity with little or no double taxation. The *Income Tax Act* provides little incentive in this situation for the corporation to choose preferred share financing over debt. If, however, the corporation is not paying taxes, it can obtain an advantage by issuing preferred shares and paying dividends out

Table 13

Comparison of Canadian and U.S. Issues of Preferred Stock as a Percentage of Common and Preferred Stock Issues

	Canada	United States	Difference
		(per cent)	
1965	46.6	31.9	14.7
1970	34.2	16.1	18.1
1975	57.6	31.8	25.8
1980	47.0	16.1	30.9
1981	54.8	6.7	48.1
1982	45.7	17.6	28.1
1983	25.7	14.3	11.3
1984	62.5	18.2	44.3
1985	54.4	18.3	36.1

Source: Department of Finance.

of income that has borne little or no corporate tax because tax relief for a notional amount of corporate tax is still provided to the recipient shareholder. The non-taxpaying corporations have also been able to use the intercorporate dividend deduction as a means of transferring some of their unused tax preferences to unrelated corporations.

In summary, after-tax financing has resulted in the loss of government revenues, in part because corporations have chosen to finance their activities using preference shares that are in essense a debt obligation. At the same time, tax relief is still provided to recipients of taxable dividends from these non-taxpaying corporations.

The White Paper Proposals

The government projects increased revenue of approximately $400 million annually upon implementation of the new preferred share rules, intended to restore the integrity of the tax distinction between equity and debt securities and prevent further tax preference transfers between corporations. The White Paper proposes to levy on a corporation a 25 per cent tax on dividends paid on certain taxable preferred shares and a 10 per cent tax on certain corporate recipients of the dividends. The corporation may elect to pay a 40 per cent tax on the dividends paid, in which case no additional tax is imposed at the recipient shareholder level. The 25 per cent basic rate of tax is designed for dividends targeted for the individual market and reflects the value of the dividend tax credit. For the issuing corporation paying taxes, the tax can be applied indirectly as a deduction to corporate income tax payable. Accordingly, it does not represent a net cost to an otherwise taxpaying company. However, a significant cost is imposed on the non-taxpaying corporation and on the company which pays insufficient income tax to fully offset the 25 per cent tax.

The exemption of up to $500,000 of preferred share dividends for any group of corporations is intended to allow small business and venture capital start-up companies continued use of preferred shares as an integral part of financing arrangements. Depending on share prices, this exemption permits the issuance of $5 million or more in preferred shares without taxes on dividends. Dividends paid to a shareholder with a substantial interest in the paying corporation will not be subject to either the 25 or 40 per cent tax on dividends received by certain corporations. Generally speaking, shareholders will have a substantial interest in a corporation if they are related to the corporation or if they own shares representing at least 25 per cent of the votes and value of all issued shares of the corporation.

Recommendations

The Committee recognizes that the issue of preferred shares is a useful and acceptable method for raising corporate funds. Nevertheless, it believes that the provision of tax relief to recipients of taxable dividends from non-taxpaying corporations is inappropriate, particularly when it contributes to the sale of tax preferences.

The Committee is not satisfied with the proposed rule or with on some of the designated exceptions such as the $500,000 exemption, which it believes is considerably

above the capital needs of most small businesses. Further, the $500,000 exemption will be open to large as well as small corporations, subject only to a claw-back provision applicable to the payment of over $1 million of dividends annually. This effectively permits a modicum of continued after-tax financing for all corporations at an indeterminate cost to the federal treasury. Overall, the Committee believes the $500,000 exemption is too generous an allocation of tax support for corporate financing. A more appropriate mechanism would be one that offered a lower level of exempted dividends or that was directed to currently non-taxable firms of a specific size. It is not clear, however, which companies the government intended to benefit from the exemption.

Therefore, the Committee recommends:

50. That the $500,000 exemption of preferred share dividends for any group of corporations be reduced to a lower level of exempted dividends or be available only to non-taxable firms of a specific size.

In spite of its earlier endorsement of the objectives of the proposed rules, the Committee questions why the government did not adapt the proposed rules to include common equity dividends. The Canadian tax system is an anomaly among integrated tax systems in that it offers a tax credit to individual shareholders without reference to actual corporate taxes paid. Furthermore, the intercorporate dividend deduction, which is designed to prevent double taxation when dividends pass between corporate entities, is also available to the corporate shareholder without reference to actual taxes paid on the part of the payer corporation. Both instances represent an unacceptable tax expenditure. The government's proposed rules deal with this fundamental problem in the case of preferred share dividends, but not for dividends on common equity.

The Committee also reviewed advance corporation tax on dividend distributions used by nations, such as Australia, which have tax systems characterized by partial or full integration. These nations levy an advance corporation tax on all dividends to ensure that all surplus from which dividends are distributed has been subject to corporate tax. Thus, in these jurisdictions, an advance corporation tax acts like a minimum tax, or a prepayment of tax that is later offset against a corporation's mainstream liability. To the extent the corporation is in a non-taxpaying position, the advance corporation tax remains effective and tax credits compensate shareholders for the full value of the advance corporation tax paid.

Department of Finance officials advised the Committee that numerous difficulties interfere with the possible imposition of a comprehensive advance corporation tax on all Canadian dividend distributions. Chief among these was the inability of foreign shareholders to obtain Canada's dividend tax credit because the credit is a subsidy designed to encourage equity investment in domestic corporations only. This would prove especially critical for those shareholders residing in the United States because of the significant level of American investment in Canada. Officials indicated that one country with an advance corporation tax, the United Kingdom, has extended partial dividend relief to foreign direct and portfolio investors under certain double tax treaties, including those with Canada and the U.S.

Although the Committee appreciates the potential tax treaty implications involved in this issue, it has concluded that this problem alone should not preclude the introduction of an advance corporation tax in Canada. The experience of the 1986 tax reform in Australia — another country with a high level of foreign ownership — provides Canada with an alternative to both the status quo and the White Paper proposals. As part of Australian tax reform, the system of imputation was altered to operate for residents and yet included an advance corporation tax without violating the recently negotiated Australia-U.S. tax treaty. The Australian method of segregating dividends into two classes for the purposes of determining tax payment and the subsequent provision of tax credits to shareholders guarantees against revenue loss and provides no disincentive for dividend distributions by corporations. Dividends that have borne a tax (qualifying dividends) and are paid to non-resident shareholders are exempt from the normal dividend withholding tax. On the other hand, dividends that have not borne a tax (non-qualifying dividends) are liable for the dividend withholding tax. Because of the qualifying dividend exemption, Australia is able to restrict its tax credit to residents. There are indications that the new Australian imputation system could prove acceptable to U.S. treaty negotiators.

The Committee notes that another approach that could avoid the potential tax treaty implications of Canada introducing a comprehensive advance corporation tax would be for the tax not to apply to dividend payments to non-resident shareholders.

The Committee also suggests a review of another model of advance corporation tax that draws a distinction between tax-paid and non-tax-paid surplus. Whereas a corporation may pay dividends out of tax-paid surplus without restriction, dividends paid in the absence of a tax-paid surplus balance would be subject to an advance corporation tax. Tax-paid surplus represents the net surplus of the corporation as calculated on a tax basis, accumulated over time. The implementation of such an advance corporation tax would require some system of accounting for pre-implementation surpluses.

In summary, the Committee believes that the following ideas will be fundamental in the design of a successful advance corporation tax for Canada:

- the advance corporation tax rate should be close to the rate of dividend tax credit at the shareholder level;
- when an advance corporation tax is introduced, the proposed preferred share dividend tax rules should be revised to form a component of the advance corporation tax;
- the excess of advance corporation tax over current taxes should be allowed to be carried back and forward for a reasonable period of time.

Therefore, the Committee recommends:

51. That the government take steps immediately to introduce a comprehensive advance corporation tax on common and preferred share dividend distributions.

Although the Committee appreciates the potential tax treaty implications involved in this issue, it has concluded that this problem alone should not preclude the introduction of an advance corporation tax in Canada. The experience of the 1986 tax reform in Australia — another country with a high level of foreign ownership — provides Canada with an alternative to both the status quo and the White Paper proposals. As part of Australian tax reform, the system of imputation was altered to operate for residents and yet included an advance corporation tax without violating the recently negotiated Australia-U.S. tax treaty. The Australian method of segregating dividends into two classes for the purposes of determining tax payment and the subsequent provision of tax credits to shareholders guarantees against revenue loss and provides no disincentive for dividend distributions by corporations. Dividends that have borne a tax (qualifying dividends) and are paid to non-resident shareholders are exempt from the normal dividend withholding tax. On the other hand, dividends that have not borne a tax (non-qualifying dividends) are liable for the dividend withholding tax. Because of the qualifying dividend exemption, Australia is able to restrict its tax credit to residents. There are indications that the new Australian imputation system could prove acceptable to U.S. treaty negotiators.

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Therefore the Committee recommends:

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CHAPTER 7

Financial Intermediaries

The White Paper includes proposals aimed at shifting the tax burden to profitable corporations. Financial institutions were targetted as the type of corporation that has paid little tax because of existing tax provisions, and specific proposals in the White Paper attempt to ensure that these institutions begin paying an appropriate share of taxes. The Committee agrees with the intent of the proposals but believes they are inadequate. Accordingly, this Report introduces a different approach to the taxation of financial intermediaries.

White Paper Proposals

The tax reform proposals affecting financial intermediaries fall into two areas: the treatment of reserves generally and the taxation of life insurance companies specifically. The overall objectives of the proposals relating to reserves are to ensure that tax deferral opportunities are eliminated and that there is consistency of tax treatment among competing financial institutions. The proposals relating to life insurance companies are intended to raise more tax revenues by ensuring that the investment income accumulating over the years in the policy reserves of life insurance companies bears a reasonable level of tax and, in the case of life insurance companies which operate both in Canada and abroad, to ensure that an appropriate portion of the insurer's net investment income is attributed to the Canadian business and thus is subject to Canadian taxation.

Reserves are a key factor in determining the taxable income of financial intermediaries. In general, a deduction may be claimed for a reserve to reflect either a reduction in the value of an asset, e.g., a reserve for loan losses, or an increase in a liability, e.g., a reserve for future claims under insurance policies. In line with the government's proposals that financial institutions will be allowed to compete in significantly more areas than previously, the tax reform proposals are intended to eliminate the different treatment of reserves for tax purposes for institutions competing in the same marketplace.

The White Paper identifies the following deficiencies in the tax treatment or reserves of financial intermediaries.

- The deduction for loan losses allowed to banks is different from that allowed for competing financial institutions and provides an opportunity for the deferral of tax.
- Trust, mortgage loan, insurance companies and credit unions are allowed a reserve for doubtful accounts based on a formula which generally exceeds actual experience.
- Insurance companies are allowed a reserve in one year for policy dividends to be paid in the next year, even though only a portion of the liability will have accrued at the year-end.
- Insurers do not always discount their liabilities in respect of expected future claims and thereby claim higher reserves than the value of their future liabilities.

As a general approach, the government proposes that loan loss reserves of financial intermediaries be based on their actual experience rather than on arbitrary formulas. Adjustments will also be made to insurers' reserves to better match underlying income and expenses. The proposals will reduce the amount of reserves permitted to financial intermediaries in computing income for tax purposes and as a result, will broaden their tax base. To spread the impact of these changes over a number of years, transition rules will be provided.

The government also proposes to introduce a 15 per cent investment income tax which will apply to investment income accruing to fund insurance liabilities of life insurance companies. This tax is similar to a tax on the investment income of life insurers which was in effect between 1969 and 1978.

The proposed tax will not apply to investment income accruing to fund liabilities attributable to life insurers' annuity business. Furthermore, it will not apply to investment income related to fixed contractual liabilities entered into before January 1, 1988. Deductions will be allowed from the investment income tax base for expenses incurred in earning Canadian investment income and for business income of life insurance companies which is already subject to tax under Part I of the Income Tax Act. The proposed investment income tax will apply to taxation years beginning after June 17, 1987 and ending after December 31, 1987. The rate will be phased in in equal steps over a five-year period.

Finally, the government proposes to alter the rules which exist for determining the amount of gross investment revenue attributable to Canadian insurance businesses carried on by resident multinational life insurance companies and non-resident insurance companies to ensure that an appropriate amount of investment revenue and security gains are subject to taxation in Canada.

The current system for determining the Canadian investment fund of life insurers and for designating investment property will be retained. However, rules similar to the equity-limit rule will be adopted to restrict the amount of rental real estate assets that may be designated by the insurer. In designating assets to the Canadian investment fund, insurance companies will have to meet a value test, a net investment revenue test and a minimum amount of gains test. Rules will also be introduced to ensure that an appropriate portion of an insurer's net investment income is attributed to its Canadian

business. This will be accomplished by requiring that a minimum amount of net investment revenue must be included in Canadian income.

The proposed changes will apply to taxation years beginning after June 17, 1987 and ending after December 31, 1987, and special transition measures will apply.

Financial Intermediaries and the Avoidance of Tax

The Committee has noted that, since 1978, the amount of federal income tax paid by banks, insurance companies and trust companies has declined drastically. On the basis of aggregate industry statistics, the Committee has determined that the federal income tax liabilities of the financial intermediaries have generally been in the range of 1 per cent to 6 per cent of Canadian profits.

In large part, this is because financial intermediaries are highly leveraged, having access to large amounts of depositor assets backed by relatively small amounts of company capital. The ratios of depositor assets to company capital range from 10:1 to 25:1. By utilizing tax preferences sufficiently, including tax-exempt income, the financial intermediaries have been able to reduce their taxable income to negligible amounts within the existing provisions of the *Income Tax Act*. There has been evidence presented of careful selection among tax preferences by financial intermediaries to minimize their income tax liabilities. Furthermore, there has been evidence presented to the Committee that formula reserves for general losses have been about twice as large as appropriate for large, regionally diversified financial institutions, and that actuarial and claims liability reserves have been overly generous for insurance companies. In addition, technical evidence has been presented concerning flaws in the detailed tax calculations for life insurance companies which have resulted in their paying very little tax. Consequently, life insurance companies did not need to rely as heavily on after-tax financing instruments as other financial intermediaries.

The history of Canadian income taxes paid by banks, trust companies and life insurance companies from 1980 to 1985 compared to their reported Canadian income is set out in Table 14. Financial institutions report profits on Canadian operations directly in their annual reports or to Statistics Canada. While information on corporate tax liabilities is not available from Revenue Canada, aggregate industry statistics have been made available to the Committee.

As can be seen, Canadian federal income taxes paid have generally been in the range 1 - 6 per cent of aggregate Canadian profits. All financial intermediaries charge a fee for their services as intermediaries. For asset management, this fee is customarily calculated as a percentage of the margin between the rate of interest paid on deposits and the rate of interest earned on investments. The margin, or pre-tax spread, after expenses ranges on individual products from about one-quarter of 1 per cent to about 1 per cent. Reported margins for the life insurance companies are about one-half of 1 percentage point higher, in part due to differences in income-reporting methods; 15 per cent of *unrealized* common stock gains and 10 per cent of *unrealized* real estate gains are added to realized earnings for reporting purposes.

A further factor is that insurance companies also charge a fee for their services as risk intermediaries. For life insurance, this fee is customarily calculated by providing for a mortality margin between the rate of mortality expected and the rate charged in the contract. At present, the non-investment-related earnings of insurance companies constitute a much larger proportion of their earnings than do the fee earnings of the other financial intermediaries.

The historical profit margins on the Canadian operations of banks, trust companies and domestic life companies are set out in Table 15.

Proposals for Change

By taking advantage of generous tax preferences, financial intermediaries have been able to adjust their taxable income and pay little, if any, tax. One way to increase the taxes paid by these institutions, therefore, is to reduce or eliminate the tax preferences they use. Recommendations in the following four subsections attempt to do so and bring taxable income more in line with actual earnings. This would increase the taxes paid by financial intermediaries under Part I of the *Income Tax Act*.

Canadian Investment Fund

In the case of the multinational Canadian life insurers, a faulty definition of the Canadian investment fund has enabled them to eliminate their Canadian income tax liability because of the effect of foreign policy loans, the year-end timing of the Canadian investment fund calculation, the selection of assets for the fund, and financial reinsurance. In addition, in an environment where interest rates were reasonably stable but fluctuated around certain mean values, or where interest rates were rising, most domestic and multinational life insurers could, through trading activity, generate tax-deductible losses when no real business loss occurred.

For example, assume that a $100 five-year 10 per cent bond was purchased to back a specific annuity. If interest rates rose one percentage point and the bond was sold at about $96.30 and replaced by an 11 per cent, five-year bond at par, no economic profit or loss would have been realized. This is because the real market value of the underlying liability should also have been valued at a one percentage point higher rate of interest. For reporting purposes, bond income would be increased by $0.59 in the first year, $0.66 in the second, $0.73 in the third, $0.81 in the fourth and $0.91 in the fifth, reflecting the higher interest rate. This would be offset by the amortization of the bond trading loss of $0.74 each year over the five-year period.

However, for tax purposes the $3.70 bond trading loss would be recognized immediately and the increase in income would be reported annually over the five-year period. Thus, by recognizing the reduction in the market value of assets at the time of sale for tax purposes while ignoring the reduction in the market value of liabilities, taxable income is reduced significantly. Larger effects can be generated for longer-term bonds.

Table 14

Canadian Taxes Paid Related to Profit of Canadian Operations

	1980	1981	1982	1983	1984	1985
	(millions of dollars)					
Banks						
Aggregate Canadian profits (7 large)	n.a.	916	951	1,641	1,865	1,766
Aggregate Canadian federal income taxes paid (industry)	15	8	7	40	17	n.a.
Trust Companies						
Aggregate Canadian profits (7 selected)	n.a.	78	124	270	303	364
Aggregate Canadian federal income taxes paid (industry)	9	4	19	25	11	n.a.
Life Insurance Companies						
Aggregate Canadian profits (industry)	578	518	552	785	643	945
Aggregate Canadian federal income taxes paid (industry)	26	19	21	25	40	n.a.

n.a. - not available

Table 15

Historical Profit Margins on Canadian Operations

	1981	1982	1983	1984	1985	1986
Banks (7 large)						
Canadian assets ($ billion)	167	194	200	200	213	230
Canadian profits ($ million)	916	951	1,641	1,865	1,766	2,110
Profit margin (per cent)	0.55	0.49	0.82	0.93	0.83	0.92
Trust Companies (7 selected)						
Canadian assets ($ billion)	21.4	28.9	31.6	34.3	40.8	47.7
Canadian profits ($ million)	78	124	270	303	364	413
Profit margin (per cent)	0.36	0.43	0.85	0.88	0.89	0.87
Domestic life companies (industry)						
Canadian assets ($ billion)	30.5	34.0	38.0	43.4	47.8	
Canadian profits ($ million)	234	363	513	632	756	
Profit margin (per cent)	0.77	1.07	1.35[1]	1.46[1]	1.58	[1]

[1] Life company reported earnings are not comparable because for reporting purposes 15 per cent of unrealized common stock gains (from 1984) and 10 per cent of unrealized real estate gains (from 1986) are added to normal realized earnings. For example, in 1986, between 20 per cent and 25 per cent of several large life insurers' earnings reflected reported unrealized real estate gains for the first time.

Therefore, the Committee recommends:

52. That, to ensure taxable income reasonably reflects business income, bond and mortgage trading profits and losses be amortized over the remaining lifetime of the security for all financial intermediaries.

Financial Reinsurance

The Committee has concluded that in general, the deficiencies in the Canadian investment fund in the existing tax legislation have been corrected by the tax reform proposals, although deficiencies in the Canadian investment fund rules relating to policy loans and timing still remain. Furthermore, in Canada, use of financial reinsurance has been limited in the past because of the ease with which corporate income tax could be avoided through the structural flaws in the *Income Tax Act*. However, in the future, significant tax losses could occur through the use of reinsurance. The Committee notes that there is no proposal in the White Paper to limit these arrangements, other than the general anti-avoidance rule.

Therefore, the Committee recommends:

53. That in calculating required Canadian assets, the calculation be made monthly, or at least quarterly.

54. That the calculation of the Canadian investment fund be made in such a manner that an increase or decrease in foreign policy loans does not affect the Canadian investment fund.

55. That the use of financial arrangements, including reinsurance contracts, between financial intermediaries be blocked by a specific anti-avoidance rule similar to section 845 of the U.S. Internal Revenue Code.

For reference, section 845 of the U.S. Internal Revenue Code is set out in the appendix to this chapter.

General Loan Loss Reserves

The Committee heard evidence that general loan loss reserves calculated by using the existing formula were generally twice as high as required in normal circumstances. The White Paper proposes to correct this situation by requiring reserves to be set up using historical loan loss ratios and recovery rates and releasing the excess reserves into income over five years. The Committee supports the proposed five-year transition.

It seems to the Committee that this approach could lead to underprovision after a long period of business expansion, which could jeopardize solvency in a severe national, regional or sectoral economic recession. Conversely, the historical ratio approach could lead to overprovision in recovery years following a recession.

In addition, recent events have indicated that small financial institutions with regional or industrial concentration of risk could require the provision of additional loan loss reserves. The Superintendent of Financial Institutions should be a position in such cases to *require* additional loan loss reserves to be set up which should be recognized for tax purposes.

Moreover, for multinational financial intermediaries, there has been considerable flexibility in allocating general loan loss reserves by country. This could lead to a reduction in Canadian income tax because of the interaction with foreign withholding taxes.

Therefore, the Committee recommends:

56. That authorized general loan loss reserves continue to be set by formula but that the level of the reserves be reduced to one-half of its current level over five years.

57. That the Superintendent of Financial Institutions be allowed to require additional specific loan loss reserves because of factors such as geographical, industrial or sovereign concentration of risk and that these reserves be tax-deductible.

58. That methods be developed to allocate loan loss reserves by country for income tax purposes.

Claims Reserves

Property and casualty insurance companies traditionally set up claims reserves not taking into account the time value of money, that is, without an interest factor. To the extent that the estimates of ultimate claims losses are accurate, this results in an overprovision for claims reserves and a deferral of tax revenues.

The White Paper proposes to require all claims loss reserves to be calculated so as to include an allowance for interest.

However, the Committee has heard evidence that the amount of reserves released into taxable income would greatly exceed the Finance Department's estimates. The Committee has also heard recent evidence from the Deputy Superintendent of Financial Institutions questioning the adequacy of existing claims reserves.

Similarly, with respect to life insurance reserves, there has been some question as to whether there is adequate provision for adverse development in mortality as a result of the spread of AIDS.

Therefore, the Committee recommends:

59. That the principle of requiring property and casualty claims reserves to be established using interest be accepted.

60. That structured settlement claims reserves be required to use interest immediately.

61. That property and casualty claims reserves for existing but unsettled claims be allowed to run off as settled.

62. That future claims reserves be required to be established using interest as soon as the Superintendent of Financial Institutions is satisfied that appropriate standards have been established by the Canadian Institute of Actuaries to ensure adequacy of reserves.

63. That increases in claims reserves or actuarial reserves required by the Superintendent of Financial Institutions for solvency purposes be tax-deductible.

An Alternative Minimum Margin Tax

Experience has demonstrated that financial intermediaries have historically been successful in avoiding paying corporate income taxes imposed under Part I of the *Income Tax Act*. To ensure that an appropriate level of tax is paid by financial intermediaries, an alternative minimum tax should be introduced. Moreover, financial intermediaries are unique among Canadian corporations in pricing their services as a spread or margin on assets managed or risk underwritten.

Therefore, the Committee recommends:

64. That effective January 1, 1988, the government institute a minimum corporate tax on the Canadian earnings of banks, trust companies and life insurance companies to be called the "alternative minimum margin tax" and that this tax be based on the margins of such financial intermediaries.

The Committee believes that the alternative minimum margin tax is an equitable way in which to raise income taxes from financial intermediaries. Immediate implementation is recommended, recognizing that the White Paper recommends the full removal of capital taxes from financial institutions in 1988.

The objectives of the alternative minimum margin tax are as follows:

- a stable source of tax revenue;
- neutrality between financial institutions;
- neutrality for Canadian operations;
- simplicity;
- operation of a tax that is related to ability to pay; and
- no undue political or fiscal hazards.

Banks, life insurance companies and trust companies would be subject to the alternative minimum margin tax. In preparing its report, the Committee considered extending the alternative minimum margin tax to property and casualty insurers, credit unions and caisses populaires but decided against such an extension. Property and casualty insurers generally appear to be paying income taxes which are already in excess of the alternative minimum margin tax level. Credit unions and caisses populaires are by and large below the minimum threshold level at which the alternative minimum margin tax applies.

The Committee notes that there is some incentive for large institutions to self-insure or self-administer pension funds, but feels that the potential revenue losses arising from such a shift would be minimal but should be monitored.

The alternative minimum margin tax would be levied at the rate of 0.15 per cent of covered Canadian assets plus, in the case of life insurance companies, $0.10 per $1,000 direct written sum assured in excess of $2.5 billion. The alternative minimum margin tax would be limited to 28 per cent of the Canadian proportion of worldwide consolidated reported earnings before income taxes.

Covered Canadian assets would be gross Canadian assets in excess of $250 million excluding the following:

- assets held in trust or only managed, such as segregated funds;
- common and preferred shares and small business development bonds which would produce tax-exempt income;
- non-revenue-producing assets such as non-interest-bearing bank deposits, accounts receivable, prepaid expenses and deferred charges; and
- debt investment in other companies in which there is a direct equity investment, for example, 20 per cent or greater.

Covered Canadian assets would include assets managed in subsidiary mortgage and real estate companies.

Because the alternative minimum margin tax is a minimum tax, the federal corporate income tax liability of a financial intermediary would be the greater of the alternative minimum margin tax or the federal income tax determined under Part I of the *Income Tax Act* net of foreign tax credits. Any alternative minimum margin tax paid in a year in excess of the financial intermediary's net federal income tax liability for that year could be carried back three years and forward seven years to be applied against its net federal income tax liability in excess of its alternative minimum margin tax liability for those years.

A number of technical considerations need to be resolved, for example, the definition of Canadian assets, Canadian proportion of earnings, and earnings themselves. However, it is anticipated that the technical aspects of the alternative minimum margin tax will be easier to administer than the corporate income tax on financial intermediaries, and the alternative minimum margin tax will be less susceptible to tax planning than the corporate income tax. The Committee acknowledges that it may be necessary to vary some of the technical aspects of the alternative minimum margin tax following further consultation.

Investments in after-tax and tax-sheltered assets, such as preferred shares, will no longer reduce the overall federal tax liability of financial intermediaries after the alternative minimum margin tax is implemented. Therefore, the Committee recommends:

65. That the limits on equity and real estate investment recommended in the White Paper be eliminated.

66. That the 10 per cent/5 per cent/2 per cent ownership limitations on certain listed preferred shares and taxable SFI shares be reviewed to assess whether they would still be required given the adoption of the alternative minimum margin tax.

To test the alternative minimum margin tax concept for neutrality and stability, detailed tax calculations were made for all major Canadian banks, trust companies and life insurance companies individually over a five-year period. Aggregate calculations by industry are shown in Table 16. Analysis prepared for the Committee shows that for 1986, the alternative minimum margin tax revenue paid by financial intermediaries would have exceeded $500 million. A breakdown of this amount for banks, trust companies and life insurance companies, and comparable total amounts of alternative minimum margin tax that would have been paid by financial intermediaries for the years 1982 to 1986 are contained in Table 17.

Table 16

Aggregate Ratios by Industry of Alternative Minimum Margin Tax to Pre-Tax Earnings of Canadian Operations

Year	1982	1983	1984	1985	1986
			(per cent)		
Banks	22.6	16.7	16.0	17.4	15.7
Trust companies	27.4	15.9	17.2	16.6	17.5
Life insurance companies	19	18	16[1]	15[1]	14[1]

[1] Life company reported earnings are not comparable because for reporting purposes 15 per cent of *unrealized* common stock gains (from 1984) and 10 per cent of *unrealized* real estate gains (from 1986) are added to normal realized earnings.

Investment Income Tax

The White Paper proposes to reinstitute "an improved version" of the tax on the investment income of life insurers which was in place between 1969 and 1978. This investment income tax was developed by the Carter Commission as a proxy tax to be levied at the insurance company level against the tax-free inside build-up in insurance and annuity policies.

Originally, the investment income tax, described as the Part XII tax, was 15 per cent of gross investment income less the following deductions:

- specific investment expenses;
- one-half of general insurance expenses;
- business income;
- a tax credit for one-half of provincial premium taxes; and
- taxable amounts reported to policyholders.

In turn, the Part XII tax was deductible from business income in determining corporate income tax liability.

In 1978, the Part XII tax was eliminated when a new Part I tax was enacted which was expected to yield considerable revenue. However, because of the flaws described above in the revised Part I tax, virtually all corporate income tax was forgone for life insurance companies after 1978.

Table 17

Alternative Minimum Margin Tax Illustrations

A) 1986	(millions of dollars)
Banks	
9 largest	335
Trust companies	
9 selected	83
Life insurance companies	
Domestic (34 companies)	105
Foreign (10 companies)	26
	131
Total for financial intermediaries analyzed	549

B) Alternative minimum margin tax totals by year

	1982	1983	1984	1985	1986
			(millions of dollars)		
Alternative minimum margin tax	309	412	466	500	549

In the 1981 federal budget, proposals were made to tax the inside build-up of all insurance and annuity contracts directly at the policyholder level. As a result of negotiations between the life insurance industry and the Department of Finance, the Department proposed splitting insurance and annuity contracts into two categories:

- *Exempt* policies which would have a low proportion of savings and a high proportion of risk; and
- *Non-exempt* insurance and annuity policies under which triennial reporting of accrued policy gains would take place.

Because of the nature of the products offered since 1981, almost all non-exempt policies are in a gain position by the end of the first triennial reporting period. Therefore, reporting only the gains on the inside build-up is unlikely in practice to penalize policyholders who may have accrued losses. However, most policyholders who purchase exempt policies are not in a net gain position until between 8 and 13 years after the policies are issued in the case of a whole-life policy and are never in a net gain position in the case of a term policy. Currently, there is no triennial reporting of accrued gains to the holders of exempt policies; however, in the event that an exempt policy is surrendered and a gain is realized, the owner of the policy is subject to tax on the gain at the time of disposition.

The Committee notes that if life insurers were to report both the accrued gains and the accrued losses for exempt policies triennially, there would be a revenue loss to the government.

The Committee's analysis of the proposed investment income tax on life insurance companies has led it to conclude that this tax contains a number of flaws.

Although the investment income tax is ostensibly directed towards interest income related to exempt policies, the proposal as formulated results in the taxation of margins on non-exempt policies together with surplus interest earnings which are already subject to corporate income tax under Part I of the *Income Tax Act*. If this flaw were eliminated, the Committee estimates that the potential revenue derived from the investment income tax would decline by about 50 per cent.

Even for the exempt policy class, all interest earnings are treated as gains. In practice, most policies are designed to cross-subsidize administrative expenses with interest earnings. If, rather than a proxy tax, a direct reporting of the increased accrued gains of policies which are in a gain position were made less an allowance for the fact that actual gains are reported on surrender, the effective tax base of the investment income tax would decline by about 75 to 80 per cent.

In addition, the Committee considers it unacceptable that the proposed investment income tax be applied to gross income without any deduction being allowed for related expenses. Furthermore, no allowance has been made for accrued losses on exempt life insurance policies during the first three or four triennial reporting periods.

Therefore, the Committee recommends:

67. That the proposed investment income tax on life insurance companies not be introduced.

Other Issues

Representations were made to the Committee by the credit union movement that price gains of credit union shares be eligible for capital gains treatment. Currently, all credit union shares are "income units" redeemable at par with annual earnings distributions.

Therefore, the Committee recommends:

68. That to the extent that "accumulation unit" shares are permitted in the future by the provinces, capital gains treatment be available in respect of credit union shares.

The Committee heard evidence that Blue Cross had a large proportion of the health insurance business and paid premium tax on its insurance premiums in the province of Quebec.

Therefore, the Committee recommends:

69. That the Department of Finance reconsider whether Blue Cross should continue to be exempt from income tax.

Appendix to Chapter 7

U.S. Internal Revenue Code

Section 845. CERTAIN REINSURANCE AGREEMENTS

(Sec. 845(a))

(a) ALLOCATION IN CASE OF REINSURANCE AGREEMENT INVOLVING TAX AVOIDANCE OR EVASION — In the case of 2 or more related persons (within the meaning of section 482) who are parties to a reinsurance agreement or where one of the parties to a reinsurance agreement is, with effect an agent of another party to such agreement or a conduit between related persons), the Secretary may —

(1) allocate between or among such parties income (whether investment income, premium, or otherwise), deductions, assets, reserves, credits, and other items related to such agreement,

(2) recharacterize any such items, or

(3) make any other adjustment, if he determines that such allocation, recharacterization, or adjustment is necessary to reflect the proper source and character of the taxable income (or any item described in paragraph (1) relating to such taxable income) of each such person.

(Sec. 845(b))

(b) REINSURANCE CONTRACT HAVING SIGNIFICANT TAX AVOIDANCE EFFECT — If the Secretary determines that any reinsurance contract has a significant tax avoidance effect on any party to such contract, the Secretary may make proper adjustments with respect to such party to eliminate such tax avoidance effect (including treating such contract with respect to such party as terminated on December 31 of each year and reinstated on January 1 of the next year).

Appendix to Chapter 7

U.S. Internal Revenue Code

Section 845. CERTAIN REINSURANCE AGREEMENTS

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(1) allocate between or among such parties income (whether investment income, premium, or otherwise), deductions, assets, reserves, credits, and other items related to such agreement,

(2) recharacterize any such items, or

(3) make any other adjustment, if he determines that such allocation, recharacterization, or adjustment is necessary to reflect the proper source and character of the taxable income (or any item described in paragraph (1) relating to such taxable income) of each such person.

(Sec. 845(b))

(b) REINSURANCE CONTRACT HAVING SIGNIFICANT TAX AVOIDANCE EFFECT — If the Secretary determines that any reinsurance contract has a significant tax avoidance effect on any party to such contract, the Secretary may make proper adjustments with respect to such party to eliminate such tax avoidance effect (including treating such contract with respect to such party as terminated on December 31 of each year and reinstated on January 1 of the next year).

CHAPTER 8

Federal Sales Tax Reform

The White Paper states that: "Pending the replacement of the existing sales tax with a multi-stage tax, changes to the existing federal sales tax are required to correct some of its most serious inequities and to stem the erosion of the tax base through the use of tax avoidance mechanisms." Moreover, "the government is also proposing other sales tax measures which, together with the corporate tax changes, will provide the additional revenues required to proceed with personal income tax reform in a fiscally responsible way."

The Committee concurred with a number of the concerns outlined in the White Paper regarding the current federal sales tax system. However, during the testimony of a large number of witnesses, it became increasingly clear that much more than a band-aid solution was required, if all of the serious inequities in the current federal sales tax system, which have built up over many years, are to be rectified. The testimony of many witnesses such as Canadian Tire Corporation, Limited, who stated that the current federal sales tax system "is plagued by inequities, inefficiencies and administrative complexity", was of great concern to the Committee. Thus, as its primary federal sales tax proposal the Committee recommends:

70. That parliament enact a law in 1988 to reform the existing federal sales tax system, such law to become effective as soon as possible thereafter.

Related Marketing Companies and the Shift to the Wholesale Trade Level

The White Paper proposes that the federal sales tax be applied to marketing companies related to the manufacturer. The proposal is intended to stop the erosion of the sales tax base and consequent loss of revenue that is occurring as manufacturers reduce the value of their products for taxes by setting up their own marketing companies and selling products through them. The problem derives from deficiencies recently brought to light in current legislation that authorizes the Minister of National Revenue to specify a fair price for tax purposes for transactions between related companies. One of the results is distortion of competition between manufacturers selling through related marketing companies and those selling directly to independent distributors.

The testimony before the Committee indicated that the White Paper proposal will not remedy the flaws in the federal sales tax. The nature of the distortions will merely change when the measures are introduced. The current advantage for manufacturers with related marketing companies will be turned into a disadvantage when the sales tax is also levied on the marketing and distribution costs incurred by the marketing companies. As noted by the Commodity Taxation Committee of the Canadian Institute of Chartered Accountants and the Canadian Bar Association, the new related marketing company rules "will discriminate against both Canadian manufactured goods and goods imported into Canada by a related distributor", and that "sales tax payable should be determined by the validity of the price between the parties, and not by their relationship."

It is proposed in the White Paper that federal sales tax will now be levied on such activities of related marketing companies as distribution, warehousing, advertising, promotion and technical assistance, which will not be levied on the same services provided by their competitors in respect of goods purchased from unrelated suppliers. The interim nature of this change in the application of the federal sales tax until Stage Two of tax reform is completed, with the related costs and disruptions to business, was of great concern not only to many witnesses but also to the Committee. The Committee cannot, therefore, support the proposed shift of the sales tax. However, something has to be done to stop the erosion of the tax base. It was suggested that Revenue Canada might go to the courts to have its price-setting powers reinterpreted in a way that would remove the tax advantage of sales through related marketing companies. But this seems an uncertain answer to a pressing problem. The Committee takes the view that the government should seek the power to treat such sales as avoidance transactions. A specific anti-avoidance rule should be enacted that applies to both existing and new related marketing companies and that effectively stops the tax-motivated creation of such companies.

With respect to the move of the federal sales tax from the manufacturers' level to the wholesale level for a limited range of products, the testimony before the Committee indicated that this measure would be discriminatory to the small retailer who purchases from a wholesaler, vis-à-vis his competitor the large retailer, who purchases directly from a manufacturer either in Canada or offshore. This move of the federal sales tax to the wholesale level was of particular concern to such groups as the Canadian Sporting Goods Association, who stated in their brief to the Committee that "the proposed shift of federal sales tax to the wholesale level would provide a very significant competitive advantage to large, integrated retailers (such as department stores)" and "threatens to wipe out small-town retailer profitability and thereby is considered a looming crisis to the trade." In addition, there was strong evidence before the Committee that large sectors of the business community, which would be negatively affected by this measure, could rearrange their affairs in such a way as to avoid the effects of this particular change. Thus, the government would not meet its revenue forecasts for this particular measure.

While the Committee recognizes that the White Paper proposals are designed both to prevent a significant loss of federal revenue and to obtain additional revenues, the Committee has nevertheless concluded that the proposals will create additional major inequities in the market place. Therefore, the Committee recommends:

71. That the proposals to apply the federal sales tax to marketing companies related to the manufacturer and to shift the tax to the wholesale level for a limited range of products not proceed; and that in their place a temporary federal sales tax surcharge of three per cent of taxes payable be introduced, but that this federal sales tax surcharge not be levied on the proposed tax on telecommunication services.

72. That a specific anti-avoidance rule be enacted with respect to related marketing companies.

The Committee acknowledges that these recommendations are not a perfect solution, but the Committee believes they are preferable as an interim solution pending the reform of the whole federal sales tax system.

Tax on Telecommunication Services

The White Paper proposes to extend the federal sales tax to telecommunication services, such as telephone and telex services, at a rate of 10 per cent. The basic line charge for local residential telephone service will not be subject to tax. The federal sales tax on cable and pay television services will be increased to 10 per cent from the present 8 per cent. Additional revenue from these measures is estimated to be $870 million in a full year.

The Committee heard from a number of witnesses concerning the negative overall effects of the proposed telecommunications tax on both businesses and individuals.

The Committee is concerned that the proposed 10 per cent telecommunications tax will be applied to the residential Touch-tone feature, which is of particular assistance and importance to the aged and the handicapped. Therefore, the Committee recommends:

73. That the residential Touch-tone feature be exempted from the proposed 10 per cent telecommunications sales tax.

It should be noted that the Committee has been advised by officials from the Department of Finance that residential and business subscribers will not be subject to a minimum federal sales tax charge.

Also of special concern to the Committee was the impact of the tax on telephone users in the more remote and isolated areas of Canada, who are far more dependent on long-distance telephone communications. In the 1986 report *Federal-Provincial Examination of Telecommunications Pricing and the Universal Availability of Affordable Telephone Service: Working Papers*, (Ministry of Supply and Services Canada), it is noted that there is not a significant monthly differential in expenditures made on long-distance calls originating from residential urban subscribers vis-à-vis residential rural subscribers (Table 18). However, there is a significant monthly long-distance expenditure increase between subscribers in the "remote North" as defined by Bell Canada, and subscribers in other parts of Canada, which ranged between 205 per cent and 270 per cent (Table 19). Even after taking into account the lower long-distance rates that are already charged in such regions, the Committee recommends:

74. That all telephone subscribers in the "Remote North", all of the Northwest Territories, Yukon, and other remote locations in Canada where year-round road, rail or boat links do not exist be subject to the proposed 10 per cent telecommunications sales tax on long-distance calls to a maximum of $3 per month.

Table 18

Long-Distance Charges on Average Residential Monthly Subscribers' Bills (1985 or 1986)

	P.E.I.	N.S.	N.B.	Ont./Que.	Alberta	Nfld.	Man.	Sask.	B.C.
Urban	$18.87	$20.93	$21.88	$19.26	$29.28				
Rural	$17.36	$20.62	$17.14	$21.50	$31.70				
Urban/Rural						$22.85	$13.88	$28.05	$22.74

Source: *Federal-Provincial Examination of Telecommunications Pricing and the Universal Availability of Affordable Telephone Service: Working Papers* (Ministry of Supply and Services Canada, October 1986).

Table 19

Average Monthly Long-Distance Revenue Per Network Access Service as reported by Bell Canada for 1978-84

Region	1978	1979	1980	1981	1982	1983	1984
Remote Northern Ontario	$36.79	$48.36	$54.81	$57.44	$71.71	$76.47	$89.45
Northern Quebec	$33.20	$38.10	$43.31	$48.07	$57.77	$66.34	$74.02
Northwest Territories	$43.13	$51.84	$54.78	$58.65	$67.35	$71.96	$76.43
Average company revenue	$13.83	$15.63	$17.16	$19.95	$19.79	$21.20	$24.25

Source: *Federal-Provincial Examination of Telecommunications Pricing and the Universal Availability of Affordable Telephone Service: Working Papers* (Ministry of Supply and Services Canada, October 1986).

CHAPTER 9

Accelerated Remittances

The White Paper proposes to accelerate the remittances of employee source deductions, individuals' quarterly income tax instalments, and federal sales and excise taxes.

Employee Source Deductions

The changes proposed in the White Paper apply to the remittance of deductions withheld at source in respect of personal income taxes, unemployment insurance premiums and Canada Pension Plan contributions. Starting in January 1990, larger employers with average monthly remittances of $15,000 or more will be required to remit employee source deductions four times a month. This represents a further acceleration in the payment of the remittances by such employers over the twice-monthly basis proposed in the February 1987 budget, starting in January 1988.

Some groups have indicated to the Committee that the $15,000 threshold is too low. Based on an average rate of witholding of, say, 30 per cent, this equates to an annual payroll of $600,000. Evidence provided by Revenue Canada indicated that the proposed change should only affect 45,000, or 4 percent, of the approximately 1.2 million employers making remittances.

A concern expressed by the Canadian Payroll Association was that the White Paper proposals would require prepayment of source deductions. In the case of semi-monthly or monthly payrolls, for example, the proposals were interpreted to require advance payments of the source deductions on a weekly basis. This interpretation was not intended and the Department of Finance has confirmed that the requirement to "pay weekly" is relevant only in relation to the day in the month on which the pay period ends. Therefore, as Table 20 reflects, the source deductions for a pay period will be due three days after the end of the week in which the pay period ends.

Quarterly Instalments

The White Paper proposes that, commencing in March 1990, individuals who make quarterly instalment payments of tax will be required to pay their instalments on

Table 20

Acceleration of Employee Source Deductions

Pay period ending during days of the month	Remittance Due Dates: Current system (until end of 1987)	February 1987 budget proposals (1988 and 1989)	White Paper (1990 on)
1st - 7th	15th of next month	25th of current month	10th of current month
8th - 14th	15th of next month	25th of current month	17th of current month
15th - 21st	15th of next month	10th of next month	24th of current month
22nd - last	15th of next month	10th of next month	3rd of next month

the 15th of March, June, September and December instead of at the end of each of these months.

A concern has been expressed by some senior citizen groups that interest earned on Canada Savings Bonds (CSBs) should be excluded from the calculation of tax instalments. The main argument is that the interest is only paid annually and consequently, this creates financial difficulty for seniors to pay tax instalments on a quarterly basis. The most recent Taxation Statistics (1984) published by Revenue Canada, Taxation indicate that bond interest (not restricted to CSBs) accounts for approximately 14 per cent of the income of individuals over 64 years of age, while the average tax paid by seniors was about $3,500. *Forum des citoyens âgées de Montréal* estimated that bond interest accounts for approximately six per cent of a senior's income, while bank interest accounts for 20 per cent. As it appears that CSB interest is not a significant portion of seniors' investment income, the Committee has concluded that it would not be appropriate to provide special rules for tax instalments on CSB interest.

Sales and Excise Taxes

Currently, collectors of sales and excise taxes are generally not required to remit the tax until the end of the month following the month in which goods are sold, although the liability to pay the tax arises when the sale is made. Certain collectors are allowed to remit these taxes quarterly or semi-annually.

To improve the government's cash flow and to benefit from a one-time revenue gain of $1.6 billion, the White Paper proposes that, commencing with sales in April 1988, taxpayers with average monthly sales and excise taxes payable of $1 million or less, remitting on a monthly basis, will be required to remit taxes by the 21st day of the month following the month in which the goods were sold. Taxpayers currently remitting on a quarterly or semi-annual basis will be required to make the remittance by the 21st day of the month following the quarter or six-month period in which the goods were sold.

Taxpayers whose average monthly liability for sales and excise taxes exceeds $1 million will be required to make payments on a semi-monthly basis. This proposal will affect fewer than one percent of taxpayers.

Recognizing the need for improved cash flow for the government, the Committee agrees with the White Paper proposals accelerating the remittances of employee source deductions, individuals' quarterly income tax instalments, and federal sales and excise taxes.

Method of Making Remittances

Historically, when a taxpayer made a remittance to Revenue Canada, it was deemed received by Revenue Canada on the day it was mailed. The February 1987 budget proposed that amounts remitted after 1987 would be deemed received on the day the Receiver General for Canada actually received the remittance. Given the Committee's acceptance of the proposals for accelerated remittances, which in the case of employee source deductions will be due three days after the end of a pay period, it does not appear appropriate for taxpayers to have to ensure that their remittances are received by the Receiver General by the due date.

Consideration should therefore be given to allowing taxpayers to make all forms of remittances to the Receiver General for Canada through members of the Canadian Payments Association (e.g., chartered banks, trust companies etc.) with any costs associated with making payments in this fashion being borne by the government. Provision should then be made to deem that payment is received by the Receiver General at the time the taxpayer makes the payment to a member of the Canadian Payments Association.

In view of the proposals for accelerated remittances to enhance cash flow for the government, the Committee recommends:

75. That a formal system, financed by the government, should be established to allow for members of the Canadian Payments Association to be recognized as authorized tax collection agents of the government.

76. That payments made by taxpayers to the Receiver General for Canada should be deemed to be received when paid to a member of the Canadian Payments Association.

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CHAPTER 10

Tax Avoidance and Compliance

General Anti-Avoidance Rule

Few subjects in the White Paper attracted as much attention as the proposed general anti-avoidance rule. The Committee heard strong objections to the introduction of this proposed rule from groups such as the Canadian Organization of Small Business, Canadian Federation of Independent Business, Canadian Bar Association, Canadian Petroleum Association, the Canadian Institute of Chartered Accountants, Retail Council of Canada, and the Canadian Cattlemen's Association. Other organizations such as the Canadian Federation of Labour approved of the government's introduction of the proposed general anti-avoidance rule.

The Existing Law and the Stubart *Decision*

The Income Tax Act contains more than a dozen specific anti-avoidance provisions to counter tax evasion and avoidance arrangements. In addition to these specific measures, the Income Tax Act contains general anti-avoidance rules, one of which is contained in subsection 245(1):

> 245(1) Artificial transactions. – In computing income for the purposes of this Act, no deduction may be made in respect of a disbursement or expense made or incurred in respect of a transaction or operation that, if allowed, would unduly or artificially reduce the income.

This provision has been the subject of extensive judicial interpretation, which has focussed on the meaning and scope of the words "artificial" or "undue". For example, the Supreme Court of Canada in *Stubart Investments Limited* v. *The Queen* rejected Revenue Canada's assertion that a transaction could be disregarded for tax purposes where no "business purpose" existed. The court developed three broad interpretative guidelines to enable other courts to interpret tax legislation. The first rule provides that where the facts reveal no bona fide business purpose for the transaction, subsection 245(1) may be found to be applicable depending on all the circumstances of the case. The third guideline further provides in part, that the formal validity of a transaction may be insufficient where the provisions of the *Income Tax Act* necessarily relate to an identified business function. Commenting in the *Stubart* case on the effectiveness of these rules in countering tax avoidance, Mr. Justice Estey said:

"These interpretative guidelines, modest though they may be, and which fall well short of the bona fide business purpose test advanced by the respondent, are in my view appropriate to reduce the action and reaction endlessly produced by complex specific tax measures aimed at sophisticated business practices, and the inevitable, professionally-guided and equally specialized taxpayer reaction." (*Stubart Investments Limited* v. *the Queen*)

The Proposed Law

The White Paper states that the current law is "inadequate to deal with a number of blatant tax avoidance arrangements," and it contains a new statutory provision. Generally speaking, this new general anti-avoidance rule in subsection 245(1) will provide that an avoidance transaction, as defined, must be ignored for tax purposes. A taxpayer's tax position will be determined without reference to the transaction, and the White Paper states that it is intended to be a "provision of the last resort" and not an "alternative to other specific anti-avoidance provisions". For the purposes of the new rule, an avoidance transaction will be defined in a way that introduces a statutory business purpose test and the statutory concept of a "step transaction" into Canadian tax law. The White Paper also states that the Minister of Finance believes a penalty for participation in an avoidance transaction is desirable and that the calculation of the penalty could be based on a specific percentage of the amount of tax deferred, avoided or reduced in a taxation year as a consequence of the avoidance transaction.

The White Paper emphasizes that the enactment of the proposed section 245 has a number of benefits. It is not intended to interfere with legitimate commercial and family transactions. Furthermore, this rule is expected to protect the tax base and the fairness of the tax system and to eliminate the need for certain specific anti-avoidance rules that may now be deficient or have seldom been applied.

Representations to the Committee

The various briefs and testimony of the witnesses reflected two types of criticisms. Overall, many witnesses and briefs argued that there is no need for the proposed general anti-avoidance rule because it will create significant difficulties and uncertainty for Canadian business. Of particular concern was the proposed introduction of a statutory business purpose test. Specific criticisms also focussed on the language of the proposed rule and the possible application of penalties to avoidance transactions.

The following is a summary of the critical testimony about the proposed general anti-avoidance rule and the reasons advanced why the introduction of a statutory business purpose test would be inappropriate:

(a) The proposed rule could disallow certain transactions that otherwise are consistent with the object and spirit of the *Income Tax Act* because these transactions expressly lack a business purpose and are designed to serve only a social or economic purpose.

(b) In the *Stubart* case, Mr. Justice Estey rejected the proposition that the courts should develop the independent or bona fide business purpose test as a canon of construction of tax statutes and stressed the need for a more appropriate

principle of interpretation that requires a determination of the "object and spirit" of a statutory provision. Witnesses argued that this test was adequate and that the three Stubart guidelines are sufficient together with other established canons of construction such as "sham" and "ineffective transaction" to counter tax avoidance.

(c) There will be a climate of uncertainty for all taxpayers because the repeal of the existing ss.245(1) may force the courts to abandon their reliance on established jurisprudence relating to phrases used in this subsection and modify existing practices of interpretation. Some witnesses expressed concern about the willingness of the courts to interpret new terms based on the explanatory notes attached to the White Paper because, in previous years, these documents have not been used by the courts as an aid to interpretation. Even if the courts chose to do so, recourse to these documents would only occur in the event there was an ambiguity or a conflict in the plain meaning of a provision. Similarly, the courts may only use a "general purpose" subsection in a tax statute such as ss.245(6) as an interpretative aid to assist in explaining the "purport and object" of a substantive provision such as ss.245(1). New terms such as "artificial tax avoidance" and "primarily for a business purpose" would require clarification. All of these factors would force both taxpayers and Revenue Canada to wait for several years until superior court decisions are released on specific aspects of the proposed rule. This was confirmed by Mr. Perry Anglin, Assistant Deputy Minister, Legislative and Inter-Governmental Affairs Branch who testified that: "Until we see the framework within which any of these terms ends up, and until we have actual cases and legal advice from the Department of Justice, it is very difficult for us to tell you what any one of these terms is going to mean."

(d) Compliance costs for taxpayers and the government will increase substantially. For example, taxpayers will likely not proceed without advance rulings from Revenue Canada which may, in turn, require additional personnel to service this need. The time required to obtain rulings may also increase. The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants concluded: ". . . the abrupt introduction of such a wide sweeping general anti-avoidance provision would have a significant effect on commercial transactions in Canada."

(e) The constitutionality of the proposed rule may be challenged as being void for uncertainty, contrary to the rule of law, or inconsistent with the Charter of Rights and Freedoms. The Committee was advised that, prior to 1984, the Income Tax Act contained another general anti-avoidance section (s.246) which contained broadly cast terms that were believed to be inconsistent with the Charter. Before the merits of this position were ever litigated, the government voluntarily withdrew s.246.

(f) The proposed rule appears to fall outside the spirit of the Declaration of Taxpayer Rights which specifically allows a taxpayer to arrange his affairs to pay the minimum amount of tax. The Canadian Federation of Independent Business told the Committee that: "The general anti-avoidance rule if implemented would reduce the Declaration of Taxpayer Rights to a farce. The solid parliamentary work which served to stop the abusive behaviour of Revenue Canada will quickly be forgotten should this measure take effect."

(g) In jurisdictions such as Britain and the United States, the courts, rather than the legislative branch, developed a business purpose test. This approach allowed taxpayers to become accustomed gradually to the rule.

(h) Although the existing laws and judicial pronouncements are adequate, Revenue Canada and the Department of Justice have not exercised their present powers under the Act to the fullest extent the existing law provides. The Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants submitted to the Committee that in their view: "If there is a deficiency in the present ability of the government to defeat artificial transactions it is not really in the law, but in our view it is an apparent unwillingness or inability of the Department of National Revenue and the Department of Justice to use the available tools to enforce the law."

Officials of the Department of Finance testified to the Committee that the enactment of a new general anti-avoidance provision is necessary. They submitted that specific rules are not effective in countering tax avoidance for three reasons: specific anti-avoidance rules create large problems of perceived unfairness in the public at large, since transactions which are completed or nearly completed are often grandfathered when the new rule is introduced; specific rules add complexity to the Act; and specific rules are often little more than roadmaps to sophisticated taxpayers who quickly contrive new means to circumvent the law.

The Department also believed that the new general anti-avoidance rule was required because the guidelines set out by Mr. Justice Estey in the *Stubart* case were not founded on a business purpose test. Mr. Allan Short, General Director, Legislation, said: "What we are attempting to do is by legislation ensure that the business purpose test which really is the same in the United States as in the United Kingdom will apply in Canada so that a transaction that has no purpose other than a tax avoidance purpose will not be recognized". He cited the "capital dividend account strips" and commodity straddles as examples of transactions that might be the subject of the proposed rule.

Recommendations

In this Report the Committee has already endorsed the adoption of specific rules to stop certain transactions. The Committee however believes that there is also a clear and urgent need for the government to adopt a more effective general anti-avoidance rule to complement these other specific anti-avoidance rules. The inability of government to effectively stop tax leakage under the current rules is amply demonstrated by the constant stream of press releases announcing new rules to close loopholes which are emerging with ever greater frequency as tax law becomes more and more complex. Unfortunately, specific rule changes generally serve to close the gate after the horse has bolted. Although the Committee believes that specific anti-avoidance rules are required, it also acknowledges that the proliferation of specific rules increases the complexity of tax laws and the possibility that they may be deficient in stopping all possible manipulations of a particular provision. The continuous correction of tax laws through the publication of press releases with specific anti-avoidance rules also provides an unnecessary advantage to persons who have readier access to this information, and it penalizes those who must become aware of future changes to the *Income Tax Act* by reading the newspaper.

Nevertheless, in spite of this need for an effective general anti-avoidance rule as a means of increasing fairness and stabilizing government revenue, the Committee does not believe that the general anti-avoidance rule proposed by the White Paper provides the ideal means for stopping artificial tax avoidance arrangements. The Committee accepts the views of various witnesses that the introduction of a statutory business purpose test would result in considerable uncertainty and would disrupt the business community. The Committee also recognizes that the business purpose test may run counter to the legislative intent of the *Income Tax Act* that serves as an instrument of socio-economic policy as well as a device to raise revenue to meet the cost of governing the community. The introduction of a business purpose test could inhibit a taxpayer from undertaking the specific activity which, in the words of Mr. Justice Estey, "... Parliament has invited in order to attain economic and perhaps social policy goals." Moreover both the Department of Finance officials and tax practitioners have been unable to advise the Committee that even the proposed subsection 245(1) found in the White Paper, which contains a business purpose test, would have been effective in preventing such "avoidance schemes" as the "Little Egypt Bump", or the "Skytrain" financing. Furthermore, the Committee takes note of the comments of Mr. Justice Estey in the *Stubart* case that the "object and spirit" approach to interpretation and the other broad interpretative guidelines, rather than a business purpose test, will provide "uniformity of application of the Act across the community, and at the same time reduce the attraction of elaborate and intricate tax avoidance plans, and reduce the rewards to those best able to afford the services of tax technicians."

The Committee, however, perceives that certain transactions may be "artificial or undue", but may escape the grasp of the interpretative guidelines enunciated by Mr. Justice Estey in the *Stubart* decision. Consequently the Committee has concluded that the existing general anti-avoidance rule in subsection 245(1) should be broadened to remedy some technical deficiencies within it. Thus, the Committee believes that the problem with the existing subsection 245(1) is not its lack of a "business purpose test" but the narrow scope of its application. For example, the existing subsection 245(1) only applies to "deductions" that would reduce "income" and not to a host of avoidance transactions that result in a decrease of "taxable income" or "tax payable" through claims for deductions or other means.

The Committee has also concluded that the existing subsection 245(1) should not be a provision of last resort but would be effective together with specific anti-avoidance rules to stop artificial tax avoidance transactions if the wording in the existing subsection 245(1) and other specific rules were broadened. The Committee acknowledges that the proposed wording for section 245 in the White Paper assists considerably in this regard because it refers to deductions from "taxable income" and "tax payable." New concepts, however, such as the business purpose test do not appear to be required. A broadly cast anti-avoidance rule based on the presence of established legal principles and expressions such as "artificial or undue" should provide Revenue Canada with the needed tools to counter artificial tax avoidance. It will not increase uncertainty and compliance costs for taxpayers. The Committee anticipates that the Canadian courts will continue to follow the *Stubart* guidelines and curtail tax avoidance by also relying on such concepts as "sham" or "ineffective transaction" and by insisting that taxpayers interpret a provision of the *Income Tax Act* based on its "object and spirit".

The Committee advocates the adoption of a general anti-avoidance rule that differs from the provision contained in the White Paper. The rule proposed by the Committee modifies the White Paper provision by:

(a) dropping the word "significant" from the definition of avoidance transaction so that any artificial or undue deferral of tax, for example, could be considered an avoidance transaction;

(b) stressing the need for an avoidance transaction to result from an "artificial" or "undue" reduction, deferral or refund of certain amounts;

(c) eliminating the need for a business purpose test in a transaction or series of transactions because the test is not suitable for the structure of the Income Tax Act that now serves as an instrument of socio-economic policy;

(d) limiting the definition of "avoidance transactions" to only certain transactions;

(e) eliminating the phrase "notwithstanding any other provision of the Act" in proposed subsection 245(1) in the White Paper to ensure that transactions specifically endorsed by other provisions of the *Income Tax Act* are not set aside even if they result in an artificial or undue reduction or deferral of taxes. Consequently, claims for capital cost allowance or charitable donations and "rollovers" or tax-deferred transfers should not be affected;

(f) providing the Minister with the discretion to decide whether to apply the proposed anti-avoidance rule after having concluded that an avoidance transaction affected the income, taxable income or tax payable of a person; and

(g) providing any other person affected by a determination of the Minister with the right, without request, to receive notification of the determination by the Minister and to appeal this action of the Minister.

In summary, the Committee's proposed language will serve important functions that the White Paper fails to accomplish. This new rule should permit Canadian business transactions to proceed with reasonable certainty, while protecting the ability of the tax system to yield predictable and reliable revenues. Only transactions that smack of artificiality will fail. The Committee believes that its proposed general anti-avoidance rule will contribute to the evolution of the existing law in this area and urges that any deficiences now present in specific anti-avoidance rules should be remedied.

Therefore, the Committee recommends:

77. That the form of the general anti-avoidance rule proposed by the White Paper not be adopted and the following substituted therefor:

General Anti-Avoidance Provision

"245(1) The Minister may ignore the consequences of an avoidance transaction and may reasonably determine the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act, having concluded that such amount had been determined as a consequence of an avoidance transaction.

Avoidance Transaction

(2) An avoidance transaction means:

(a) any transaction that results in an artificial or undue reduction, deferral or refund of tax or other amount payable under this Act; or

(b) any transaction that is part of a series of transactions or events, which series results in an artificial or undue reduction, deferral or refund of tax or other amount payable under this Act.

Interpretation

(3) For the purposes of this section, "transaction" includes an arrangement, scheme, or event.

Adjustments in the course of a Ministerial Determination

(4) To make a reasonable determination under subsection (1) of the income, taxable income, tax payable or other amount payable of or refundable to any person under this Act, the Minister may:

(a) disallow in whole or in part any deduction in computing income, taxable income, or tax payable or any part thereof;

(b) allocate any deduction or any income, loss or other amount or part thereof to any other person; and

(c) recharacterize the nature of any payment or other amount.

Adjustments by the Minister to Prevent Double Taxation.

(5) The Minister, in order to eliminate double taxation, shall make any adjustment to income, taxable income, tax payable, or other amount payable or refundable under this Act of any person other than a person referred to in subsection (4), and the Minister shall notify the other person of the adjustment within 90 days of the day of mailing of any notice of assessment to the person referred to in subsection (4) for the year in which the avoidance transaction occurred.

The Committee also does not agree that a penalty should be imposed on a taxpayer for tax avoidance given the established principle in the *Income Tax Act* that penalties should only attach to wilful evasion or gross negligence. The Committee also perceives that the existing penalty provisions of the Act and the imposition of a non-deductible interest expense at a rate compounded daily sufficiently deter artificial tax avoidance.

Therefore, the Committee recommends:

78. That no specific penalties be applied to taxpayers who participate in an avoidance transaction as defined in proposed section 245.

Penalties

The White Paper, in an attempt to ensure better tax reporting, proposes to introduce some new penalties, amend other penalties and amend certain fines.

There will be new penalties in connection with dishonoured cheques, failure to report income, and late or deficient instalment payments. Commencing in 1988 a new $10 penalty will be assessed for any cheque given to Revenue Canada, Taxation, that is not honoured. Where there is a failure to report income which results in an understatement of tax liabilities but not as a result of a false statement or omission, a penalty of 25 per cent of the tax understated will apply. This new penalty will only apply to the second "failure to report" in a three year period.

A significant new penalty has been introduced with respect to late or deficient instalment payments. Currently, interest is charged on late or deficient instalments. Commencing in 1989, the White Paper proposes to assess an additional penalty of 50-per-cent of the interest charged. This measure essentially allows Revenue Canada to charge interest at one-and-a-half times the prescribed rate on deficient instalments, while paying interest on any overpayments at the prescribed rate. This concept is unfair, particularly when it is considered that instalments are estimates, and the amount due in a particular year may be impacted by a subsequent year's reassessment. For example, a taxpayer may pay tax instalments based on an estimate of current taxes. Initial assessment of their tax return may confirm these calculations and no interest or penalties would be payable. Up to three years later, an audit of the return may be done resulting in an increase in the tax originally assessed. Under the White Paper proposals, such an adjustment would result in interest being charged on the deficient instalments at one-and-a-half times the prescribed rate.

While the Committee supports in principle attempts to improve tax reporting, it recommends:

79. That the 50 per cent penalty on interest on late or deficient installments not be implemented.

A number of penalties will be amended, with the intent being to consolidate some existing penalties and to generally increase the amount of such penalties. Amendments are proposed in generally the areas of failure to file certain returns, or failure to withhold or remit certain amounts. The amendments make two major thrusts: (1) the imposition of a "two-tier" style penalty, and (2) the general increase in the amount of the penalty. The "two-tier" element is a new concept where the maximum penalty will not be assessed on the first ocurrence of an infraction, but will generally only be imposed on the second ocurrence of a similar infraction within a three-year period. The rates of penalty on the second ocurrence generally represent a significant increase over the current penalty.

The level of fines will also generally be increased for failure to comply with such sections of the *Income Tax Act* as tax evasion.

Certain briefs submitted to the Committee felt that the increase and amendments to penalties and fines were excessive, particularly when the complexity of filings is considered. As most significant fines are assessed for serious offences under the *Income Tax Act*, combined with the new "two-tier" concept on many penalties, the Committee except as noted supports the amendments to the penalties and fines provisions as proposed in the White Paper.

CHAPTER 11

Tax Reform and Tax Simplification

Review of the White Paper has once again brought the Committee face to face with the extraordinary complexity of the Canadian tax system. The extent of this complexity and the need for simplification were brought out in many of the briefs and hearings. The chairmen of the Joint Committee on Taxation of the Canadian Bar Association and the Canadian Institute of Chartered Accountants appeared before the Committee and linked the inherent complexity in the system and the need for simplification.

> . . . the very fact that the system, by its nature, must be complex only emphasizes the need that the various elements be so carefully crafted to be as simple as possible in the circumstances, and . . . that is a very important point.

The White Paper obviously agrees with the need for simplification and lists it as one of the goals of tax reform. The next section of this chapter lists those areas in which the White Paper has attempted to simplify the tax system. Unfortunately, although there are some simplifications in the proposed system, there are additional complications. Moreover, the simplifications are in the nature of modest pruning of a bush that has been allowed to run wild.

The White Paper and Tax Simplification

One of the five stated objectives of tax reform was simplicity, which the White Paper explains as follows:

> A simpler tax system will ease compliance and reinforce the self-assessment principle that is the foundation of our tax system.
>
> In a society as advanced and diverse as Canada, the tax system will, of necessity, be complex. But it can be made easier for individuals to understand and for businesses to comply with. A simpler structure of tax rates on income and fewer invidious borders between products taxed differently under the sales tax will contribute to meeting this objective.
>
> A tax system with fewer special preferences will also be more straightforward and more readily understood by Canadians.

The Minister of National Revenue appeared before the Committee in early October and also acknowledged the importance of simplification for Canadian taxpayers. He pointed out the attempts of his Department to improve the readability of tax forms, guides and related documents — work that is laudable but not directly related to proposals for a reformed tax system.

The claim of the White Paper that the tax system will be simpler with reform is based, in part, on the reduction in the number of tax brackets from ten to three. As the Economic Council of Canada pointed out, however, in its brief to the Finance Committee:

> Reducing the number of personal tax rate brackets to three does little to simplify the tax system; the complexity of the tax system derives more from the definition of the tax base than the number of tax brackets.

The Report on Tax Simplification

By the nature of its work, the Committee has long been interested in the simplification of the Canadian tax system, regularly examining ways and means motions and analyzing specific proposals that would require changes to the tax laws of this country. The complexity of existing tax laws and the increasing complexity of proposed changes to laws make analysis difficult.

In June 1986 the Committee issued the report *Tax Simplification* which concentrated on the personal income tax system. Research for that report exposed a tax system that baffled even acknowledged experts in tax accounting and tax law; one expert suggested that the Canadian Income Tax Act was "becoming unworkable," and another referred to it as "an unmitigated mess."

Faced with this problem, lawmakers must struggle to compare the intent of tax changes with their probable effects. Attempts at patching up the legislation and eliminating unintended consequences often lead to a more complicated tax system, with greater uncertainty for the tax filer. The patchwork legislation leads, of course, to its own unintended consequences and further patching.

Review of the personal income tax system convinced the Committee that the tax system must be simplified. The Committee concluded that:

> . . . the trend, which has taken place for a generation, whereby the tax system becomes more and more complicated with each Budget must be reversed. People must be able to read and understand the *Income Tax Act*. Citizens must be able to read and understand the tax forms they are required to submit.

In an effort to provide some guidance for tax simplification, the Committee's report included the following recommendations:

1. That the Government make no changes to the income tax system without first examining the possible complexity these changes would introduce to the *Income Tax Act* and the tax forms.

2. That the Government now begin examining measures that can be introduced to reverse the trend in the tax system that seems to make it more complicated with each Budget.

3. That the tax system should be used to promote equity or growth only if no other method is simpler or less costly.

4. That Revenue Canada employ a team to redraft the current *Income Tax Act* to make it readable and understandable.

5. That the redrafting team follow the example of Quebec and make the federal Act at least as understandable as the Quebec *Income Taxation Act*.

6. That the redrafting team consider the following arrangement for each topic covered in the Act:

   a) set out the general rule in one provision;

   b) set out in subsequent provisions the sequence of the exceptions, qualifications, special rules, administrative provisions and definitions;

   c) put the provision with the broadest application before those dealing with special cases;

   d) put more important provisions before less important ones;

   e) follow with technical housekeeping and administrative provisions; and

   f) put detailed rules and explanations in the regulations, using examples when appropriate.

7. That if the redrafting team discovers major drafting problems that seem to be caused by relatively minor tax measures, these tax measures should be brought to the attention of this Committee and the Minister of Finance who should consider the advisability of eliminating these measures or modifying them to simplify the drafting of the Act.

8. That future proposals to change the Act should consider the implications on drafting.

9. That although drafters should not determine economic and social policy, they should have an early voice in any discussion of proposed tax legislation and should always be involved in the process leading to a change in the Act.

10. That the Government review the current package of exemptions, deductions and special tax measures to see whether the benefits from these can be provided in a simpler manner, by some method outside of the tax system, or by adjusting tax rates or general exemptions.

11. That Revenue Canada examine the possibility of introducing a questionnaire tax form for the 1986 tax year.

12. That wherever possible Revenue Canada eliminate lines from the tax return and tax guide by incorporating the implicit calculation for exemptions or deductions in the tax table.

13. That the Minister of Finance consider the advisability of amending the *Income Tax Act* to allow spouses the opportunity of filing joint income tax returns.

14. That Revenue Canada, with counsel from the Department of Finance and Statistics Canada, review its tax statistics and attempt to correct any bias that may exist in the recording of total, net and taxable income.

These recommendations are still applicable, and the Committee believes that following them would produce a far simpler and much improved tax system. It is understandable, however, that there is some resistance to adopting them, because they appear to call for the complete revamping of the income tax system, a project that would need large investments of time and money. It is easy to delay beginning such a large project, as Revenue Canada and the Department of Finance have immediate concerns that demand their attention and use up their budgets.

The Committee suggests that a pilot project, aimed at a complicated part of the *Income Tax Act*, would show the usefulness of the recommendations. One source of great complexity in the current tax system is the rules of attribution (the process by which one member of a family attributes income to another family member). Simplifying these rules would be a large step towards showing that the tax system can be made less complicated.

Therefore, the Committee recommends:

80. That, as a pilot project, the relevant government departments form a group to follow the recommendations of the report *Tax Simplification* and simplify the sections of the tax system dealing with attribution rules.

The analysis of tax reform in this Report is of course much broader than tax simplification by itself. Nevertheless, this Committee also attempts to discover needless complications in the White Paper and to suggest modifications or alternatives.

The Personal Income Tax System

Not all taxpayers are affected by each change to the personal income tax system. The numbers who will be affected by some of the proposed changes are estimated in Table 21.

While the table does not list all the changes to the personal income tax system, it does highlight the range of filers covered by the proposed reform. Not all the changes in the table are simplifications. The revisions to the treatment of capital gains and the new treatment of farm income and losses certainly add complexity to the system.

Transfers of Exemptions and Credits to Related Taxpayers

The proposed changes should also simplify transfers between spouses. The exemptions and deductions eligible for transfer include:

- the spouse's age exemption;
- the spouse's disability deduction;
- the spouse's education deduction;
- the lesser of (a), the sum of the pension income deduction and the investment income deduction, and (b) the unclaimed amount of the basic married exemption.

Table 21

Scope of Tax Reform

Change in Tax System	Number Affected[1]
Reduction of the number of tax brackets	Over 10 million
Employment expenses deduction	Over 11 million
Interest and dividend income deduction	Over 7 million
Restrictions on home-office expenses	(2)
Elimination of forward averaging	30,000
Elimination of block averaging (for farmers and fishermen)	Part of 500,000 farmers and fishermen (about 4% per year)
Treatment of capital gains	Over 1 million
Restrictions on automobile expenses	(2)
Treatment of farm income and losses	Over 500,000
Replacement of deductions and exemptions by credits	Almost all (over 15 million)

1 Based on 1984 tax statistics.
2 It is not possible to estimate the number of those now claiming these expenses who will be affected by restrictions.

These items are reduced by the amount by which the spouse's net income exceeds his or her basic personal exemption. Over half a million taxfilers claimed transferred deductions or exemptions.

Under the proposed system, the unused portion of the following credits will be transferable: age credit, pension income credit, disability credit, and tuition and education credits. A parent or grandparent may also claim the transfer of the unused portion of disability, tuition and education credits. In all the cases, the amount of the federal credits transferable will be reduced by 17 per cent of the excess over $6,000 of the net income of the transferring spouse or related child (at $6,000, the tax on the net income of the spouse or child equals the basic personal tax credit for a single person).

Claiming the transferred items is now complicated; the necessary calculation takes an entire page of the income tax return. With the proposed tax system the calculations will be simpler, but they still may drive filers to tax preparers.

Capital Gains

The lifetime capital gains exemption, which was introduced in 1985, now has a limit of $100,000, except for farmers and small businesses. The eligibility of certain assets for the capital gains exemption has also changed. When treated differently from other income, capital gains always produce a complicated income tax system. The proposals relating to cumulative net investment losses add complexity to the calculation of the lifetime capital gains exemption. As noted above, the formula is not as complex as it might have been. However, the White Paper proposals could lead to more confusion and uncertainty, elements that add to the frustration of the tax filer who sees little stability in the treatment of capital gains and may wonder about the fairness of the system.

Farmers

Since the beginning of federal income taxation in Canada, farmers have used a cash accounting system; the White Paper proposes they use a modified accrual system. While there may be reasons for the switch, simplicity is not among them. Some accounting firms and several briefs submitted to the Finance Committee identified problems with the wording in the new accounting proposal. The accounting firm Peat Marwick, for example, asked the following questions that were prompted by the original presentation in the White Paper:

> . . . how does a dairy man compute the cost of a heifer calf born to one of his cows which will be raised as a replacement animal? Should any of the feed the cow consumed during the gestation period be factored into the cost of the calf when the cow was owned primarily for her milk producing ability? Should the cost of the cow be amortized over the expected number of calves she can be expected to produce during her lifetime? What do you do if the cow gives birth to a bull calf which is generally less desirable than a heifer calf? What overhead should be allocated to the cost of the calf and the raising of the calf?

Requests for clarification of some points in the White Paper led the Department of Finance to issue an information bulletin on 31 August 1987. One of the areas covered was modified accrual accounting rules for farmers:

> Farmers who choose to value their inventory at the lower of cost or market value may consider the cost of crops grown by the farmer or animals born on the farm to be nil, effectively giving a cash basis write-off, rather than allocating direct and indirect costs of the farm operation to their cost, and deferred cash tickets received by grain farmers will be considered to be an account receivable, with the result that the amount of the deferred cash ticket will be eligible for the proposed cash basis adjustment that may be claimed to reduce positive farm income to nil.

These and other clarifications answered some of immediate questions raised by the White Paper proposals, but they indicate the complexities in the proposed changes to the tax system.

It is easy to foresee a series of patchwork revisions to the system in the future—first revisions to eliminate some technical flaws and loopholes and then new revisions to eliminate the new loopholes. This has been the history of change in taxation for most of the postwar period; the proposed reform, despite paying lip-service to the objective of simplification, does not alter the system enough to reverse the trend toward greater complexity.

Conversion to Credits

Less than 10 per cent of tax filers will be affected by the changes in the treatment of capital gains or farm income. The conversion of exemptions and deductions to credits, on the other hand, affects almost all filers.

The conversion to credits was made primarily on grounds of equity, and its effect on simplicity is not clear-cut. Some of the more simple conversions involve replacing a

fixed deduction with a fixed credit (for example, the $1,000 pension income deduction becomes a $170 credit). Others involve multiplying the previous deduction by 17 per cent (for example, the tuition credit will become 17 per cent of allowable tuition expense), which are slightly more complicated. One observer remarked that Canadians will soon be very adept at using the 17-times multiplication table.

In the case of charitable contributions, there is an additional complication in that the calculation of the deduction can take two steps. Members of the Committee were also interested in how the new treatment of charitable contributions might affect charitable giving and government revenue. The Committee believes that the new system will improve charitable giving, but it did note as an important concern that the two-tier approach to calculating the credit was much more complicated than the current one.

Alternative Minimum Tax

In 1985 the government introduced the alternative minimum tax (AMT). There are two reasons for a minimum tax. The first is to prevent excessive use of tax preferences whereby Canadians with high incomes pay little or no tax. The second reason is to prevent future erosion of the tax base.

Although the goals of a minimum tax are laudable, the AMT in practice has introduced two significant problems into the tax system. As many experts pointed out to the Committee, during its previous work on tax simplification and during the current analysis of the White Paper, the AMT is extraordinarily complicated. It affects many sections of the *Income Tax Act* and necessitates multiple calculations for those who might be affected by it.

The second problem is that the AMT may catch only the unwary, namely those who do not have access to sophisticated tax planning advice. Some taxpayers, for example, who have received a capital gain and claimed it as part of the lifetime capital gains exemption could have to pay the AMT, as could taxpayers who transfer pension benefits or retiring allowances into a registered retirement savings plan. Other taxpayers may restructure their transactions to avoid the AMT. With the AMT, therefore, the tax system treats different high-income Canadians differently; and those who come out second best are the unwary and the unsophisticated.

One thrust of tax reform has been base broadening by the elimination of tax preferences, especially those used extensively by high-income Canadians. The recommendations in this Report support that thrust. In fact, the proposals in the White Paper as modified by the recommendations in this Report would go quite far towards eliminating the tax preferences that offerred high-income Canadians the most scope for lowering their taxes. By 1990, some others that now remain will have been phased out.

In other words, tax reform can be seen in part as a substitute for a minimum tax. There is thus a good reason for reviewing the need for a minimum tax, if tax reform as outlined in this report is put in place. In terms of simplification, moreover, there are very good reasons for eliminating the AMT.

Therefore, the Committee recommends:

81. That once the tax system as outlined in this Report is put in place and enough time has passed for the reform to be fully phased in, the Minister of Finance should review the need for the alternative minimum tax.

Tax Forms

The ever-increasing complexity of the Tax Act is reflected in the returns filed by Canadian taxpayers. Preliminary estimates for 1986 show that 42 per cent of tax filers received help in preparing their returns (28 per cent used professional tax preparers and 14 per cent used other help, such as a friend, relative or social group). Over one-fifth of those filing the T1 Special Form, which is a four-page form for those with relatively straightforward reporting requirements, used outside assistance. In recent years the proportion of those using assistance with their filing has increased. Moreover, those who do not use assistance must struggle with a complicated form whose guide directs the taxfiler to other pamphlets and interpretation bulletins.

When the Minister of National Revenue appeared before the Committee he brought two versions of what a 1988 T1 General Form might look like; an official from the Department emphasized that "the two packages are obviously not entirely complete as there are still some rough edges on some of the proposals." The 1988 forms did have slightly fewer lines than the 1986 forms, but as the Committee went through the sample forms, it became obvious that the average taxpayer would find the proposed system as complicated as the old.

It is true, of course, that *any* new tax system would produce problems for filers, especially in the year the new system takes effect. This is because many filers use their returns from the previous year to aid in filling out the return for the current year. The transition to a new system means that previous returns can no longer be used as a guide. In time, transitional problems will fade and the significant differences in the complexity of the two systems will stand out.

The Committee concludes that the new forms have not been simplified and will not lower the number of filers who pay for the services of tax preparers.

The Corporate Income Tax System

Corporations often use specialists in tax accounting and tax law, and moderate tax simplification will not lead to mass unemployment of these professionals. As the White Paper points out, a society as advanced and diverse as Canada will have a complex tax system. Unfortunately, society's diversity is often exaggerated and used to rationalize needless complexity in administrating it.

The Joint Committee on Taxation of the Canadian Bar Association and Canadian Institute of Chartered Accountants argued that simplification was possible and pointed out that "meaningful simplification in the small-business area was achieved a number of years ago". Having acknowledged this, the committee expressed concern that the tax system suffered from what they called the "Rube Goldberg syndrome". In the words of one member:

By that I mean the tendency of legislators when a problem is perceived, just to tack provision on top of provision. It creates an enormously complex set of rules when maybe the approach should be to take it right back to ground zero and re-think the whole concept.

In its brief to the Finance Committee, Dunwoody and Co., chartered accountants, discussed the basic problem and provided a partial list of some of the complexities that have been added to the corporate tax side by side with the proposed reforms. Following are some of the comments in the brief:

> Over the years, the Act has become incredibly complex. There are general rules, exceptions, exceptions to the exceptions, special transitional rules, phasing-in and phasing-out provisions, and various other complicating factors. Some sections of the Act are almost totally unintelligible, while others are so arcane as to be known by only the most seasoned tax experts.
>
> A particular transaction may be affected by any number of provisions, some specifically related, and others dealing with general concepts and restrictions. Tax practitioners must be aware of all these and understand when and how they may apply. This responsibility is becoming more and more difficult to fulfill.
>
> Thus it was particularly disappointing to see that the Tax Reform proposals do virtually nothing to simplify the Act. Indeed, in many respects they compound the problems:
>
> - There are now a whole new series of transitional rules and phase-in dates.
> - There will be the additional administrative burden of keeping track of those expenses that are no longer fully deductible, or that are otherwise restricted. A separate CCA pool will be required for each car in certain cases. In other cases, both pre- and post-reform CCA classes will be required.
> - Determining a corporation's tax rates, capital gains inclusion rates, and capital cost allowance rates is no longer a simple matter. These rates can only be determined by pro-rating based on the corporation's year-end.
> - Tax practitioners must now deal with a broad new anti-avoidance provision which could potentially apply to virtually any business transaction.
>
> How is the average businessman to keep track of these constant changes in order to be able to comply? How is his general accountant/auditor to maintain his tax knowledge to be able to verify the tax provision and so attest to financial statements? How is a tax practitioner to advise his clients with any certainty? And how is Revenue Canada to maintain a staff of individuals who are able to answer taxpayers' queries and administer the rules consistently and competently?

The list omits such new complexities as the treatment of preferred shares and the put-in-use rule for capital cost allowance and investment tax credits but does highlight the importance of the new anti-avoidance provisions. Prior chapters have dealt with these provisions.

The White Paper also suggested that a system with fewer special preferences would be simpler, but simplicity would depend on a number of factors. A new system with fewer preferences could still be more complicated than the old. In fact, the proposed reforms do not so much eliminate preferences as alter the existing preferences so as to limit the extent that corporations can take advantage of these preferences. Examples are the revised treatment of flow-through shares and the changes in the calculation of capital cost allowances for various capital goods.

The new corporate tax system will undoubtedly be at least as complicated as the current one. As Dunwoody and Co. concluded: "It seems as though the goal of tax simplification has been completely abandoned."

Recommended Simplifications

In the area of tax simplification it is easy to to imagine and ask for a tax system that is structurally and administratively simple and that has readable forms and straightfoward filing requirements. It is no bad thing to have such an ideal as a goal. But as the White Paper pointed out and as several briefs and witnesses conceded, a sophisticated economy is bound to have a complicated tax system.

Nevertheless, it is possible to find needless complications in the tax system and work to eliminate them. The discussion above pinpoints complications, and the recommendations in the previous chapters have been proposed in part with the desire for a simpler tax system. Among these recommendations are:

- the rejection of modified accrual accounting for farmers;
- replacement by a surtax of the interim changes to federal sales tax;
- treatment of eligible capital property as another form of depreciable property;
- maintenance of the capital gains inclusion rate at two-thirds and the federal dividend tax credit at 13 1/3 per cent of the grossed-up dividend to neutralize any temptation to exploit any distinctions between these two types of income;
- uniform treatment of the business use of automobiles; and
- conversion of CPP contributions on self-employed earnings to a credit.

On the other hand, there are recommendations in this Report that would lead to some additional complexity for the sake of greater fairness, such as those for the child tax credit. Other recommendations in this Report may seem complicated, but they are less so than the proposals in the White Paper, as in the tax treatment of preferred shares.

Conclusions

It is disappointing for the Committee to draw the inevitable conclusion that the proposed tax reform has not successfully addressed the problem of simplifying the tax system. There are, of course, some elements of the proposed system that are less complex than corresponding elements in the current system. But overall the new system

is at least as complicated as the old. As many tax filers in the future as in the past will need the services of tax preparers, and corporations will face the same uncertainty in interpreting the *Income Tax Act* as they have in the recent past.

In reviewing the White Paper, the Committee noted that the goals of efficiency and fairness were given priority over the goal of simplification. While the Committee agrees in theory with such a balancing of objectives, in practice the White Paper proposals would lead to needless complications.

Occasionally, much is made of the tradeoffs among the objectives of tax reform, as if a push for simplification would *always* be at the expense of efficiency or fairness. There are tradeoffs, which obviously should be identified, but it is easy to overstate their importance. The recommendations in this Report and in the Committee's previous Report *Tax Simplification*, for example, would lead to a tax system that is more efficient and one whose fairness is more visible.

The White Paper also suggested that a system with fewer special preferences would be simpler, but simplicity would depend on a number of factors. A new system with fewer preferences could still be more complicated than the old. In fact, the proposed reforms do not so much eliminate preferences as alter the existing preferences so as to limit the extent that corporations can take advantage of these preferences. Examples are the revised treatment of flow-through shares and the changes in the calculation of capital cost allowances for various capital goods.

The new corporate tax system will undoubtedly be at least as complicated as the current one. As [illegible] and [illegible] concluded: "It seems as though the goal of tax simplification has been completely abandoned."

Recommended Simplifications

In the area of tax simplification it is easy to imagine and ask for a tax system that is structurally and administratively simple and that has readable forms and straightforward filing requirements. It is no bad thing to have such an ideal as a goal. But as the White Paper pointed out and as several briefs and witnesses conceded, a sophisticated economy is bound to have a complicated tax system.

Nevertheless, it is possible to find needless complications in the tax system and work to eliminate them. The discussion above proposes simplifications, and the recommendations in the previous chapters have been motivated in part with the desire for a simpler tax system. Among these recommendations are:

- the rejection of modified accrual accounting for farmers;
- replacement by a series of the interim changes to federal sales tax;
- treatment of eligible capital property as another form of depreciable property;
- maintenance of the capital gains inclusion rate at two-thirds and the federal dividend tax credit at 13 1/3 per cent of the grossed-up dividend to neutralize any incentives to make any distinctions between these two types of income;
- uniform treatment of the business use of automobiles, and
- conversion of CPP contributions on self-employed earnings to a credit.

On the other hand, there are recommendations in this Report that would lead to some additional complexity for the sake of greater fairness, such as those for the child tax credit. Other recommendations in this Report may seem complicated, but they are less so than the proposals in the White Paper, as in the tax treatment of preferred shares.

Conclusions

It is disappointing for the Committee to draw the inevitable conclusion that the proposed tax reform has not achieved the additional objective of simplifying the tax system. There are, of course, some elements of the proposed system that are less complex than corresponding elements of the current system. But overall the new system

APPENDIX A

Definition of Scientific Research Under the *Income Tax Act*

Having addressed the issues raised by the White Paper with respect to Stage One of tax reform, the Finance Committee would like to return to an issue also dealing with the *Income Tax Act* and discussed in a previous Committee Report. The issue concerns the expansion of the definition of scientific research and experimental development to include the social sciences and humanities. The following Report was tabled in the House of Commons on March 12, 1987:

The Standing Committee on Finance and Economic Affairs has the honour to present its

FOURTH REPORT

In accordance with its mandate under Standing Order 96(2), your Committee has agreed to report the following:

Section 37(1)(a)(vi) of the *Income Tax Act* allows the deduction for payments made by a taxpayer to an approved organization which includes the Natural Sciences and Engineering Research Council, the Medical Research Council and the Social Sciences and Humanities Research Council. The payment received by the organization must be allocated to an association, institution or corporation undertaking scientific research and experimental development. However, the definition of scientific research and experimental development provided by section 2900 of the regulations made under the Income Tax Act excludes the social sciences and humanities.

Canadian universities and research institutions are staffed with experts in the social sciences and humanities. Our sociologists, psychologists, economists, historians, philosophers and theologians contribute daily to world knowledge in their specialities. Their books, monographs and scholarly articles testify to their prominence in the world of ideas. But our current Income Tax Act leaves them an untapped resource.

Discriminating against the social sciences and humanities could be short-sighted. In addition to the technical side of business there is a human side. Efficiency may be improved — and unit costs lowered — by focusing research on this human side.

Not all English professors or sociologists will be doing work of interest to business, of course, just as not all theoretical physicists experiment so that factory owners will have lower costs.

The rewards from research and development do not follow a simple formula — investing $1 in scientific research may not lead automatically to $1.25 in benefits. It may lead to more, it may lead to nothing. Research and development is risky. People take chances, play hunches, but always believe that the creative use of intelligence will produce something worthwhile. Broadening the scope of research to include the social sciences and humanities may increase the payoff to research and development.

Therefore your Committee recommends:

That the government should consider the advisability of amending the definition of scientific research and experimental development in section 2900 of the regulations made under the *Income Tax Act*, in order to include social sciences and humanities, so that payments made to an approved organization would be eligible for tax credit allowances.

APPENDIX B

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APPENDIX C

List of Briefs, Letters and Submissions

The Committee regrets that it was unable to receive more witnesses. The following is a list of briefs, letters and submissions to the Committee from organizations and individuals from whom the Committee could not receive personal testimony.

ORGANIZATIONS

ABITIBI-PRICE INC.
ABSTAINERS/MAPLEX GENERAL INSURANCE COMPANIES
ACTON CHOWDHRY & GUNDERSON
ACTION COMMITTEE TAXATION
AGRICULTURAL INSTITUTE OF CANADA
AIR CANADA
ALLIANCE OF CANADIAN CINEMA, TELEVISION & RADIO ARTISTS
ALLIANCE OF CANADIAN TRAVEL ASSOCIATIONS
AQ FINANCIAL GROUP LTD.
ASSOCIATION DU DISQUE ET DE L'INDUSTRIE DU SPECTACLE QUÉBÉCOIS
ASSOCIATION DES FEMMES COLLABORATRICES
ASSOCIATION DES FEMMES DIPLOMÉES DES UNIVERSITÉS
ASSOCIATION DES MINES DE MÉTAUX DU QUÉBEC INC.
ASSOCIATION OF CANADIAN DISTILLERS
ASSOCIATION OF CANADIAN FILM & TELEVISION PRODUCERS
ASSOCIATION OF CANADIAN FINANCIAL CORPORATIONS
ASSOCIATION OF REGISTERED INTERIOR DESIGNERS OF ONTARIO
ASSOCIATION OF UNIVERSITIES AND COLLEGES OF CANADA
ATTRACTIONS ONTARIO AFRICAN LION SAFARI & GAME FARM LTD.
AUTOMOBILE IMPORTERS OF CANADA
B. SCHULZE STAMPS LTD.
BAUSCH & LOMB CANADA INC.
BMW CANADA INC.
BOBIT PUBLISHING CANADA LIMITED
BORDEN & ELLIOT
BOTTOM LINE
BOW VALLEY INDUSTRIES LTD.
BRAMPTON BOARD OF TRADE
BRISTOL-MYERS PRODUCTS CANADA INC.

BRITISH PENSIONERS ASSOCIATION
BURRIDGE & ASSOCIATES
BUTLER BROS. LIMITED
CANADA COUNCIL
CANADA LIFE
CANADA TRANSPORT INTERNATIONAL LIMITED
CANADA'S ROYAL WINNIPEG BALLET
CANADIAN ARTISTS REPRESENTATION
CANADIAN ASSOCIATION FOR THE DEAF
CANADIAN ASSOCIATION OF BROADCASTERS
CANADIAN ASSOCIATION OF OPTOMETRISTS
CANADIAN ASSOCIATION OF PROFESSIONAL DANCE ORGANIZATIONS
CANADIAN ASSOCIATION OF RETIRED PERSONS
CANADIAN ASSOCIATION OF UNIVERSITY TEACHERS
CANADIAN ASSOCIATION OF WHOLESALE SALES REPRESENTATIVES
CANADIAN AUTOMOBILE ASSOCIATION
CANADIAN AUTOMOTIVE TRADE
CANADIAN BUSINESS PRESS
CANADIAN CABLE TELEVISION ASSOCIATION
CANADIAN CENTRE FOR PHILANTHROPY
CANADIAN CENTRE FOR POLICY ALTERNATIVES
CANADIAN COUNCIL OF CHRISTIAN CHARITIES
CANADIAN COUNCIL OF THE BLIND
CANADIAN COUNCIL ON REHABILITATION AND WORK
CANADIAN CRAFTS COUNCIL
CANADIAN DENTAL ASSOCIATION
CANADIAN EXPORTERS ASSOCIATION
CANADIAN FEDERATION OF INDEPENDENT GROCERS
CANADIAN FEDERATION OF STUDENTS
CANADIAN FILM AND TELEVISION INDUSTRY
CANADIAN FRIENDS OF SCHIZOPHRENICS
CANADIAN GAS ASSOCIATION
CANADIAN IMPORTERS ASSOCIATION LTD.
CANADIAN INDEPENDENT ADJUSTERS' ASSOCIATION
CANADIAN JEWELLERS ASSOCIATION
CANADIAN MEAT COUNCIL
CANADIAN NATIONAL INSTITUTE FOR THE BLIND (THE)
CANADIAN PAPER BOX MANUFACTURERS ASSOCIATION
CANADIAN PRINTING INDUSTRIES ASSOCIATION
CANADIAN REAL ESTATE ASSOCIATION
CANADIAN RED CROSS SOCIETY (ONTARIO)
CANADIAN RED CROSS SOCIETY (SASKATCHEWAN)
CANADIAN TOY MANUFACTURERS
CENTRE STAGE COMPANY
CERTIFIED GENERAL ACCOUNTANTS ASSOCIATION OF CANADA
CHILD POVERTY ACTION GROUP
CHRISTIAN STEWARDSHIP SERVICES
CITY OF WINNIPEG
CLEARBROOK SPORTING GOODS LTD.

COALITION OF SPORTS EQUIPMENT MANUFACTURERS
CONCORDIA AND LAVAL UNIVERSITIES
CO-OPERATIVE UNION OF CANADA
CONFÉDÉRATION DES CAISSES POPULAIRES DESJARDINS
CONNOR FINANCIAL CORPORATION
CONSUMER ELECTRONICS MARKETERS OF CANADA
COOPER CANADA LIMITED
COOPERS & LYBRAND (N.B.)
CORNING CANADA INC.
COUNCIL ON AGING
CROWN LIFE INSURANCE COMPANY
CS CO-OP
D'OBRENAN & MAH
DANFOSS MANUFACTURING CO. LTD.
DARTMOUTH CHAMBER OF COMMERCE
DATA PLAN CONSULTING ASSOCIATES LIMITED
DELOITTE HASKINS & SELLS
DMB ENTERPRISES
DUGGAN BENEFITS INSURANCE AGENCIES INC.
DUNWOODY & COMPANY
DURACELL INC.
ELKIND, LIPTON & JACOBS
ETOBICOKE GENERAL HOSPITAL
EXPLO INC.
FAIR RENTAL POLICY ORGANIZATION OF ONTARIO
FAMILY SERVICE ASSOCIATION OF METROPOLITAN TORONTO
FAMILY SUPPORT CENTRE
FEDERATION OF CANADIAN MUNICIPALITIES
FERGUSON-ALDER INVESTMENT COUNSEL LTD.
FIRST EXPLORATION CORPORATION
FORUM SENIOR CITIZENS
FUNDING OF THE ARTS IN CANADA
FREDRIC PRICE REAL ESTATE LIMITED
GABRIEL OF CANADA
GILLES PRONOVOST ET ASSOCIÉS INC.
GLACIER NATIONAL LIFE ASSURANCE COMPANY
GOODMAN & CARR
GOODYEAR CANADA INC.
GOVERNMENT OF MANITOBA
GRAND FALLS CHAMBER OF COMMERCE (NEWFOUNDLAND)
GRAND TOYS
HANDLEMAN COMPANY OF CANADA
HARWELL ELECTRIC SUPPLY CO. LTD.
HAWKER SIDDELEY DIESELS & ELECTRICS LTD.
IMPERIAL OIL LIMITED
INDEPENDENT FACTORS LTD.
INFORMCO INC.
INSTITUTE OF ASSOCIATION EXECUTIVES
INTERCONTINENTAL MAPS & CHARTS

INTERNATIONAL ASSOC. OF MACHINISTS & AEROSPACE WORKERS
ISLAND TELEPHONE COMPANY LIMITED
JEUNE CHAMBRE ÉCONOMIQUE ET DU COMMERCE DE L'ESTRIE INC.
JOHNSON & JOHNSON INC.
KAMLOOPS SMALL BUSINESS COMMITTEE FOR BANK ACT REFORM
KANGO WOLF INTERNATIONAL INC.
KIDNEY FOUNDATION OF CANADA
KING INSURANCE & FINANCIAL SERVICES
KLEIN AND ROTENBERG
KODAK CANADA INC.
LANDSCAPE ONTARIO HORTICULTURAL TRADES ASSOCIATION
LANG MICHENER LASH JOHNSTON
LE GROUPE PEMP
LEVER BROTHERS CORPORATION
LIFE INSURANCE MANAGERS ASSOCIATION OF CANADA
LUTHERAN LIFE INSURANCE SOCIETY OF CANADA
M.A. HENRY LIMITED
MACNEILL JOHNSTON & CO.
MAHEU NOISEUX
MARINE AIR CARGO
MARITIME TELEGRAPH & TELEPHONE COMPANY LIMITED
MCCULLOUGH ANNUITY & INSURANCE SERVICES
MCGILL UNIVERSITY
MILLER WATSON & CO. LTD.
MILNER & STEER
MONARCH MARKING
MONTREAL BOARD OF TRADE
MOTOR VEHICLE MANUFACTURERS' ASSOCIATION
NATIONAL ASSOCIATION OF TOBACCO & CONFECTIONERY DISTRIBUTORS
NATIONAL ASSOCIATION OF WOMEN AND THE LAW
NATIONAL BALLET OF CANADA
NATIONAL COUNCIL OF WOMEN IN CANADA
NESBITT THOMSON
NORTHERN TELEPHONE LIMITED
NORTHWEST TERRITORIES GOVERNMENT
OLIVER-JAK PRODUCTIONS INCORPORATED
ONTARIO FILM DEVELOPMENT CORPORATION
ONTARIO TELEPHONE ASSOCIATION
ORDRE DES AGRONOMES DU QUÉBEC
OTIS CANADA INC.
OTTAWA-CARLETON BOARD OF TRADE
P.E.I. SMALL FARMS ADVISORY BOARD
P.K. DOUGLASS INC.
PITNEY BOWES
PRICE WATERHOUSE
RADIO QUÉBEC
RADIO SHACK
REGIONAL MUNICIPALITY OF PEEL
RETAIL MERCHANTS ASSOCIATION OF CANADA (ONTARIO) INC.

ROBINSON, TWIGG & KETILSON
ROTHMANS, BENSON & HEDGES INC.
RUBBER ASSOCIATION OF CANADA
S.I.R. MAIL ORDER
SAFEGUARD BUSINESS SYSTEMS LIMITED
SAINT JOHN BOARD OF TRADE
SASKATCHEWAN REAL ESTATE ASSOCIATION
SASKATOON BOARD OF TRADE
SEABOARD LIFE INSURANCE COMPANY
SIEMENS ELECTRIC LIMITED
SMITH, GRAHAM, HUNT, BUCK
SOCIAL SCIENCE FEDERATION OF CANADA
SPALDING CANADA
ST. JOHN'S COLLEGE
ST. VITAL SCHOOL DIVISION NO. 6
STANLEY TOOLS
STELCO INC. (TORONTO)
STERN, COHEN, WEINSTEIN, BAINES & MASCHING
STEVENS HOME FASHIONS
SUPERIOR MEMORIALS
T.A. KLEMKE & SON CONSTRUCTION LTD.
TASK FORCE ON FUNDING OF THE ARTS
TAX EXECUTIVE INSTITUTE INC./PETROCAN INC.
TELE-DIRECT (PUBLICATIONS) INC.
TORONTO JEWISH CONGRESS
TORONTO REAL ESTATE BOARD
TOUCHE ROSS & CO.
TOURISM ONTARIO INC.
TRANSPORT ISSUES GROUP
TV ONTARIO
U & R TAX SERVICES LTD.
UNIFARM
UNION OF MANITOBA MUNICIPALITIES
UNIVERSITÉ DU QUÉBEC à TROIS-RIVIÈRES
UNIVERSITY OF ALBERTA
UNIVERSITY OF ALBERTA (DEPARTMENT OF ECONOMICS)
UNIVERSITY OF GUELPH
VERES WIRE INDUSTRY
WADDINGTON SANDERS LIMITED
WEGO CONSULTANTS LIMITED
WHITEHORSE CHAMBER OF COMMERCE
WILFRID LAURIER UNIVERSITY
WOLRIGE MAHON
WOOLLEY, DALE & DINGWALL
WOMEN'S ASSOCIATION FOR EDUCATION AND SOCIAL ACTION
YOUR CHOICE RESTAURANT GROUP

INDIVIDUALS

ABRAMOWITZ, MICHAEL
ALBRIGHT, LELAND S.
ALLAN, JACKIE
ATCHISON, JOHN
BAINES, ROBERT F.
BARLTROP, CHRISTOPHER S.
BARNSTIJN, J.A.
BAYER, F.W.
BAYLISS, PETER
BEEBE, ROGER
BELL, FLORENCE L.
BLACK, J.
BOHL, K.H.
BORNSTEIN, RICHARD
BROUGHTON, J.H.
BRUCE, P. GRAHAM
BUCKERFIELD, K.H.
BURCHILL, KEN
CARROLL, PAUL
CARSON, JOHN KENNETH
CASEY, LIAM & HILARY
CHARBONNEAU, ALBERT
CHIARELLI, RICK
CLARK, ROBERT M.
COHEN, MARVIN
CONABOY, GERALD
COUPLAND, C. WALTER
COUTTS, M.C.
CROW, STANLEY
CROWE, MICHAEL A.E.
DAVIS, CHAS A.
DECORE, LAURENCE
DEEKS, PETER A.
DEMERS, TELESPHORE
DESBRISAY, JOHN T.
DONEGANI, ERIC
DONEVAN, W.J.
DROK, IAN
DURRANT, BRUCE G.
EASTWOOD, JOHN
EDWARDS, JIM, M.P.
ELKIND, STANLEY W.
ENRIGHT, JOHN A.
ERIKSSON, PHILLIP
FENWICK, W. PETER
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GAUNCE, HARRY W.
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GNAEDINGER, P.E.
GORDON, SHAWN H.
GOSLETT, WILLIAM
GRAY, E.S. ROSS
GREEN, TIMOTHY
HALL, RICHARD E.
HANLEY, PATRICIA
HANNA, JAMES A.
HASHAM, BASHIR
HAWRANIK, GERALD
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HENEAULT, ROBERT E.
HERON, GEORGE
HIGGINS, JOHN L.
HOGG, PETER W.
HOLDER, GERALD
HOWARD-JONES, PETER J.
HUBER, HERB
IKEDA, DOUG
JAMAL, AMIN E.
JOHNSON, RALPH
JOHNSTON, J.A.
JONES, PAUL
KANE, SHEILA
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KARST, GRANT C.
KASTNER, ARNOLD
KEILHACK, KARL
KILLAM, MALCOLM
KIMBERLEY, MARK
KING, WAYNE D.
KLEMENT, ARNOLD
KNIPPEL, JEFFREY
KOWALCHUK, R.W.
KRULICKI, JAMES J.
LAURIN, CYRILLE J.
LEFAIVRE, ROMEO
LOEWEN, DAVID
LOZO, JOHN G.
MACGILLIVRARY, LINDA D.

MACK, H.L.
MACQUARRIE, R.H.
MARTIN, K.B.
MASCHING, ROBERT J.
MATHESON, W.G.
MCCAIG, ELLIE
MCKAY, O.R.
MCKENNA, BRUCE
MELLOR, CHRIS F.
MILDON, A. DAVID
MILLARD, R.O.
MILLER, R.D.
MILON, M.
MIRANDA, A.J.
MOLLER, PHILIP V.
MONCEK, JOHN
MORGAN, M.R.
MORRISSON, TOM
MOWAT, DONALD
NAGY, JEROME E.
NEWMAN, GEOFFREY R.
NICKOL, JUDITH ANNE
NORDMAN, ROBIN
O'KANE, J. WILLIAM
OLDFIELD, M.
OLIVER, WINNIFRED
OPSTAD, A.L.
PARKER, DOROTHY
PEDRAZZINI, ITALO
PENNER, KEITH, M.P.
PÉPIN, LUCIE, M.P.
PERRONI, VIC
PHILLIPS, MICHAEL M.
PILLER, RANDY
RAIL, FRANÇOIS J.J.M.
RALPH, JUNE
RAY, DR. A.K.
REABURN, RONALD
REENES, AUDREY
REEVES, KENNETH C.
RENSHAW, JACK E.
ROBINSON, RUSSELL L.
ROTHMAN-BENHAIM, SHELLEY
ROWE, RON
SANDERSON, DONALD W.

SAX, HERSCHELL
SHARPE, J.B.
SHAW, D.R.
SHERMAN, JOHN M.
SHORE, H.H.
SIDLE, JOHN S.
SINCLAIR, MICHAEL D.
SINGH, PARMINDER
SMITH, STANLEY NOEL
SMITH, G.W.
SMITTEN, R.
SMYTHE, JOAN M.
SPIRO, SOLOMON
STAMP, GORDON
STEGMAN, JOHN
STEPHENS, BOB
SWAYZE, JACK
TADROS, P.
TASKER, PETER C.
THOMAS, DOUGLAS P.
THOMPSON, GORDON W.
THOMPSON, JOHN C.
TIESSEN, HUGO P.
TINSON, JACK C.
TORNO, NOAH
TREMBLAY, MIVILLE M.
USHER, ANTHONY
WADDELL, WM. D.
WADE-LABARGE, MARGARET
WAGNER, BOB
WALKER, KEN H.
WALKER, DAVID J.
WEBSTER, DONALD BLAKE
WEINSTEIN, J. LEONARD
WELDON, DALE
WHITEHEAD, TIMOTHY B.G.
WILLIAMS, AMY F.
WILLIAMSON, BRUCE D.
WILSON, DALE
WINK, WERNER J.
WITER, ANDREW, M.P.
WONG, LEO
YACHIMEC, MIKE
ZADO, SCOTT
ZUFELT, BRIAN C.

APPENDIX D

Dissenting Opinion — Liberal Party

The Liberal members of the Standing Committee on Finance and Economic Affairs have analysed the White Paper on Tax Reform, and the briefs submitted to the Committee, and have come to the conclusion that Finance Minister Michael Wilson's tax reform is unacceptable.

We were happy to work with the other members of the Committee to correct the White Paper's shortcomings, and we have reached a consensus with them on a large number of recommendations. Nonetheless, although we support most of the recommendations, we have serious reservations about some of them, for reasons that will be explained further on.

In all, the Committee heard 174 witnesses. The main thrust of their message was that the White Paper's proposals are inadequate, even totally unacceptable. More specifically they pointed out to us that the proposals will do nothing to make the personal income tax system more progressive; that they will reduce benefits for families; that they will discourage capital formation; and that they will make our businesses, especially in the manufacturing sector, less competitive.

Even though we support a good many of the recommendations in the Committee's report, we find it deplorable that the report's introduction implies that the recommendations deal simply with matters of "detail". One has only to read the recommendations on assistance programs for families with more than two children, on insurance and financial institutions, on the film industry, on agriculture, on research and development, on automobile expenses, on capital gains, on the general anti-avoidance provision and many others, to realize that these recommendations do not deal simply with details but rather go the heart of the matter.

Although the Committee's report takes a highly critical approach to the White Paper, we, the Liberal members of the Committee, have serious reservations about the report's recommendations in the following areas: (a) tax rates and brackets; (b) family assistance programs; (c) taxation of small businesses; and (d) flow-through shares. We also wish to comment on the taxation of financial institutions. Lastly, we note that the report is incomplete, since the Committee's mandate restricted it to studying stage I of the reform.

Tax rates and brackets

We are opposed to the Committee's first recommendation, which proposes that the rate structure and the brackets for personal income tax be implemented as set forth in the White Paper. In our view, that structure is blatantly unprogressive; not only is it unjust to middle-income earners, it also provides upper-income earners with all-too-generous tax reductions.

Family assistance programs

We regard the Committee's recommendations on family assistance programs as too timid. They go in the right direction, but they do not go far enough to meet the real needs of families. The expert witnesses who appeared before the Committee showed that the cumulative effects of the proposed tax reform and the last three federal budgets will reduce assistance to middle-income families by more than $400 per child. It is not surprising that the Wilson reforms have been described as an attack on the family.

Small businesses

With regard to small businesses, we consider that the Committee should have rejected the White Paper's proposed increase of the tax rate on small manufacturing enterprises (from 10% to 12%). We do not understand why small manufacturers should be the only group to suffer a tax-rate increase. There are more than 40,000 small manufacturing firms in Canada, and they have created more than 74% of the jobs in this sector in recent years.

Moreover, we believe the Committee should have recommended that a vendor of small business assets be entitled to a $500,000 capital gains exemption. Initially, the Committee said it was in favour of this idea, but subsequently the majority of members allowed themselves to be convinced by the Finance Department that it would be extremely difficult to draft this kind of legislation. We also recognize the fact that this would be a difficult task, but, we believe, a task no more insurmountable than the problems encountered by the Department when it decided to introduce the general exemption in May 1985.

Flow-through shares

We oppose the Committee's recommendation regarding flow-through shares in the resources sector. As suggested in the White Paper, the Committee proposes to do away with the earned depletion allowance, but wants to delay implementing this measure for only six months. We believe that the existing flow-through share mechanism has increased the pace of resource exploration, a high-risk activity. Furthermore, flow-through share provisions are responsible for sustained development in the regions where exploration activities are centred. Coming on the heels of the gradual elimination of investment tax credits for a number of regions and cutbacks in funds earmarked for

economic and regional development, the elimination of the earned depletion allowance provides further confirmation of the near total abandonment of Canadian regional development policies.

Financial institutions

With regard to financial institutions, we agree with the general thrust of the Committee's recommendations which call for this sector to pay its fair share of tax. As far as the recommendations are concerned, we believe that government policy should place more emphasis on the solvency and soundness of financial institutions, rather than on mechanisms for taxing their reserves unwisely. It should be remembered that the primary purpose of these reserves is to provide adequate protection for the savings of Canadians.

Mandate of the Committee

Lastly, we believe that given the Committee's mandate, which is to consider Stage I of tax reform, the report is incomplete. The Committee has not formulated and opinion on the question of the government's overall tax strategy which includes the last three budgets as well as Stages I and II of tax reform. Consequently, it has not expressed an opinion about the introduction of a sales tax on food, a measure which we strongly oppose.

Conclusion

The government promised comprehensive changes. It has failed to keep its promise. For political reasons, it has recommended that the reforms be introduced in two stages, and has postponed the announcement of new sales taxes. We hope that the Committee will undertake a study of the second phase of tax reform as soon as possible. Until we take an in-depth look at sales tax reform, which was supposed to be the key component of tax reform, we will not have a clear picture of the Minister's true intentions, particularly as regards a tax on food.

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APPENDIX E

Dissenting Opinion — New Democratic Party

1. Introduction

The Canadian tax system is long overdue for fundamental reform. There is now all but unanimous agreement that the changes of the past twenty years have resulted in a system which is highly complex, grossly unfair, and monumentally inefficient. Tax experts, business and ordinary Canadians are all agreed on the need for change. However, the direction of real reform remains very much a matter for debate and discussion. New Democrats have been in the forefront of this debate, speaking out for fairness, efficiency and simplicity in the tax system. We raised the issue of tax reform in the 1984 Election, have since conducted a major review of the tax system, Tax Probe '86, and have published three major studies. We will continue to work for real tax reform.

The White Paper proposals upon which the Finance Committee was asked to deliberate are seriously deficient on grounds of broad principle and constitute, in our view, a prescription for a tax system which will be different, but no more fair, and scarcely more efficient than that which now exists. The Committee has improved the work of the Finance Minister in technical detail and substance, but it has failed to take up the challenge of redrafting the proposal in terms of the fundamental principles which should, in our view, underpin real tax reform.

As New Democrats on the Finance Committee we have actively participated in a lengthy process of analysis and review of the tax reform package proposed by the Mulroney government. The Committee has proposed a number of changes which would improve this proposal, and the major elements of the Report of the Committee which have our support are noted below.

2. Principles for Tax Reform: Fairness, Efficiency, Accountability, Simplicity

A) *Fairness*

A major function of the tax system is to raise funds for government expenditures in a fair and efficient manner. This introduces a large number of technical criteria for

judging the appropriateness of a particular set of proposals. We would stress, however, that taxation equally involves serious moral and philosphical issues. We live in a society where income is unequally distributed to individuals and families through the mechanism of the market in the form of wages and salaries, rent, interest, dividends and so on. Such income is, to say the least, not distributed equally, nor would we expect it to be. Opinions will differ on whether the market is a good mechanism for realising the goal of economic efficiency, but most would agree that it is a poor instrument for realising social equity. We would stress that a central function of the tax system should be to achieve a redistribution of income from the wealthy to average and lower income Canadians.

This is by no means an abstract or philosophical point. In Canada today, about one family in five lives in poverty while the wealthy few receive a highly disproportionate share of total national income. The poorest 20% of Canadian families must live on less than one sixth the income of the wealthiest 20%. Average Canadian families are asked to bear more than their fair share of the cost of government while many of the wealthy still pay little or no tax. Astonishingly, the tax system taken as a whole fails to achieve any substantial redistribution of income among Canadians and the one progressive part of that system, the personal income tax, is not far from being neutral in its impact. Certainly the effective rate of tax on the wealthy is little greater than that imposed on the average family. Any tax reform worthy of the name must address this problem of fairness in a serious way by reducing the share of the tax burden borne by average and lower income Canadians and increasing the share paid by the wealthy.

The Conservative "reform" package dismally fails the test of fairness because it is consciously structured so as to be neutral in terms of income distribution. Otherwise progressive features such as the conversion of tax exemptions (which favour upper income earners) to tax credits (which favour lower income earners) are more than offset by changes to the structure of tax rates. Trading tax breaks for lower rates most emphatically does not result in a fairer tax system for average Canadians. At the same time the White Paper fails to significantly change the overall balance between progressive and regressive elements of the tax system, and indeed anticipates an increase in the regressive sales tax.

The goal of fairness demands that all forms of income should be treated equally. Income from property such as capital gains, dividends, rent and interest should be taxed on the same basis as wage and salary income. Further, the corporate share of the overall tax burden — representing a witholding tax on property income — should be increased, and the sales tax share — representing a regressive tax on consumers which is not geared to ability to pay — should be reduced if the total tax burden is to be more fairly divided among Canadians. Unfortunately the Committee chose not to examine in depth the issue of balance between the three pillars of the tax system — the personal and corporate income tax and the federal sales tax — an issue which is central to fairness.

The goal of fairness equally demands that the tax burden on small businesses should be lower than that imposed on big business. As things stand, tax benefits intended to create jobs are monopolised by big business, while small business pays more tax and yet creates the vast majority of new jobs.

B) *Efficiency*

The goal of efficiency should be no less central to real tax reform. Expenditures through the tax system in the form of special write-offs and deductions constitute a massive "hidden Budget" which promotes a wide range of important goals such as investment, saving and particular areas of consumption.

It has been generally recognised that many (if not most) of these tax expenditures in both the personal and corporate tax systems are inefficient means of realising stated goals, and the White Paper recognises this in proposing a significant degree of broadening of the tax base through the elimination or reduction of specific tax incentives. However, the goal of economic efficiency has been ill-served by the decision of Mr. Wilson to lower corporate and personal tax rates to match the reduction of special breaks and incentives on almost a dollar for dollar basis. This does make the system somewhat more neutral in its impact upon different sectors of the economy, but the issue of how to promote investment and growth more efficiently through the closer targetting of tax measures to specific sectors (eg. small business, industries in the weak regions) was scarcely addressed by either the White Paper or the Committee.

Greater targetting of tax expenditures would, in our view, more efficiently promote such key economic goals as job creation and regional economic development. In addition, under many circumstances direct government expenditures are a more efficient and less costly means of realising national economic goals.

C) *Accountability*

The goal of accountability has also not been seriously addressed by the Government or the Committee. Tens of billions of dollars are spent annually through the tax system, but we continue to lack sufficient formal mechanisms for review and scrutiny of these measures by Parliament, the public and within government. The Conservatives intensively scrutinised government spending programs in the Nielsen Task Force, but only 3.5% of the 6500 page report was devoted to analysis of the $30 billion of tax expenditures, and no new measures have been taken to make this form of spending more accountable.

D) *Simplicity*

Finally, the goal of simplicity still remains to be addressed. Ordinary Canadians are increasingly baffled by the complexity of the tax system and are rightly suspicious that this serves the interests of those who can afford to hire high-priced accountants and lawyers to negotiate their way through the maze. The need for a comprehensible, easily completed tax form remains as paramount as before this particular tax "reform" was introduced.

3. A Fairer Balance Between Individuals

The White Paper proposals dismally fail to pass the test of fairness. Under this proposal, households with an income of more than $100,000 will get an average income

tax break of $1,615 while families with an income of between $30,000 and $40,000 will get an income tax break of $320. As well, 175,000 "winner" households with income of more than $100,000 get an average tax break of $4,365 compared to just $90 for "winner" families with income of less than $15,000. One in every five dollars of tax savings from this reform will go to the 2% of families with income of more than $100,000.

The average income tax cut for a two earner family with two children making $30,000 will be $263, compared to a $966 tax increase (personal and sales tax changes combined) since the Conservatives were elected in 1984. A similar family with an income of $40,000 will get an income tax cut of $421 compared to a total tax increase of $1,139 since 1984. In overall terms, then, the average family will be much worse off than when the Conservative government was elected, and the only families that will gain overall will be among those fortunate to have an income of $100,000 or more. In addition, Phase Two of this "tax reform" will see the imposition of a new sales tax.

It should be noted that the new credits to be introduced in 1988 will not be fully indexed to inflation, with the result that the income tax burden on average families will increase in real terms, and with the result that many more poor families will be forced back onto the tax rolls. Because of indexing, both lower and middle income families will be worse off than now within three years.

The demonstrable failure to achieve fairness between individuals and families is primarily rooted in the White Paper's failure to introduce a fair tax rate structure. While some special breaks for the wealthy have been reduced or eliminated and the change from exemptions to credits reduces deductions for the wealthy, the effect has generally been more than offset by a cut in the top rate of tax. The top federal rate for those with taxable income of more than $55,000 falls from 34% to 29%.

We are deeply disappointed the Committee did not agree with our request to reconsider the rate structure. An increase in tax rates applicable to upper income earners would permit a reduction in the rate of tax on average and lower income earners and/or an increase in tax credits. We would add that it is utterly bogus to suggest that the new three tier rate structure is simpler than the existing system since the average tax filer will continue to calculate tax payable from tax tables in any case.

Recommendation 1

The structure of tax rates should be further examined and a higher top rate should be imposed on high income Canadians.

We have a number of concerns with the structure of personal income tax credits as endorsed by the Committee and suggest that it would be appropriate to convert additional exemptions and deductions (including pension contributions) to credits. Most importantly, the new credits — which are indeed a welcome and progressive change from the existing system of exemptions and deductions which favours those in higher income brackets — should be fully indexed to inflation to preserve their value over time. We note that this position was supported before the Committee by groups as diverse as the Canadian Labour Congress and the Canadian Chamber of Commerce,

and the post-reform U.S. tax system is indexed to inflation. It should be stressed that total taxable income in the hands of individuals increases broadly in line with inflation, and that a failure to fully index credits thus represents a hidden annual tax increase. The cost of full indexation of the personal income tax credits could be reduced by deindexing credits claimable by upper income earners, thus matching the phase-out of tax credits in the U.S. (This phase-out means that the top marginal tax rate in the U.S. is higher than that proposed by the Conservative government.)

Recommendation 2

The personal income tax system should be fully indexed to inflation.

We further disagree with the approach of the White Paper and the Committee to the broadening of the personal income tax base. While progressive changes have been proposed, we would urge that other measures be taken.

Recommendation 3

We recommend that capital gains income (except for farmers and small businesses) be fully taxable and the lifetime exemption eliminated (as in the U.S.).

Recommendation 4

We recommend that other personal tax measures which largely favour the wealthy such as the deduction for RRSP contributions for upper income earners (the so-called "top ups"), special treatment of dividend income and full deduction for interest costs in excess of investment income be further reduced.

Again, revenue increases from these measures could be used in part to increase tax credits and thus to reduce effective rates of tax on lower and middle income Canadians.

We support the recommendations of the committee regarding the treatment of capital gains of farmers and small business, and we agree that taxation of capital gains income should be net of losses.

The goal of fairness demands that families living in poverty should not be liable to income tax. We urge that this objective be accomplished through further broadening of the tax base, changes in tax rates on upper income earners, and increases in tax credits as called for by the National Council of Welfare and other social policy groups.

In 1984, 287 wealthy Canadians with income of more than $250,000 paid no income tax, and many more paid tax at well below average rates. The minimum tax introduced in 1986 will remain necessary to prevent abuse, and should be overhauled to ensure that it is effective. (By the government's own admission, one in four non-taxable wealthy Canadians can still dodge the minimum tax.)

4. A Fairer Tax System for Families

The White Paper proposals continue the steady erosion of family benefits which has been in train since the 1985 Budget when family allowances were partially de-indexed and the child tax exemption sharply reduced. This reduction has been temporarily offset (for low income families) by increases in the child tax credit, but middle income families have seen a significant reduction. (At a family income level of $30,000 the family allowance net of tax, child tax credit and child tax exemption combined are worth $203 less than in 1984.)

Perversely, the White Paper proposals will give signficantly lower tax cuts to families with children, including low income single parent families headed by women, than to childless families and individuals. This is the result of the replacement of the child tax exemption with a derisory credit of just $65 per child. In addition, many families now in receipt of the refundable child tax credit will see a reduction in benefits. Overall, a two child low income family ($23,433) will receive a $56 cut in child benefits as a result of the White Paper proposals and a middle income family will lose more than $200. These reductions are in addition to those already experienced since 1985. The National Council of Welfare calculates that by 1991 total child benefits for a two child family at the poverty line will have been reduced by $314, while the average 2 child family will lose $925.

The Committee has gone some way towards addressing this erosion of support through the tax system for families with children, but much more needs to be done.

Recommendation 5

We urge that the value of the new $65 tax credit be significantly increased and indexed to inflation. The new credit could then be melded with an increased, re-indexed family allowance. We also reiterate the long-standing policy of the New Democratic Party to increase the existing refundable child tax credit by 80% — an essential step towards lifting low income families with children above the poverty line.

The above measures are essential if tax reform is to serve the interests of Canadian families, particularly families headed by women.

5. No Sales Tax on Food

Recent sales tax increases have added to the tax burden on low and middle income Canadians. Sales taxes are the most regressive and hidden form of taxation, hitting hardest at those spending most or all of their income on necessities and those who cannot afford to save, and bearing least on those who divert a significant share of current income to investments.

The Conservatives have used sales tax hikes to generate almost 60% of new revenues between 1985 and 1990, adding $600-700 to the tax bill of middle income

families. The low income tax credit fails to offset the impact on even the poorest families.

Canada now collects more revenue from these goods and service taxes (35% of total revenues) than most OECD countries (average 29%) and much more than in the U.S. (only 17% off all revenues). There is broad agreement on the need to overhaul the current federal Manufacturers Sales Tax which is damaging to Canadian industry, adversely affects Canadian jobs, and is generally a regressive form of taxation. The Conservatives are, however, being less than frank regarding their plans for sales tax changes and it is unlikely that Canadians will be told how the proposed new tax will work before the next election.

New Democrats are particularly disturbed that the option of a new broadly based sales tax on essential goods and services, including food, is still being considered. While Phase II of tax reform was not studied by the Committee, we wish to emphatically state our total opposition to such a new tax which could not be other than regressive in its impact. We would add that the prospect of a credit to offset sales tax increases on essentials like food is scarcely reassuring to low and middle income Canadians who have paid more and more in hidden taxes under this government and who have not been compensated by the derisory low income tax credit put in place by Mr. Wilson. Surely government assurances will be viewed with skepticism in view of the fact that even this small credit is not fully indexed to inflation.

The Committee has proposed a temporary 3% surcharge on the Manufacturers Sales Tax as an alternative to Mr. Wilson's interim sales tax measures. While this is preferable to the White Paper proposals, we cannot support any addition to the massive increase in the sales tax burden since 1984.

It is our strong view that reform of the Manufacturers Sales Tax should be undertaken in tandem with a commitment to reduce the share of the sales tax in the total federal tax burden.

Recommendation 6

Reform of the federal sales tax should not involve taxation of food and should reduce the reliance of the federal government on indirect taxes.

6. A Fair Tax Deal from Business

Personal and corporate income tax revenues were about equal in the early 1950s. By 1980, individuals were paying $3 for every $1 paid by corporations, and by 1990 individuals will pay $4 for every $1 paid by corporations. This shifting balance at the expense of ordinary Canadians must be reversed by rolling back unproductive corporate tax breaks and by making sure that profitable companies pay their fair share of tax. It is a scandal that inrecent years the majority of corporations in Canada have paid no tax at all even though the profits of such untaxed corporations have averaged between $10 billion and $12 billion each year. An effective corporate tax system is also needed to achieve greater stability in government revenues and to ensure that tax measures do indeed promote their avowed objectives of increasing investment and jobs.

The White Paper proposes a number of significant changes to the corporate tax system, including a tightening up of fast write-offs for new investment in machinery and equipment and elimination of some special breaks in the resource, finance and real estate sectors. At the same time, the general corporate tax rate will be cut from 36% to 28%, and the special rate for manufacturing will be cut from 30% to 23%. The overall result will be to increase corporate income tax revenues by $470 million in 1988, rising to an additional $1.58 billion in 1992 when the changes are fully phased in.

Mr. Wilson claims that these changes will ensure that "corporations will carry a bigger share of the total tax load," but the extent of the increase is modest even if government figures are taken at face value. To put the so-called "bigger share" into perspective, it should be recalled that the recent U.S. tax reform hiked corporate taxes by a total of $120 billion over 5 years. The comparable Canadian figure is a $5 billion total revenue increase over 5 years — or less than one half the U.S. increase relative to the size of corporate profits in the two countries.

Even with this increase in total revenues, corporate tax reform will result in significant tax reductions for many Canadian companies. While the average tax paid on profits will increase very marginally from 18.7% to 19.6%, the average will actually fall in a number of sectors. The only sectors to experience an increase will be mining (from 15% to 16.6%), manufacturing (from 18.9% to 19.7%) and finance (14.5% to 21.3%). In fact the Committee was skeptical that increases in the finance sector will be on anything like the scale suggested by Mr. Wilson.

Conservative "reform" of the tax system income tax will — if fully implemented — increase the share of the corporate income tax as a proportion of the total federal income and sales tax burden from 15.6% in 1987-1988 to 17.2% in 1991-92, but the proportion will still be below the 20.3% level when the Conservatives were elected.

The modest nature of Tory tax "reform" can be highlighted by comparison to the new U.S. tax laws which, as noted above, raised business income taxes by twice the amount of the Wilson proposals. In the U.S. there is a minimum tax of 20% of corporate profits; no such tax is proposed for Canada and indeed the White Paper itself estimates that 60,000 profitable Canadian corporations will continue to entirely escape payment of tax. In the U.S., is taxed on the same basis as other corporate profits, while in Canada 25% of such income will still not be liable to tax even when tax reform is fully phased in.

The White Paper also failed to move in some key areas which have caused concern. Interest costs incurred in corporate takeovers will continue to be deductible, and many lucrative tax breaks remain within the system. On balance, then, Tory "reform" of the corporate tax system can be judged a very modest gesture in the direction of greater fairness which fails to truly deliver what has been promised.

The Committee has moved some distance towards improving the White Paper proposals on corporate tax. We would, however, propose further measures.

The carry-forward of unused tax losses and deductions for up to seven years is a major underlying reason why profitable companies are able to avoid tax and corporate tax revenues fluctuate wildly from year to year. Indeed 35,000 companies will continue to escape tax after tax reform if no change is made to these provisions.

We are concerned that the deductibility of interest costs incurred in corporate take-overs will continue after tax reform, since tax revenues are in effect being used to encourage corporate concentration and unproductive mergers which result in job losses. Changes in this area must be sensitive to the need not to give foreign bidders for Canadian companies a competitive advantage, a problem that could be addressed by tighter rules on foreign ownership or by other administrative means. We are encouraged that the U.S. Congress is now considering new measures to limit interest deductibility.

Recommendation 7

Special treatment for capital gains relative to other corporate profits should be eliminated. Tax measures which favour large profitable corporations, such as the 7-year carry-forward/2-year carry-back loss provisions and deductibility of interest costs incurred in corporate take-overs should be reviewed.

The Committee has gone some way towards recognising and addressing the problem of untaxed profits and inter-corporate dividends. We particularly welcome those recommendations which will bring dividend income deductions more closely into line with the tax actually paid by the originating corporation, and which will impose fairer taxes on financial institutions. However, we continue to believe that a corporate minimum tax is needed to cover other reasons for minimal tax payment and to *ensure* that corporations earning profits are indeed obliged to pay tax. Such a measure is essential if the perception — as well as the reality — of fairness is to be restored to the tax system. The existence of a 20% corporate minimum tax in the U.S. demonstrates that technical problems are by no means insurmountable, and we urge that such a measure be implemented as a central element of tax reform while recognising that — to the extent reform is successful — such a minimum tax should only rarely come into play since corporate profits will indeed be liable to tax as a result of other measures. It should not be forgotten that — if the White Paper proposals are implemented as they now stand — 60,000 profitable corporations will continue to avoid tax.

Recommendation 8

That a corporate minimum tax be implemented.

The White Paper proposals continue to leave in place a number of special deductions and write-offs which should be further reviewed in terms of effectiveness and cost-efficiency. This is particularly true of those measures which allow expenses to be written-off at a faster rate for tax purposes than on corporate financial statements. Further, we are concerned that the White Paper has not examined proposals to target tax incentives more efficiently or to tie such incentives more directly to government objectives.

The central approach has been to remove or reduce corporate tax breaks while lowering corporate tax rates, an approach which explicitly recognizes the need to

maintain after tax reform a healthy rate of investment and a tax regime which does not impose undue competitive disadvantages on Canadian businesses. While recognizing the broad validity of this approach, we are concerned that the replacement of tax incentives with lower rates does not address a number of key problems.

To summarise, both tax deductions and low rates tend to favour large, well-established and well capitalised corporations at the expense of new businesses (especially small businesses) and companies in financial difficulties, for the obvious reason that both lack large taxable profits. The reliance on corporate tax deductions to stimulate investment has meant that large companies pay lower rates of tax than the small and medium sized companies (which in fact create the vast majority of new jobs), and that tax incentives have largely failed to benefit the weaker economic regions.

There have been some significant exceptions like investment tax credits for the regions. Flow through share provisions have also benefitted small companies and the sectors but are so broadly designed that large, well established corporations which do not need the assistance have also benefitted.

Recommendation 9

We urge the development of tax measures which are specifically targetted to smaller companies and to regions in need of investment.

We are disappointed that the Committee did not recommend alternative measures to encourage mineral exploration when the earned depletion allowance is phased out.

In our view, a share of the increased corporate revenues from real tax reform should be directed to small business and regions in need of economic development assistance in the form of either direct grants or investment tax credits. Such a policy would also help secure a greater degree of accountability for corporate tax expenditures.

7. A More Accountable Tax System

Government spending through the "hidden budget" of tax measures is as massive as it is unscrutinised. Analysts of tax expenditures point out that these measures — deductions, credits, special rates and the like — are designed not to raise revenue but to provide subsidies to activities which governments wish to encourage. As such, they should be evaluated on the same basis as direct government spending, according to such key criteria as efficiency, cost effectiveness, and fairness.

As the Nielsen Report on *Services and Subsidies to Business* argued, direct spending programs by government always involve prior studies on program design and delivery, complex internal audit and accountability procedures, and scrutiny of the spending of Departments by special internal units and a number of central government agencies such as Treasury Board, Parliamentary committees, and the Auditor General. But in the words of the Nielsen Report "taxation is a different world". Often there is

little clear evidence that a tax break will induce real changes, while spending programs are almost always subject to effectiveness tests. In addition, there is much evidence that direct spending is more cost efficient in many instances. Corporate tax breaks taken as a whole are, for example, a remarkably inefficient way of creating jobs. Certainly tax measures suffer from a number of defects in terms of efficiency and accountability — one of the most important being "automaticity", the fact that no lid can be placed on a tax expenditure program because all those qualified will be granted the deduction.

It is unfortunate that the Nielsen Task Force — while calling for greater efforts to evaluate the cost effectiveness of tax expenditure programs and sunset provisions on any new measures — spent only 221 pages out of 6500 pages examining this issue, and that it accepted the dominant view of large corporations and the wealthy that spending through the tax system is to be preferred because it involves less interference with private decision-making. It must be said, however, that the goal of efficiency is ill served when there is no adequate mechanism for the review of government tax expenditures which run to the tens of billions of dollars. The Auditor General pointed out in his 1984 Report that the federal government now spends 30¢-50¢ through the tax system for every $1 of government spending, and the Nielsen Task Force estimated that 1983 tax expenditures totalled $36 billion compared to direct expenditures of $57 billion. Clearly this massive "hidden budget" should be spent in an efficient and accountable manner to the greatest degree possible.

Recommendation 10

We urge that each tax expenditure program should be assigned to the relevant Department for review and consideration vis-à-vis alternative policy instruments; that an appropriate tax expenditure analysis should be presented annually with the spending estimates, the Budget, and the Public Accounts; and that tax expenditures should be integrated with the spending envelope system, and be subject to the approval of Parliament.

The key point is that the costs, rationale and objectives of tax expenditure programs should be made public in such a way as to facilitate full accountability.

8. A Simpler Tax System

Neither the White Paper nor the committee paid close attention to the issue of simplicity despite this being a stated objective of tax reform and a major concern of average taxpayers.

The personal income tax system should be made as clear and intelligible as possible in order to help restore public co-operation and trust. The average tax form is twenty times as long as it was thirty years ago, forcing even ordinary Canadian taxpayers to use expensive tax professionals to complete their returns.

A recent survey commissioned by Revenue Canada revealed that, in 1986, 51% of tax filers had someone else fill out their returns and 32% paid a tax preparer for that help. Tragically, this includes a large number of low-income Canadians who can ill afford the assistance of a tax firm or consultant.

This same Revenue Canada survey found that average taxpayers have found the tax form to be even less comprehensible since the election of the Mulroney government. In fact, the proportion of Canadians who have found the tax form to be excessively complex has doubled since that time, from 13% to 27%.

Recommendation 11

> **The government should develop a simple, plain language tax form that is readily accessible to all tax filers, and Revenue Canada officials should be available to meet with taxpayers on a regular basis to assist in tax filing.**

Conclusions

Opportunities to implement comprehensive tax reform rarely arise because powerful vested interests almost invariably resist real change while the general sentiment in favour of fairness is diffuse and hard to focus. The tax "reform" implemented in the wake of the Carter Commission almost 20 years ago fell far short of what was, in many respects, a blueprint for a much fairer tax system. The opportunity now before us must not be similarly wasted.

One way or another the Canadian tax system will be overhauled in 1988 because the current structure is unacceptable to all sectors of opinion and, quite frankly, because reform cannot be avoided in the wake of the massive overhaul of the U.S. tax laws. It does, however, very much remain to be seen if ordinary Canadians will gain a fairer tax system, or just a different tax system. Certainly New Democrats will continue to fight for a system which shifts the burden from average and lower income Canadians to the wealthy and to profitable corporations, and which helps secure growth and jobs in an efficient way. Any tax reform that does not accomplish the central objectives of fairness, efficiency and simplicity will not be worthy of the name.

Michael Cassidy
M.P. for Ottawa Centre
and
Simon de Jong
M.P. for Regina East

A copy of the relevant Minutes of Proceedings and Evidence of the Standing Committee on Finance and Economic Affairs (*Issues no. 70, 71, 73 to 77, 78 to 124 inclusive and no. 125 which includes this report*) is tabled.

Respectfully submitted,

Don Blenkarn, M.P.
Chairman

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Michael Cassidy
M.P. for Ottawa Centre
and
Simon de Jong
M.P. for Regina East

MINUTES OF PROCEEDINGS

TUESDAY, JUNE 23, 1987
(95)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:36 o'clock a.m. this day, in Room 209 (West Block) the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Raymond Garneau, Bob Layton, W. Paul McCrossan, George Minaker, Norman Warner and Geoff Wilson.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, Geoff Fisher and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Laurent Desbois and Terrence J. Thomas, Research Officers.

Pursuant to Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of its future business.

At 10:59 o'clock a.m., the Committee adjourned to the call of the Chair.

MONDAY, AUGUST 24, 1987
(103)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:37 o'clock a.m. this day, in Room 308 (West Block) the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Raymond Garneau, W. Paul McCrossan, George Minaker, Aideen Nicholson, Norman Warner and Geoff Wilson.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Edwin Grant Kroft and Barbara MacKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer. *From David Humphreys Public Affairs Group*: David Humphreys.

Pursuant to Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of its future business.

At 11:42 o'clock a.m., the Committee adjourned to the call of the Chair.

TUESDAY, SEPTEMBER 15, 1987
(129)

The Standing Committee on Finance and Economic Affairs met in camera at 12:10 o'clock p.m. this day, in Room 209 (West Block) the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Murray Dorin, Raymond Garneau, W. Paul McCrossan, Aideen Nicholson, Norman Warner and Geoff Wilson.

In attendance: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconner, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara MacKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer. *From David Humphreys Public Affairs Group*: David Humphreys, Margot Maguire.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of the draft Report to the House.

At 1:30 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 6, 1987
(158)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:51 o'clock a.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Other Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara MacKay, Research Officers.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of the draft report to the House.

At 1:14 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 8, 1987
(164)

The Standing Committee on Finance and Economic Affairs met *in camera* at 12:15 o'clock p.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Raymond Garneau, W. Paul McCrossan, Aideen Nicholson and Norman Warner.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara MacKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of the draft Report to the House.

At 1:29 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 13, 1987
(166)

The Standing Committee on Finance and Economic Affairs met *in camera* at 2:00 o'clock p.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 4:14 o'clock p.m., the sitting was suspended.

At 4:22 o'clock p.m., the sitting was resumed.

At 5:42 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 13, 1987
(167)

The Standing Committee on Finance and Economic Affairs met in camera at 7:52 o'clock p.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 9:53 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 14, 1987
(168)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:05 o'clock a.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 10:38 o'clock a.m., the sitting was suspended.

At 10:57 o'clock a.m., the sitting was resumed.

The Committee resumed consideration of the draft Report to the House.

At 12:09 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 14, 1987
(169)

The Standing Committee on Finance and Economic Affairs met in camera at 2:05 o'clock p.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara

McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 3:45 o'clock p.m., the sitting was suspended.

At 3:58 o'clock p.m., the sitting was resumed.

At 5:54 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 14, 1987
(170)

The Standing Committee on Finance and Economic Affairs met *in camera* at 7:50 o'clock p.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*SeeMinutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 9:58 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 15, 1987
(171)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:36 o'clock a.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 9:47 o'clock a.m. the sitting was suspended.

At 10:01 o'clock a.m., the sitting was resumed.

At 12:14 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 15, 1987
(172)

The Standing Committee on Finance and Economic Affairs met *in camera* at 1:32 o'clock p.m. this day, in Mont Ste-Marie, Quebec, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Suzanne Blais-Grenier, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee proceeded to the consideration of its future business.

At 2:27 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 20, 1987
(173)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:56 o'clock a.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, George Minaker and Norman Warner.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; France Castonguay, Geoff Fisher and Anthony Knill, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:11 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 20, 1987
(174)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:46 o'clock p.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Robert E.J. Layton, Aideen Nicholson, George Minaker and Norman Warner.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 5:54 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 20, 1987
(175)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:13 o'clock p.m. this day, in Room 253-D Centre Block, the Vice-Chairman, Robert E.J. Layton, presiding.

Members of the Committee present: Michael Cassidy, Simon de Jong, Murray Dorin, Robert E.J. Layton, W. Paul McCrossan, Aideen Nicholson and Norman Warner.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 9:59 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 21, 1987
(176)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:40 o'clock p.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, W. Paul McCrossan, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); France Castonguay, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

Witness: *From Peat Marwick*: Andy Friedman, Senior Tax Advisor.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

Andy Friedman answered questions.

At 4:35 o'clock p.m., the sitting was suspended.

At 4:40 o'clock p.m., the sitting was resumed.

The Committee proceeded to the consideration of the draft Report to the House.

At 5:30 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 21, 1987
(177)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:16 o'clock p.m. this day, in Room 253-D Centre Block, the Vice-Chairman, Robert E.J. Layton, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan and Aideen Nicholson.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 10:24 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 22, 1987
(178)

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:13 o'clock a.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Simon de Jong, Raymond Garneau, Robert E.J. Layton and George Minaker.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Edwin Kroft and Barbara McKay, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:34 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 22, 1987
(179)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:39 o'clock p.m. this day, in Room 253-D Centre Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Simon de Jong, Raymond Garneau, Robert E.J. Layton, George Minaker and Aideen Nicholson.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

Witness: *From the Canadian Bankers' Association*: A.G. Kenyon, Senior Vice-President, Taxation, Canadian Imperial Bank of Commerce.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

A.G. Kenyon answered questions.

At 4:36 o'clock p.m., the sitting was suspended.

At 4:42 o'clock p.m., the sitting was resumed.

At 6:07 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, OCTOBER 26, 1987
(180)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:50 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Robert E.J. Layton and George Minaker.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 5:41 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, OCTOBER 26, 1987
(181)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:17 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Murray Dorin, Aideen Nicholson and Norman Warner.

Other Member present: Geoff Wilson.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 10:02 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 27, 1987
(182)

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:08 o'clock a.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Robert E.J. Layton, George Minaker and Norman Warner.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Kirk Falconer, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:30 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 27, 1987
(183)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:54 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Murray Dorin, Raymond Garneau, Robert E.J. Layton, Aideen Nicholson and Norman Warner.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House. At 5:01 o'clock p.m., Robert Layton took the Chair.

At 5:24 o'clock p.m., Don Blenkarn took the Chair.

At 5:57 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, OCTOBER 27, 1987
(184)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:07 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Don Blenkarn, Michael Cassidy, Raymond Garneau, Robert E.J. Layton, Aideen Nicholson and Norman Warner.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 10:07 o'clock p.m., the Committee adjourned to the call of the Chair.

WEDNESDAY, OCTOBER 28, 1987
(185)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:55 o'clock p.m. this day, in Room 308, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, George Minaker and Aideen Nicholson.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, France Castonguay, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 4:42 o'clock p.m., the sitting was suspended.

At 5:07 o'clock p.m., the sitting was resumed.

At 6:10 o'clock p.m., the Committee adjourned to the call of the Chair.

THURSDAY, OCTOBER 29, 1987
(186)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:57 o'clock a.m. this day, in Room 308, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, George Minaker and Norman Warner.

In attendance: *From the Committee's Research Staff*: H. Bert Waslander, Research Director; Sean Aylward, Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:16 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 2, 1987
(187)

The Standing Committee on Finance and Economic Affairs met *in camera* at 10:15 o'clock a.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan and Aideen Nicholson.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:31 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 2, 1987
(188)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:39 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Raymond Garneau, Robert E.J. Layton and W. Paul McCrossan.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 6:02 o'clock p.m., the Committee adjourned to the call of the Chair.

MONDAY, NOVEMBER 2, 1987
(189)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:11 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Raymond Garneau, Robert E.J. Layton and W. Paul McCrossan.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 9:59 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 3, 1987
(190)

The Standing Committee on Finance and Economic Affairs met *in camera* at 9:38 o'clock a.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Michael Cassidy, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan, Aideen Nicholson and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 12:24 o'clock p.m., the Committee adjourned to the call of the Chair.

TUESDAY, NOVEMBER 3, 1987
(191)

The Standing Committee on Finance and Economic Affairs met *in camera* at 3:48 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher, Anthony Knill and Edwin Kroft, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

At 6:05 o'clock p.m., the Committee adjourned to the call of the Chair.

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:23 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: *From the Committee's Research Staff*: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher and Anthony Knill, Research Officers. *From the Research Branch of the Library of Parliament*: Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

Bill Attewell moved,- That the Draft Report as amended, be adopted as the Committee's Eleventh Report to the House and that the Chairman be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the Draft Report and that the Chairman be instructed to present the said Report to the House.

And the question being put on the motion, it was agreed to, on division.

It was agreed, - That, the Committee authorize the printing of the dissenting opinions of Raymond Garneau, M.P., from the Liberal Party and of Michael Cassidy, M.P. and Simon de Jong, M.P., from the New Democratic Party, in Appendix to the Committee's Eleventh Report provided they be in the hands of the Clerk of this Committee no later than Thursday, November 5 1987, at 9:00 o'clock a.m..

At 10:50 o'clock p.m., the Committee adjourned to the call of the Chair.

Marie Carrière
Clerk of the Committee

TUESDAY, NOVEMBER 3, 1987
(92)

The Standing Committee on Finance and Economic Affairs met *in camera* at 8:23 o'clock p.m. this day, in Room 269, West Block, the Chairman, Don Blenkarn, presiding.

Members of the Committee present: Bill Attewell, Don Blenkarn, Simon de Jong, Murray Dorin, Raymond Garneau, Robert E.J. Layton, W. Paul McCrossan and Norman Warner.

Acting Member present: Geoff Wilson for Mary Collins.

In attendance: From the Committee's Research Staff: C. David Weyman, Research Director (Tax Reform); H. Bert Waslander, Research Director; Geoff Fisher and Anthony Knill, Research Officers. *From the Research Branch of the Library of Parliament:* Terrence J. Thomas, Research Officer.

In accordance with its mandate under Standing Order 96(2), the Committee resumed consideration of the White Paper and other related documents on Tax Reform tabled in the House of Commons on Thursday, June 18, 1987. (*See Minutes of Proceedings and Evidence, Monday, June 22, 1987, Issue No. 70*).

The Committee resumed consideration of the draft Report to the House.

Bill Attewell moved, - That the Draft Report as amended, be adopted as the Committee's Eleventh Report to the House and that the Chairman be authorized to make such typographical and editorial changes as may be necessary without changing the substance of the Draft Report and that the Chairman be instructed to present the said Report to the House.

And the question being put on the motion, it was agreed to, on division.

It was agreed, - That, the Committee authorize the printing of the dissenting opinions of Raymond Garneau, M.P., from the Liberal Party and of Michael Cassidy, M.P. and Simon de Jong, M.P., from the New Democratic Party, in Appendix to the Committee's Eleventh Report provided they be in the hands of the Clerk of this Committee no later than Thursday, November 5,1987, at 9:00 o'clock a.m.

At 10:50 o'clock p.m., the Committee adjourned to the call of the Chair.

Marie Carrière
Clerk of the Committee

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