
As the senior voice of business in Canada, the Business Council on National Issues is the means by which leaders have chosen to contribute personally to the development of public policy and to the shaping of national priorities.

The Business Council comprises the chief executive officers of 150 leading Canadian corporations. With about 1.5 million employees, these companies administer over \$725 billion in assets and generate over \$275 billion in annual revenues.

The Council's purpose is fourfold: to help build a strong national and international economy, progressive social policies, healthy political institutions, and a more secure Canada.

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APPENDIX 1:

An International Comparison of The Corporate Income Tax Burden

FOREWORD

A bold and effective reform of Canada's taxation system is essential to strengthening the country's competitiveness and to enhancing our economic prospects. It was this conviction that compelled the business leaders who make up the Business Council on National Issues (BCNI) to call for comprehensive tax reform in 1984, and to launch a two-year assessment leading to a report and recommendations in 1986.

THE BUSINESS COUNCIL'S TAX REFORM GOALS

The Council's mission was strategic. It was to produce a framework for reform that would coalesce support within the Canadian economic community around a number of fundamental principles. Those principles emerged at the conclusion of our study. We advocated that personal and corporate income tax rates be sharply lowered, that the income and sales tax bases be broadened, and that the current reliance on personal income taxation be reduced by shifting the burden of taxation towards consumption. Underscoring these fundamentals was the Council's insistence that any tax reform initiative be a comprehensive and integrated one, and that reform result in a taxation system that is competitive with those of our major trading partners.

Our approach to tax reform was also influenced by our strongly held view that taxation is inextricably linked to other fundamental economic policies of the nation, in particular trade and industrial policy, and fiscal management. Canada's heavy dependence on export trade and the need to significantly improve the country's productivity performance led us to stress the competitiveness issue in the tax reform debate. The Council's long-standing concern about persistent deficits in our federal and provincial finances and the soaring national debt led us to remind our political leaders in Ottawa and in the provinces that taxation cannot and must not be a substitute for responsible fiscal management.

THE FEDERAL GOVERNMENT'S TAX REFORM INITIATIVE

The federal government under the leadership of the Minister of Finance, decided in 1986 to tackle tax reform in a comprehensive manner. The result of this initiative is the White Paper on Tax Reform -- an initiative which

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respects some of the fundamental principles recommended by the BCNI. Notable among these are the government's first steps in reducing personal and corporate income tax rates and its commitment to shifting the burden of taxation towards consumption. Also encouraging is the government's pledge to achieve broadening of the tax base and with it a sorely needed simplification of the system.

THE BUSINESS COUNCIL'S CONCERNS

Following a careful assessment of the federal government's tax initiative, the members of the Business Council remain concerned in a number of important respects.

Uncertainty of the form and timing of sales tax reform

The dominant concern is that the tax proposals leave unanswered questions as to the form and timing of the sales tax reform. In our recommendations in 1986, a condition of our support for a tax reform initiative was that the reforms must be comprehensive and integral. Our reasons were simple ones. First, we wanted to avoid long periods of delay in implementing reforms. Undue delays breed uncertainty and undermine business confidence. Secondly, we wanted to be assured that we could assess accurately the totality of the proposed reforms. The only way to do this is to know the full contents of the tax measures prior to their implementation.

The federal government instead has chosen to approach the reforms in two stages, promising action on the sales tax issue at some time in the future. In the meantime, in order to protect its revenue sources, it proposes to enact transitional measures that will add further to the shortcomings and complexities of the current system, and to the burden of taxation carried by corporations.

The Business Council, with considerable reluctance, chose to support the proposed two-stage approach for one major reason. We believe that it would be in the best interests of the economic community and the country as a whole to implement one national sales tax based on federal-provincial agreement. This will require intergovernmental negotiation and it will require time to accomplish.

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The key point here is that the time in question must be short and it must reflect a high degree of certainty. Accordingly, we recommend that the Finance Ministers of the federal government and the provinces engage immediately in consultations and work to achieve an agreement in principle on sales tax reform by January 1988. Having achieved an agreement in principle by that date, we recommend that legislation be introduced in the first quarter of 1988 and that a federal-provincial, multi-stage sales tax be adopted by January 1989. We recognize that the federal and provincial governments may balk at the ambitious schedule we are recommending for sales tax reform. Nevertheless, we are convinced that a combination of political will and administrative efficacy can overcome the obstacles that stand in the way. Failure to act swiftly may bear heavy consequences — among them the disintegration of business support for the federal tax initiative in its present form. (The Council accepts the possibility that an intergovernmental agreement may not materialize. In such a case, we would recommend that the federal government move without delay to implement sales tax reform at the federal level.)

The new federal-provincial, multi-stage sales tax should replace the Manufacturers' Sales Tax, federal income surtaxes, and provincial sales taxes. Moreover, the National Sales Tax should bear a higher share of the personal tax burden so as to reduce the excessive reliance on personal income taxation. And to encourage economic efficiency, the National Sales Tax should be applied on a comprehensive base of goods and services at a common federal rate, and should provide a full credit for taxes paid on business inputs.

The new sales tax, in our view, also should be used to replace any revenue losses resulting from the personal and corporate income tax changes the Council is proposing, to ensure that the overall reforms respect the goal of "revenue-neutrality". And so that the sales tax reform does not hurt low-income Canadians, the sales tax credit should be substantially enriched when the new measures are in place. It is also important, in our view, that the new sales tax be visible to consumers rather than hidden in the prices of goods and services.

The shortcomings of the corporate income tax proposals

In its recommendations, the Business Council insisted that a key goal of tax reform must be the enhancement of Canada's competitiveness. The tax system, in other words, must not be an impediment to the ability of Canadian

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enterprises to produce and to export goods and services. The federal government's corporate tax reform proposals acknowledge this fact insofar as they result in lower rates. However, we are concerned that a combination of measures in the tax reform package may in fact erode the competitive position of our enterprises. The measures that concern us most are: the sharp reduction in capital cost allowances for manufacturing equipment, including the put-in-use rule; the proposed reduction in incentives for research and development; the telecommunications tax, which will be borne primarily by business; and the proposed changes which will increase capital gains taxes. These changes would result in a net increase in the tax burden borne by the corporate sector, which in turn has negative implications for investment, production and job creation.

We believe that the proposed reduction in the capital cost allowances for manufacturing assets is too large to be achieved over the planned four-year period, and we recommend that the severity of the proposals be mitigated. Modification of the put-in-use rule, which would unduly delay claims for tax depreciation on new investments, is also required to reduce the uncertainty that this would cause businesses considering large capital investments.

The proposed restrictions on the research and development tax credit should be rescinded. Research and development expenditures are a legitimate business expense and should not be arbitrarily restricted, particularly when the level of research and development and innovation in Canada already lags so far behind the levels of our trading partners.

To build upon the positive aspects of the proposed federal reforms, corporate income tax rate reductions at the provincial level would be desirable to help bring combined federal-provincial tax rates down towards the goal of 35 percent -- the goal recommended by the Business Council in its reports on tax reform. Provincial rate reductions could be financed by the revenue increases that will occur as a result of the changes made to the federal corporate tax base. We acknowledge that this measure would require that the proposed personal tax cuts be financed to a greater extent by increased reliance on the National Sales Tax. However, we believe it is appropriate for personal income tax cuts to be financed by increases in expenditure taxation rather than by higher corporate taxes.

An additional problem, which needs to be addressed in our view, is the lack of indexation in the corporate tax system. This shortcoming erodes the value of

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unclaimed capital cost allowances and also results in the overstatement of profits. To mitigate the effects of this problem, we urge that consideration be given to introducing inflation adjustments on either an ad hoc or a regular basis. Adjustments of this nature, of course, should not be considered an appropriate substitute for a vigorous anti-inflationary policy -- a policy which remains a cornerstone of overall Business Council economic priorities.

The shortcomings of the personal income tax proposals

The federal government's proposals for reform of the personal income tax are encouraging. Lower marginal rates, a broader tax base and the shift of the burden of personal taxation towards expenditure are steps in the right direction. They will reward individual initiative more fairly. And as personal rates of taxation fall, respect for and compliance with the tax system will rise among most Canadians.

In our view, however, the proposed reductions in personal tax rates do not go far enough. Further rate cuts are desirable, at both the federal and provincial levels, and these should be financed by a shift towards expenditure taxation. The shift towards expenditure taxation can be achieved through a greater use of deferred savings plans similar to Registered Retirement Savings Plans (RRSPs) or by increased reliance on sales taxes. We believe that contribution limits for deferred savings plans should be increased in both absolute terms and as a percentage of individual income. This would permit individuals to effectively forward-average their income and would reduce the double taxation of savings.

On the sensitive question of capital gains taxation, the position of the Business Council is clear. We were prepared, in our recommendations of 1986, to consider the elimination of the preferential treatment of capital gains "if tax reform was comprehensive, including the indexation of the cost base of assets, and if marginal rates of personal taxation fell very sharply." In the current federal government proposals, this has not happened and we are concerned, therefore, with the dampening effect on investment and entrepreneurialism of higher taxes on capital gains. Accordingly, we recommend that the federal proposals in question be revised.

Finally, there is the matter of indexation. The existing partial de-indexation of the personal tax brackets and exemptions results in automatic tax increases in an inflationary environment -- increases that are not visible and for which

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the government need not account -- increases that materialize even when real incomes remain constant. The Council recommends, therefore, that the personal tax system, including tax brackets, credits and exemptions, be indexed for inflation.

TAX REFORM AND THE NATIONAL AGENDA

The coming months will be critical ones for the Canadian economy. International trade, fiscal policy, and taxation issues dominate the national economic agenda. (The Business Council's views on the importance of these three issues is contained in a recent statement, "The Triple Challenge -- An Economic Statement of the Business Council on National Issues" dated September 9, 1987.) Maintaining momentum on taxation reform will present a difficult challenge in an environment so heavily loaded with other pressing issues. In our view, tax reform deserves priority attention at both the federal and provincial levels. It is imperative that agreement be reached on a National Sales Tax -- and that the economic community in Canada be confident that governments will act on this question without delay. Otherwise support for the initiatives taken by the federal government to date may collapse, and an important opportunity will be lost.

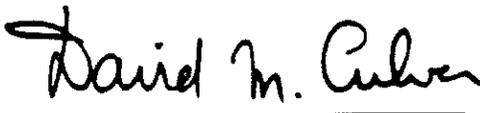
In this statement, we have commented on the positive aspects of the federal government's tax proposals. We also have offered our views on the shortcomings. We expect that some of our criticisms will be resisted by the federal authorities on the grounds that they would disrupt the revenue balance contained in the tax proposals. In anticipation of encountering this resistance, we offer two suggestions -- suggestions that conclude our statement.

First, we readily acknowledge that tax reform must achieve greater fairness and simplicity. These are principles which the Business Council strongly supports. But tax reform also must result in enterprises that are more efficient and competitive. Upon the attainment of this goal depend investment, job creation and economic prosperity. The balance being sought by the government among the personal, corporate and sales tax reforms must recognize the importance of this goal.

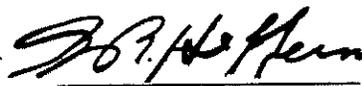
Secondly, accommodation of our concerns should not result in an even higher deficit. Heavier taxation or a higher deficit have never been accepted by the Council as the only ways to meet the government's spending requirements.

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Indeed, taxes have risen very considerably in recent years and deficits still remain unacceptably high. The answer to this conundrum lies, in part at least, in further expenditure reduction and in the avoidance of new spending, other than for absolute essentials. This is a prescription that those in public office and some special interest groups -- undoubtedly some businesses among them -- may not want to hear. But, hear it they must. For tax reform will never be successful if the critical link between sound fiscal management and taxation is not fully appreciated and acted upon.



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SUMMARY OF RECOMMENDATIONS

1. SALES TAX REFORM

- 1.1 A federal-provincial multi-stage National Sales Tax should be implemented without delay to replace the Manufacturers' Sales Tax, provincial sales taxes and the existing federal income surtaxes.
- 1.2 We recommend that the Finance Ministers of the federal government and the provinces accelerate their consultations and work to achieve an agreement in principle on sales tax reform by January 1988. Having achieved an agreement in principle by that date, we recommend that legislation be introduced in the first quarter of 1988 and that a federal-provincial, multi-stage sales tax be adopted by January 1989.
- 1.3 The new National Sales Tax should replace any revenue losses resulting from the personal and corporate income tax changes we advocate.
- 1.4 The new multi-stage National Sales Tax should be applied on a comprehensive base of goods and services at a common (federal) rate and should be structured to provide a full credit for taxes paid on business inputs.
- 1.5 The new sales tax should be visible to consumers rather than hidden in the prices of goods and services.
- 1.6 To insulate low-income Canadians from the increased expenditure tax burden, the sales tax credit should be increased.
- 1.7 The National Sales Tax should be set at a level which will re-establish a more appropriate balance between revenues raised from the income and sales tax systems.

2. CORPORATE INCOME TAXATION

- 2.1 We urge that the competitive impact of the planned increase in the corporate tax burden resulting from the sharp reduction of capital cost allowances be reviewed and that serious consideration be given to reducing the severity of these measures before they proceed the full distance proposed in the White Paper.
- 2.2 We recommend that the provinces reduce their corporate income tax rates to help bring combined federal-provincial corporate tax rates down towards 35%. This measure could be financed by base-broadening.

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- 2.3 We recommend that the proposed restrictions on the use of research and development investment tax credits be rescinded. Tax benefits from research and development expenditures should not be restricted arbitrarily to some corporations.
- 2.4 We recommend that consideration be given to means of introducing inflation adjustments in the corporate income tax system. This can be achieved through either appropriate ad hoc measures or by the wholesale indexing of the tax system.
- 2.5 We recommend that the problems associated with the administration and interpretation of the proposed General Anti-Avoidance Rule be examined in greater detail with private sector representatives before such a major step is taken.

3. PERSONAL INCOME TAXATION

- 3.1 Provincial income taxes should be reduced in line with the reductions in federal tax rates to help bring top combined federal-provincial rates down towards 35%. This measure will require increased financial reliance on expenditure taxation.
- 3.2 Full inflation indexing should be reintroduced when fiscal circumstances permit.
- 3.3 Income-averaging provisions should be retained to recognize the high degree of annual variation in personal incomes.
- 3.4 Annual contribution limits for registered savings vehicles should be increased, over time, beyond those maximum limits currently proposed in order to permit improved income forward-averaging and to reduce the burden of double taxation on personal savings. Allowable contribution increases should be made in both absolute terms and as a share of income.
- 3.5 We recommend that the proposed increases in capital gains taxation that would result in capital gains bearing higher taxes than dividends be reconsidered, since this proposal would discourage risk-taking and introduce distortions in the financial markets.

1. SALES TAX REFORM

1.1 The Imperative of Sales Tax Reform

In recent decades, Ottawa and the provinces have generated a rising share of total tax revenue from the direct taxation of income. Less revenue has come from indirect sources such as sales taxes.¹ However, when income is taxed heavily people tend to spend rather than save -- because both the income from which savings are made and the return on these savings (e.g. interest, dividends) are taxed. This discourages saving and economic investment with the result that our economy is less efficient and competitive.² And the net result of slower economic growth is a slower rate of job growth. The Macdonald Commission described the problems caused by high rates of income taxation and the benefits of greater reliance on consumption/expenditure taxation in the following way:

"Consumption taxation, unlike income taxation, does not distort savings. An income tax, by taxing the returns to savings, raises the "price" of future consumption relative to present consumption and thus favours the latter. Under a consumption tax, present and future consumption bear the same rate of tax. The consumption tax, therefore, does not influence the timing of consumption or the level of savings and investment. Replacement of the income tax by a consumption tax would also result in an increase in the labour supply and in the rate of return on investment. It would appear then, that the move from an income-based tax to a consumption-based tax could result in substantial efficiency gains and a major boost to GNP."³

Tax reform must not discourage investment at the same time as it finds ways to finance Canada's large and costly public sector, ways that do not stifle growth and leave us unable to compete. In part, we can do this by moving to an integrated and comprehensive tax in each area, and by shifting a greater share of the tax burden towards expenditure taxation. Together with an expanded system of low-income tax credits, such a move would enhance both the progressiveness and competitiveness of the tax system.

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The prompt replacement of the existing federal Manufacturers' Sales Tax, federal income surtaxes and provincial sales taxes with a broadly-based expenditure tax is imperative to improving our economic efficiency and competitiveness. The Manufacturers' Sales Tax is a harmful anachronism which favours imported products over domestically produced ones, reduces the ability of our exporters to remain competitive and applies at widely varying effective rates among products thus distorting demand and production patterns.⁴ The expeditious replacement of the Manufacturers' Sales Tax with a National Sales Tax must therefore be recognized as an urgent national priority.

The BCNI supports the replacement of the Manufacturers' Sales Tax with a federal-provincial, multi-stage sales tax applied at a uniform (federal) rate on as broad a tax base as possible. Such a reform would improve the fairness of the overall tax system, permit personal tax rates to be further reduced and help Canadian industry to generate additional exports and employment. **According, we urge that the Finance Ministers of the federal government and the provinces accelerate their consultations and work to achieve an agreement in principle on sales tax reform by January 1988. Having achieved an agreement in principle by that date, we recommend that legislation be introduced in the first quarter of 1988 and that a federal-provincial, multi-stage sales tax be adopted by January 1989.**

We recognize that the federal and provincial governments may balk at the ambitious schedule we are recommending for sales tax reform. Nevertheless, we are convinced that a combination of political will and administrative efficacy can overcome the obstacles that stand in the way. A

swift resolution of this outstanding issue will contribute very significantly to business certainty and confidence -- essential ingredients of economic development.

1.2 The Sales Tax Base

We support the option of a broadly-based multi-stage National Sales Tax. Applying the tax to a broad base will permit rates to be kept down and would have a neutral impact on consumption patterns because the tax would represent an equal share of all prices at the consumer level. The more the tax base is narrowed by exemptions and special concessionary rates, the higher the general sales tax rate will have to be to raise the same amount of revenue. A broad tax base could extend to food products, which constitute 12% of personal consumption,⁵ and should be extended to services, which are largely exempt from taxation. Now that our economy is service-oriented it is anachronistic to maintain the tax on manufactured products and to exclude other sectors of the economy from sales taxation. The application of the new National Sales Tax to both food and services would thus improve its fairness and economic neutrality.

The application of a sales tax to food is not inconsistent with the goals of progressivity and improved fairness for three primary reasons. First, the application of a sales tax to food would be fully offset for the low-income population by prepaid, refundable sales tax credits. Second, the more affluent half of the population spends much more on food than the lower-income half, and would thus contribute proportionately more to government revenues if food were taxed.⁶ Third, if food is exempted from the new sales tax, the

revenues foregone will have to be made up by increasing the rate of tax on the remaining tax base -- which will result in higher costs for the low-income population on their other items of consumption.

An additional consideration is that a significant share of food consumption is already taxed by the federal and provincial governments. Not only are restaurant meals widely taxed by provinces but confectionery products, soft drinks and snack foods are subject to federal and some provincial taxation as well. Furthermore, government sanctioned marketing boards already impose indirect "taxes" on eggs, milk, wheat, chicken and many other products by setting wholesale prices and restricting supply.⁷ Accordingly, the application of a National Sales Tax to food would not be inconsistent with current public policies in Canada. A broadly-based sales tax will enable government to raise tax revenue in the fairest and most neutral way and, even if this includes food, the goal of progressivity need not be compromised in the slightest. Indeed, the intention of the government to more than offset the impact of a National Sales Tax for the low-income population with higher sales tax credits indicates that progressivity will actually be improved by Stage 2 of the tax reform process.

1.3 The Role of a National Sales Tax

Whereas the current administration of separate federal and provincial sales taxes entails high compliance costs and considerable complexity, the adoption of a National Sales Tax applied on a common base of goods and services would simplify the administration of sales tax collection in Canada. Consumers would benefit from such a reformed system because administrative

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costs would decline and because economic efficiency would be improved by having taxes represent a more equal share of product/service prices than is now the case. In addition, the prevalent tax "cascading" process, where taxes are applied on top of one another, would be ended. The benefits of a National Sales Tax would be considerable, and we urge all provinces and the federal government to work together to realize such an achievement without delay.

We endorse the White Paper's proposal to use the new National Sales Tax to replace the Manufacturers' Sales Tax, provincial sales taxes, and the current income surtaxes and to raise additional revenues to permit personal income tax rates to be cut further. However, we believe that the proposed personal income tax rate cuts are too small, and that larger cuts effecting all tax brackets are needed which could be financed by a more significant shift of the tax burden towards expenditure taxation. The planned reduction of the proposed middle-income bracket -- i.e. down from the 26% rate -- is particularly important given that this federal rate would result in an excessive combined federal-provincial income tax rate of around 40% for middle-income earners. Greater reliance on expenditure taxation will reduce the current over-dependence on income taxation. This will promote savings, investment and economic growth.

1.4 The Planned Increases in the Existing Commodity Tax System

The proposed "transitional" increases in commodity taxes as part of Stage 1 of the tax reform process represent a retrograde step for tax policy rather than "tax reform." These tax increases, especially the new telecommunications tax and the switch to the wholesale level for a significant

part of the federal sales tax, will fall largely on business and result in a further erosion of the competitive position of Canadian industry. The proposed increases in commodity taxation are also at variance with the principles underlying the tax reform package because they would make the tax system less neutral and more burdensome. Accordingly, we recommend that the transitional commodity tax measures be replaced as soon as possible by the adoption of a National Sales Tax.

Recommendations

- 1.1 A federal-provincial multi-stage National Sales Tax should be implemented without delay to replace the Manufacturers' Sales Tax, provincial sales taxes and the existing federal income surtaxes.
- 1.2 We recommend that the Finance Ministers of the federal government and the provinces accelerate their consultations and work to achieve an agreement in principle on sales tax reform by January 1988. Having achieved an agreement in principle by that date, we recommend that legislation be introduced in the first quarter of 1988 and that a federal-provincial, multi-stage sales tax be adopted by January 1989.
- 1.3 The new National Sales Tax should replace any revenue losses resulting from the personal and corporate income tax changes we advocate.
- 1.4 The new multi-stage National Sales Tax should be applied on a comprehensive base of goods and services at a common (federal) rate and should be structured to provide a full credit for taxes paid on business inputs.
- 1.5 The new sales tax should be visible to consumers rather than hidden in the prices of goods and services.
- 1.6 To insulate low-income Canadians from the increased expenditure tax burden, the sales tax credit should be increased.
- 1.7 The National Sales Tax should be set at a level which will re-establish a more appropriate balance between revenues raised from the income and sales tax systems.

2. CORPORATE TAXATION

Major corporate income tax reforms have been undertaken in both Britain and the United States in the last two years which have reduced corporate tax rates sharply and broadened corporate tax bases. These reforms reflect the well-founded concern that the developed western countries may fall behind in the race for international competitiveness unless they can achieve greater economic efficiency. Improving economic efficiency and growth by making the corporate tax system more neutral between sectors and more competitive internationally must be a primary goal of our tax reform process as well. The tax reforms undertaken by our established trading partners, adding to the rivalry posed by the growing ranks of our new competitors, must therefore provide the guideposts by which we reform our own system of corporate taxation.

2.1 International Competitiveness

Canada faces many non-tax competitive disadvantages with regard to its major international competitors. Not only are many business inputs more costly in Canada than the United States (e.g. construction, capital borrowing rates), but manufacturing economies of scale and new product innovations also lag behind those of other major industrialized countries due to our smaller market.⁸ As already stated, commodity taxes also raise domestic production costs and hurt our competitiveness. To counterbalance these disadvantages, the corporate income tax system must ensure that our high domestic cost base is not translated into a declining ability to compete at home and abroad.

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The goal of achieving superior international competitiveness suggests that Canadian tax reform should not strive to achieve a tax structure that strictly parallels those of our major competitors. Rather, the benchmark for corporate tax reform must be the ability of our export products, both goods and services, to compete in an ever more difficult international marketplace. We believe that the question of international competitiveness has been given unacceptably short shrift in the White Paper on Tax Reform, and urge that greater consideration be given to the challenge of improving our national competitiveness in the continuing debate on corporate tax reform.

The Business Council supports the broad thrust of the corporate income tax reform measures which even out intersectoral tax levels and provide lower income tax rates. However, we believe that the country's competitiveness may be hindered by a combination of measures in the tax reform package, including those involving a sharp reduction in capital cost allowances, reduced research and development incentives, the relative worsening of the treatment of dividend income and other changes that make capital more difficult to raise. The increase in federal corporate income tax revenues alone is expected to grow from \$530 million in 1988-89 to \$1,525 million in 1991-92, with corporations also being required to pay very substantial additional provincial income taxes and the largest part of the increased sales tax burden.

Capital Cost Allowances

The proposed reductions in capital cost allowances will increase the threshold of viability for new investments and reduce the after-tax returns from those new investments which go ahead. The most significant proposal is

the reduction in the benchmark capital cost allowance on most manufacturing equipment (class 29) from its present 3-year straight-line writeoff to a declining balance amortization at the rate -- ultimately -- of 25%. This represents a major cutback in the depreciation allowance on such equipment, reducing it to a level well below that allowed for the past two decades and below that in the United States. (On a roughly equivalent basis, a substantial amount of U.S. manufacturing equipment falls into a 7-year depreciation class, resulting in depreciation which is the equivalent of about 31% on a declining balance basis.) Accordingly, we believe that the proposed cutbacks in capital depreciation rates should be made less severe and that it would be desirable to halt the phase-in of planned changes in the area of capital cost allowances before they proceed the full distance proposed in the White Paper.

2.2 The Corporate Tax Burden: An International Comparison

The average corporate income tax burden in Canada is relatively high by international standards as a percentage of national income. The White Paper proposals would further increase this heavy burden. Taxes on corporate profits as a percentage of gross domestic product (GDP) in Canada were above the average of all Organization for Economic Co-operation and Development (OECD) countries in 1984, the most recent year in which comparative statistics are available. (see Appendix 1, Table 2 and 3)⁹ Corporate taxes in Canada by this measure were even higher than those in the high-tax countries of Sweden and France. Furthermore, the Manufacturers' Sales Tax, which is an indirect business tax unique to Canada, adds significantly to the domestic tax burden borne by corporations.

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Canadian corporate income taxes as a percentage of GDP measured almost 43% higher than the income tax burden borne by United States corporations in the same year (i.e. 3% of GDP in Canada vs. 2.1% in the U.S.). While U.S. corporate income taxes have recently risen and somewhat reduced this discrepancy, the remaining difference in the relative weight of corporate income taxation between Canada and the United States must be of particular concern to policymakers given the considerable integration of our economies and the potential for mobility of people and corporations.¹⁰

Canada's international competitiveness has been improving in recent years. While the European Management Forum (EMF) ranked Canada in 11th place for international competitiveness in 1984, our 1986 ranking improved to 6th place.¹¹ The two major domestic economic problems noted by the Management Forum in its latest analysis of Canada's competitiveness are high labour costs and a low pace of investment in the private sector. The EMF noted in this regard that corporations in Canada paid the 7th highest share of income taxes paid by corporations in all OECD countries (based on 1983 data, see: Appendix 1, Table 3).¹² The EMF also noted that our system of capital depreciation -- which the White Paper now proposes to reduce sharply -- ranked in 9th position (out of 21) in terms of its perceived generosity (Appendix 1, Table 4).¹³

Given that the White Paper proposes to reduce the incentives for capital investment, serious consideration must be given to the impact that this will have on our international competitiveness. On this question, a recent analysis of the implications of the EMF's findings on Canadian competitiveness by Professors D'Cruz and Fleck of the University of Toronto noted that:

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"The pace of investments in Canadian manufacturing may improve somewhat in the future. Canada's business leaders are optimistic about prospects for profits in 1986 and beyond. As long as the tax system permits businesses to retain a significant proportion of these profits, reinvestment in manufacturing may help to turn around the country's poor performance in productivity growth. Problems may arise, however, depending on Canada's responses to the recent reforms of the tax system in the U.S. ... If Canada follows suit (and increases corporate taxes) improvements in corporate profits will be less likely to result in increased investment."¹⁴

The White Paper notes that the share of direct income taxes paid by corporations has declined over time, and suggests that corporate income tax increases are needed to restore balance in the tax system. These claims serve as the basis for federal corporate income tax increases that will amount to \$5 billion over the next five years, plus increases in other indirect corporate taxes (e.g. the telecommunications tax and higher commodity taxes) and probable increases in provincial corporate income taxes. There are several factors which explain why the share of total income taxes paid by corporations has declined, and these suggest that the planned substantial increase in corporate taxes is both unreasonable and unnecessary.

First, the share of national income accruing as corporate profits has declined sharply over the last thirty years, falling from around 14% in the early 1950s to about 9% in recent years (see Appendix 1, Table 1).¹⁵ This relative decline in profitability accounts for a large part of the observed decrease in corporate income tax receipts as a share of all income taxes.

Second, and the obverse of the first, is the fact that the rising incomes of individual taxpayers have yielded a more than proportional increase in taxes

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due to the progressive nature of the personal income tax system.¹⁶ The share of taxes paid by individuals was also increased by the lack of indexation in the personal income tax system before 1974. (In contrast, corporate income taxes apply at a flat rate).

Third, personal income taxes have risen largely to pay for the rapidly expanding social programs that directly benefit individuals, such as Medicare, Unemployment Insurance, post-secondary education, the Family Allowance and the Old Age Security program. Individuals should properly be expected to pay a larger share of the total tax burden when taxes are raised primarily to finance social spending. This is the case now that social spending accounts for almost two-thirds of federal program expenditures and is the most rapidly growing area of program spending.¹⁷ Moreover, Canadian businesses, which export 63% of the goods they manufacture in Canada and also "export" a growing share of services,¹⁸ cannot be expected to absorb a continuously increasing tax burden imposed to finance rising domestic social spending since these costs cannot readily be passed on to foreign customers. If the prices of our domestic products/services rise more quickly than those of our competitors because the costs of social spending are shifted to business, Canadian businesses will inevitably lose both export sales in the competitive international markets and sales to imports in the domestic market. A higher domestic corporate tax burden will also encourage firms to locate new investments in countries offering lower levels of taxation.

All of these factors explain why the share of total federal taxes paid by corporations has declined over the last thirty years, and suggest that the allegation that corporations "aren't paying their fair share" is unfounded.

Indeed, the share of corporate profits paid in taxes has risen from 38% in 1964 to over 53% for the 1984 tax year (See Appendix 1, Table 1). We believe that the government has failed to make a case for increasing direct (i.e. on income) and indirect corporate taxes (e.g. the new telecommunications tax and increased commodity taxes). Accordingly, we oppose the huge and growing shift in the overall tax burden towards business proposed by the White Paper. We recommend that the planned overall increase in corporate taxes be reviewed and that in-depth studies be undertaken to determine the impact that the proposed tax increases will have on the competitiveness of the Canadian corporate sector.

2.3 The Put-In-Use Rule

This proposal could have an onerous impact on resource "mega-projects" and other major investments where high costs must be incurred over a period of years before income is earned. Given that Canada's industrial structure is heavily dependent on resource development and other capital-intensive activities, the put-in-use rule could raise significantly the threshold of economic viability for new investments.

The intention of the government to compensate for the adverse effect of the put-in-use rule by negotiating the fiscal terms governing mega-projects on a case-by-case basis is a positive but less than satisfactory measure that would result in an inconsistent and discriminatory fiscal treatment of investment projects. Ad hoc fiscal arrangements will not likely be as generous or predictable as the current regime. One compromise position which would both increase government revenues and provide the certainty needed for corporate

planning would be to allow corporations to continue to claim one-half of the capital cost allowance earned each year on projects under construction (because of lower CCA rates this would result in lower depreciation claims and higher current tax liabilities). Given the necessity of reducing uncertainty to permit business planning, further study must be devoted to the compromise position we propose and other mechanisms which would lessen the severity of the put-in-use proposal.

2.4 Inflation and Corporate Taxation

The lack of any proposal for inflation indexing in the White Paper is cause for concern. Due to the lack of inflation indexation, the value of capital cost allowance claims, which are based on historical costs, is eroded. Corporate profits are also overstated due to the lack of inventory value indexation. Capital gains taxes are also unfairly increased by the lack of indexation of capital assets. These problems will be aggravated by the proposed reduction in capital cost allowances and the increase in the inclusion rate for capital gains (i.e. 75% of capital gains will be included as regular taxable income by 1990, even though a significant share of capital "gains" merely reflect inflationary price increases). Accordingly, we recommend that consideration be given to means of introducing inflation adjustments in the corporate tax system. This can be achieved either with appropriate ad hoc measures or -- perhaps ultimately -- by the wholesale indexing of the corporate tax system.

2.5 Research and Development Incentives

Higher levels of industrial research and development are essential to

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promoting a more advanced and competitive manufacturing sector in Canada, which now lags behind all major western countries in the share of national income devoted to industrial research and development.¹⁹ Given the competitive necessity of keeping up with technological change, we support the decision to retain the basic tax credits for research and development in Canada. However, we reject the proposed measure which would reduce the incentive for research and development in Canada by restricting the amount of the research and development investment tax credit that a corporation can use to reduce of its federal tax liability. This measure is arbitrary and ignores the fact that research and development is a legitimate business expense. This proposal constitutes a sort of corporate minimum tax that applies in a selective and unjustified manner.

The proposed change in the R&D investment tax credit would be particularly harmful to the leaders in innovation who spend the largest amounts on research and development. It is unfair to blunt selectively the effectiveness, for the leading research and development corporations, of an incentive that is regarded as appropriate for those that spend substantially less on research (since smaller firms and firms spending only modest amounts are still permitted a full offset). We therefore urge that R&D investment tax credits continue to be available to offset all federal income tax. The tax credit should also apply to expenditures made to acquire buildings for R&D purposes. Failure to rectify these proposals could mean that the most active companies in research will be excluded from the full benefits of the R&D tax credit and may never be able to claim all of the credits to which they are legitimately entitled. This would discourage R&D activities in Canada at a time when encouragement is needed.

2.6 Provincial Tax Rates

The reductions in federal corporate tax rates proposed in the White Paper are highly desirable. Rate reductions at the provincial level will also be required to bring overall corporate income tax rates down towards the goal of 35%. Provincial rate reductions could be financed by the corporate tax revenue increases that will occur as a result of the changes made to the federal corporate tax base.²⁰ The reduction of provincial corporate income tax rates would require that personal tax cuts be financed to a greater extent by increased expenditure taxation. However, this need not result in lower corporate tax receipts at the provincial level -- despite lower corporate rates -- because the corporate tax base would be broader.

2.7 The General Anti-Avoidance Rule

The Business Council supports the objective of reducing tax avoidance. However, the proposed general anti-avoidance rule would hinder many normal business transactions in addition to reducing some avoidance activities. The general anti-avoidance rule could be used in a heavy-handed way to increase tax revenues and its lack of precision will increase uncertainty and delays in business planning. The net effect could be to discourage legitimate business activities. Accordingly, we recommend that, before such a major step is taken, the compliance costs of adopting general rather than specifically targetted anti-avoidance measures be examined in greater detail in consultation with private sector representatives.

Recommendations

- 2.1 We urge that the competitive impact of the planned increase in the corporate tax burden resulting from the sharp reduction of capital cost allowances be reviewed and that serious consideration be given to reducing the severity of these measures before they proceed the full distance proposed in the White Paper.
- 2.2 We recommend that the provinces reduce their corporate income tax rates to help bring combined federal-provincial corporate tax rates down towards 35%. This measure could be financed by base-broadening.
- 2.3 We recommend that the proposed restrictions on the use of research and development investment tax credits be rescinded. Tax benefits from research and development expenditures should not be restricted arbitrarily to some corporations.
- 2.4 We recommend that consideration be given to means of introducing inflation adjustments in the corporate income tax system. This can be achieved through either appropriate ad hoc measures or by the wholesale indexing of the tax system.
- 2.5 We recommend that the problems associated with the administration and interpretation of the proposed General Anti-Avoidance Rule be examined in greater detail with private sector representatives before such a major step is taken.

3. PERSONAL INCOME TAXATION

Personal income tax reform which sharply lowers tax rates is overdue. High marginal income tax rates discourage personal initiative and also encourage tax avoidance. Moreover, the broad range of rates, exemptions and deductions has become incomprehensible to a growing number of taxpayers, while the complexity of the system has fostered mistrust. Tax reform which reduces the number of tax brackets, lowers tax rates and provides fixed tax credits in place of exemptions and deductions will make income taxation fairer, better understood and, hopefully, better respected.

A key to maintaining public respect for the income tax system is to keep marginal rates as low as possible. And, ultimately, the best way to reduce the burden of personal taxation is to strictly control government expenditures. In this regard it is essential that the debate over tax policy reform not be divorced from discussions on the federal deficit and the control over federal and provincial government spending.

3.1 Personal Income Tax Rate Reductions

The reform proposals to lower marginal tax rates are highly desirable but do not go far enough. The share of the total personal tax burden which will continue to be borne by income taxation remains excessive.²¹ Combined maximum federal and provincial income tax rates (with the federal surtax) will exceed 44%, on average, and remain significantly in excess of corresponding figures in the United States. These high rates of income taxation will continue to discourage economic effort and point to the need for further rate reductions.

The Business Council favours a shift in the personal tax burden towards expenditure taxation and away from income taxation. This shift can be achieved by greater use of deferred savings plans similar to Registered Retirement Savings Plans, but with broader investment options, and by an increased emphasis on expenditure taxation. A shift in our tax structure towards a greater reliance on expenditure taxes is essential to permit a further reduction in personal income tax rates.

We believe that top combined federal-provincial personal tax rates in the order of 35% should be the benchmark against which further income and sales tax reform proposals at both the federal and provincial levels are considered. Thus, while the White Paper establishes a sound basis for the direction of personal income tax reform, the precedent that it sets for lowering personal tax rates should be built upon by both the federal and provincial governments with further reform measures over the next few years. And, recognizing the need to reduce annual fiscal deficits further, continued fiscal restraint combined with new expenditure reduction measures are also essential to reducing the burden of personal income taxation further.

3.2 Social Policy Implications of Reform Proposals

The proposed conversion of personal exemptions into tax credits is a progressive measure which we support. Tax credits permit limited resources to be targetted more efficiently than exemptions and have a much more tangible value for recipients than tax exemptions. Tax credits also offer the advantage of being easily converted into refundable and/or "vanishing" forms, i.e. ones that decline in amount as income rises and are reduced to zero at

specified income levels (e.g. the Child Tax Credit). Future tax reforms should consider the possibilities that this flexibility introduces for the integration of the tax and income transfer systems.

The decision to remove 850,000 Canadians from the tax rolls by increasing the income tax threshold levels is a laudable measure which will improve work incentives and introduce greater fairness. Together with the increase in the refundable sales tax credit, this measure will reduce the tax burden of many low-income households. In addition, the increase in the sales tax credit, which will be implemented when the National Sales Tax is adopted, should further reduce the tax burden of the low-income population and, in the words of the Minister of Finance, "more than offset the impact of the new sales tax."²²

3.3 Indexation for Inflation

The lack of full indexation for inflation in the personal income tax system results in increases in taxation over time even when real incomes remain constant. While the reduction in the number of tax brackets from ten to three has reduced the possibility of "bracket creep" for many but not all taxpayers, full indexation of brackets should be reintroduced when fiscal circumstances permit. Full indexation of credits and exemptions should also be introduced. Indexation would improve the fairness of the tax system and reduce the hidden taxation increases caused by inflation. Indexation would also encourage greater fiscal discipline and accountability, since governments would find it more difficult to raise tax rates explicitly than to rely on hidden and automatic increases in revenues resulting from the inflationary erosion of credits and exemptions.

3.4 Personal Income-Averaging and Registered Savings Vehicles

Mechanisms in the tax system which enable individuals to average their income over their working and retired lives improve the fairness of the tax system and should be a fundamental part of the reformed tax system. As the Department of Finance noted in its 1985 publication entitled A Minimum Tax For Canada, there is considerable variation from year to year in personal income. For example, government survey data of the high-income population showed that a mere 24% of this group consistently earned high annual incomes (defined as \$50,000 or more) during the period 1972-1979.²³ Significant income fluctuation is also prevalent at the low and middle income levels.

To improve the opportunities for lifetime income-averaging, we suggest that the annual contribution limits for registered savings vehicles be expanded once the currently proposed maximum limits are attained (i.e. in both absolute terms and as a percentage of income). Annual contribution limits should also be indexed for inflation to permit real retirement savings to rise in line with the real costs of retirement. These measures would be responsive to widely varying patterns of labour force participation, personal income generation and family circumstances.

Allowing individuals to defer income tax on a larger part of their earnings would move the basis of our tax system in the direction of expenditure taxation and away from its current heavy reliance on income taxation, a shift recommended by both the Macdonald Commission and the Economic Council of Canada because of the favourable effect that this would have on savings and investment.²⁴ Registered savings plans also perform important social and tax functions. First, by encouraging personal savings for retirement they diminish the magnitude of future claims that are likely to be

made on government support programs. Second, they permit individuals to achieve some averaging of their annual earnings over their working and non-working lives. This improves the fairness of the tax system by ensuring that those with equal lifetime earnings pay similar amounts of tax and by reducing the double-taxation of savings. Given the large amount of fluctuation that can occur in individuals' annual incomes it is unfair to remove income-averaging from the personal income tax system. Retention of the current forward-averaging system, or a more effective mechanism to achieve a similar purpose, should therefore be an integral part of a reformed system. The most effective and equitable way to achieve this objective in the long run would be to expand the annual contribution limits -- in both absolute terms and as a share of income -- of registered personal savings vehicles.

3.5 The Taxation of Capital Gains and Dividends

Achieving greater fairness in the treatment of different sources of income is essential to reducing the distortions caused by the tax system. It is thus inconsistent with the principles of tax reform that the White Paper proposes to tax capital gains more heavily than dividends by 1990 (when the 75% inclusion of capital gains is proposed to go into effect). Taxing capital gains at a higher rate than dividends would put pressure on corporations to increase dividends rather than to retain earnings to finance growth (which is the source of capital gains). This would reduce the financial flexibility of corporations by increasing annual fixed dividend payments. A higher tax burden on capital gains than on dividends would discourage risk-taking investments in common share equity in favour of preferred shares or other less risky securities. The effect of this would be to deny investors the higher financial reward commensurate with higher risks.

Given the many problems that will be caused by an inequitable treatment between dividends and capital gains, we urge that the taxation of these two income sources be made fairer.²⁵ One way to achieve fairer treatment would be to freeze the capital gains inclusion rate at 66%, although even this approach does not recognize the impact of inflation on capital gains or the risk borne by investors in common equity. This and other approaches should be considered, since the proposed heavy taxation of capital gains would be a retrograde step for tax policy.

Recommendations

- 3.1 Provincial income taxes should be reduced in line with the reductions in federal tax rates to help bring top combined federal-provincial rates down towards 35%. This measure will require increased financial reliance on expenditure taxation.
- 3.2 Full inflation indexing should be reintroduced when fiscal circumstances permit.
- 3.3 Income-averaging provisions should be retained to recognize the high degree of annual variation in personal incomes.
- 3.4 Annual contribution limits for registered savings vehicles should be increased, over time, beyond those maximum limits currently proposed in order to permit improved income forward-averaging and to reduce the burden of double taxation on personal savings. Allowable contribution increases should be made in both absolute terms and as a share of income.
- 3.5 We recommend that the proposed increases in capital gains taxation that would result in capital gains bearing higher taxes than dividends be reconsidered, since this proposal would discourage risk-taking and introduce distortions in the financial markets.

FOOTNOTES

Chapter 1

- 1 As a share of total government revenues, direct taxes on persons were less than one-half of indirect taxes in 1950. By 1971 direct taxes on persons were equal to indirect taxes and by 1986 direct taxes were 33% higher than indirect taxes. Source: Quarterly Economic Review: Annual Reference Tables (Department of Finance, June 1987) p. 80.
- 2 The Economic Council of Canada has estimated that a "lifetime income tax" which removed the current tax bias against savings "could lead to substantial increases in per capita output and real wages and, in the process, enhance the average Canadian's standard of living by as much as 7%." The Council noted that such a tax would also be fairer and simpler than the current tax system in addition to being more efficient and economically neutral. See: Road Map for Tax Reform, (Ottawa: Economic Council of Canada, 1986) P. 15.

The negative economic effects of high income tax rates are also discussed in Robin Boadway and Neil Bruce, "Theoretical Issues in Tax Reform," in: Approaches to Economic Wellbeing (Toronto: University of Toronto Press, 1985) pps. 149-150.
- 3 Report of the Royal Commission on the Economic Union and Development Prospects for Canada, (Supply and Services, 1985) Volume 2, p. 207.
- 4 Sales Tax Reform (Department of Finance, June 18, 1987) pps. 9-24.
- 5 1986 personal expenditures on food and non-alcoholic beverages constituted 12.16% of total personal expenditures on goods and services. 1986 personal expenditures on goods constituted 53.7% of total personal expenditures while personal expenditures on services constituted 46.3% of total personal expenditures. Total personal expenditures amounted to \$297.25 billion in 1986. Source: National Income and Expenditure Accounts (Ottawa: Statistics Canada, March 3, 1987) Table 7.
- 6 Higher-income households account for 64% of food purchases while lower-income households account for only 36% of food purchases. Source: The White Paper on Tax Reform (Department of Finance, June 18, 1987) p. 66.

- 7 Over 100 agricultural marketing boards were in place in 1978. Source: Reforming Regulation (Ottawa: Economic Council of Canada, 1981) pps. 55-64.

Chapter 2

- 8 Many business input costs are higher in Canada than the United States while economies of scale in manufacturing are frequently lower. Capital borrowing costs are higher due to higher interest rates in Canada than the U.S. Construction material costs are frequently higher due to our harsh climate and labour costs in construction are also higher than comparable U.S. levels (based on productivity and pay rates).

Economies of scale in Canadian manufacturing have traditionally been lower than in the U.S. due to our smaller market and the barriers posed by tariffs on imports and exports. See: John R. Baldwin and Paul K. Goreki, The Role of Scale in Canada-U.S. Productivity Differences in the Manufacturing Sector 1970-1979 (Toronto: University of Toronto Press, 1986).

New product innovations have lagged behind the United States by several years, on average. See: The Bottom Line: Technology, Trade, and Income Growth (Ottawa: Economic Council of Canada, 1983).

- 9 Canadian taxes on corporate profits as a percentage of gross domestic product (GDP) amounted to 3% in 1984 while the Organization for Economic Co-operation and Development (OECD) average was 2.9% of GDP. See: Canadian Tax Journal (Vol. 34, No. 6) p. 1505 (included in Appendix 1).
- 10 The average 1987 statutory federal-provincial corporate tax rate in Canada is 49% versus 45% in the United States (excluding the 3% federal surtax). By 1990 the average statutory tax rate in Canada will be 42% versus 39% in the United States. This assumes average provincial tax rates in Canada of 14% and average U.S. state taxes of 7.5%. Source: Income Tax Reform (Department of Finance, June 18, 1987) pps. 12, 98.
- 11 The Financial Post (September 27, 1986) pps. 41-48.
- 12 World Competitiveness Report (Geneva: European Management Forum, 1986) p. 126.
- 13 Ibid. p. 145.

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- 14 J.R. D' Cruz and J.D. Fleck, "The 1986 EMF Scorecard for Canada: Mixed but Encouraging", Business Quarterly (Summer 1986) p. 81.
- 15 Corporate profits as a share of GNP fell from an average of 12.66% in the 1950-54 period to 8.52% in the 1982-86 period. Source: The National Income and Expenditure Accounts (Ottawa: Statistics Canada, Quarterly) (See Appendix 1, Table 1).
- 16 Personal income as a share of GNP has risen from 76% in the early 1950s to around 86% today. Source: The National Income and Expenditure Accounts (Ottawa: Statistics Canada, Quarterly) (See Appendix 1, Table 1).
- 17 Federal social spending has risen from \$24.6 billion in 1980-81 to over \$57 billion this year. During this period the share of total federal program expenditures accounted for by social spending has risen from 54.7% to 64.3% -- an 18% increase in the share of expenditures going to social programs. Source: Main Estimates, 1981/82-1987/88.
- 18 1986 merchandise exports were \$120.5 billion while domestic merchandise production was \$192 billion. Source: System of National Accounts, Gross Domestic Product by Industry (Ottawa: Statistics Canada, monthly). Major Canadian services exports are in banking, insurance and real estate. Services are considered to be "exported" when they are performed by Canadian businesses either domestically or abroad for foreign parties abroad.
19. Domestic expenditures on industrial research and development were less than one-half the OECD average in 1981 (0.8% of GDP vs. the OECD average of 1.7% of GDP). Source: Science and Technology Indicators 1985 (Ottawa: Statistics Canada, 1986) p. 106.
- 20 The White Paper on Tax Reform (Department of Finance, June 18, 1987) p. 79.

Chapter 3

- 21 Under the White Paper proposals the share of federal tax revenues raised from personal income will fall from 65.1% in 1987-88 to 62.9% in 1991-92. See: Economic & Fiscal Outlook (Ottawa: Department of Finance, June 18, 1987) p. 48.
- 22 Michael H. Wilson (Speech delivered in the House of Commons, June 18, 1987) p. 9.

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- 23 A Minimum Tax for Canada (Ottawa: Department of Finance, May 1985) p. 9.
- 24 Royal Commission on the Economic Union and Development Prospects for Canada (Ottawa: Supply and Services, 1985) Volume 2, pps. 204-207. Road Map for Tax Reform: The Taxation of Savings and Investment (Ottawa: Economic Council of Canada, 1987).
- 25 The BCNI suggested in its October 1986 policy statement Taxation Policy Reform and the National Agenda that capital gains could be taxed as regular income subject to the conditions that: the cost base of capital assets be fully indexed for inflation; that combined, federal-provincial personal income tax rates be reduced to 35%; and that the personal and corporate income tax systems be fully integrated. In the absence of these reforms, capital gains should not be fully taxed as regular income since they represent, in part, inflationary gains.

APPENDIX 1

AN INTERNATIONAL COMPARISON OF THE CORPORATE INCOME TAX BURDEN

An International Comparison of the Corporate Income Tax Burden

The data presented in this appendix on corporate income taxation provides only a partial view of the total tax burden borne by corporations. A comprehensive assessment of the total tax burden would require an analysis of the indirect property, payroll and commodity taxes borne by corporations in addition to the direct burden of corporate income taxation. Unfortunately such a comprehensive assessment is not available.

While an assessment of the relative international importance of property and payroll taxes is not readily available, it is clear that the commodity tax burden borne by Canadian corporations is exceptional because Canada is the only major industrialized country in the world that has a Manufacturers' Sales Tax. Therefore, it should be noted that Canada's international ranking in terms of its total corporate income tax burden would be significantly worsened if the hidden Manufacturers' Sales Tax were considered as an indirect tax on corporate income.

Table 1 shows that personal income as a share of gross domestic product (GDP) has risen consistently since 1950 while corporate income as a share of GDP has consistently declined. This shift in the receipt of national income shares has had a major effect on the shares of total income tax paid by the corporate and personal sectors. While the share of national income received by corporations as profits has declined the share of corporate profits paid in income taxes has risen sharply since 1950 (see column on extreme right). Both personal income taxes (PIT) and corporate income taxes (CIT) are adjusted in Table 1 to include Unemployment Insurance and Canada/Quebec Pension Plan taxes (which are quasi-income taxes).

TABLE 1
Personal Income and Corporate Profits and the
Relationship between Taxes and Tax Bases

Year	Personal income	Corporate profit	As a % of GNP		Adj. PIT as % of personal income	Adj. CIT as % of corporate profit
			Personal income	Corporate profit		
	<i>millions of dollars</i>		<i>per cent</i>			
1950	14,262	2,608	77.1	14.1	4.7	40.0
1951	16,791	3,144	77.6	14.5	5.8	47.6
1952	18,592	3,071	75.6	12.5	6.7	47.8
1953	19,550	2,985	75.7	11.6	7.0	44.0
1954	19,717	2,755	76.1	10.6	7.0	42.9
1955	21,265	3,485	74.5	12.2	6.5	39.6
1956	23,531	3,928	73.4	12.3	6.7	38.7
1957	25,170	3,554	75.1	10.6	7.1	40.9
1958	26,651	3,669	76.6	10.6	6.2	38.7
1959	28,108	3,966	76.3	10.8	6.6	42.8
1960	29,595	3,870	77.2	10.1	7.2	43.9
1961	30,104	4,066	75.9	10.3	7.5	43.4
1962	32,788	4,450	76.4	10.4	7.5	41.9
1963	34,829	4,932	75.8	10.7	7.6	40.6
1964	37,282	5,841	74.1	11.6	8.3	38.0
1965	41,071	6,318	74.2	11.4	8.6	36.6
1966	46,094	6,714	74.6	10.9	9.4	43.3
1967	50,579	6,823	76.2	10.3	10.6	45.1
1968	55,677	7,742	76.7	10.7	11.6	46.6
1969	61,804	8,294	77.4	10.4	13.0	49.1
1970	66,633	7,699	77.8	9.0	14.1	51.1
1971	74,092	8,681	78.4	9.2	14.6	49.4
1972	83,767	10,799	79.6	10.3	14.4	46.7
1973	97,832	15,417	79.2	12.5	14.4	40.7
1974	116,867	20,062	79.2	13.6	14.9	43.8
1975	136,205	19,663	82.4	11.9	14.3	49.2
1976	155,142	19,994	80.9	10.4	14.7	49.2
1977	171,516	20,940	81.6	10.0	14.9	48.6
1978	191,498	25,722	82.5	11.1	14.0	44.9
1979	215,367	34,000	81.5	12.9	13.9	39.8
1980	244,712	37,664	82.2	12.7	14.2	42.7
1981	288,529	32,606	84.9	9.6	14.8	51.6
1982	317,426	21,110	88.6	5.9	14.9	76.3
1983	336,984	32,684	86.4	8.4	15.1	56.3
1984	362,086	39,606	86.0	9.4	15.1	53.3

Table 2 shows that taxes on personal income in Canada in 1984 of 11.4% of GDP fell slightly below the OECD average of 11.7%, but above the levels in the United States, Germany, The United Kingdom, France, Italy and other OECD countries. Canada's corporate tax burden in 1984 of 3% of GDP was above the OECD average of 2.9% and sharply above the United States (2.1%), Germany (2.0%), Sweden (1.9%), France (1.9%) and other countries. Canada's corporate tax burden as a share of total taxes is also relatively high, standing at 8.8% compared with the OECD average of 7.9% and a U.S. level of 7.2% of total taxes.

TABLE 2
Major Tax Revenues of OECD Member Countries, 1984

Country	Taxes on personal income as a % of		Taxes on corporate profits as a % of	
	GDP	Total taxes	GDP	Total taxes
Australia	14.0	44.7	2.9	9.2
Austria	9.5	22.6	1.3	3.0
Belgium	16.2	34.7	2.9	6.2
Canada	11.4	33.9	3.0	8.8
Denmark	23.9	49.8	2.5	5.3
Finland	16.4	45.7	1.6	4.4
France	6.0	13.3	1.9	4.1
Germany	10.5	27.9	2.0	5.4
Greece	5.1	14.5	0.9	2.6
Ireland	12.1	30.8	1.3	3.3
Italy	10.8	26.3	4.0	9.8
Japan	6.7	24.5	5.8	21.1
Luxembourg	11.4	27.5	6.4	15.5
Netherlands	9.5	20.9	2.6	5.7
New Zealand	17.5	56.5	2.7	8.8
Norway	11.0	23.8	7.7	16.5
Portugal	na	na	na	na
Spain	6.5	22.8	1.4	5.0
Sweden	19.4	38.5	1.9	3.7
Switzerland	11.5	35.7	1.9	5.9
Turkey	6.3	43.9	1.6	11.2
United Kingdom	10.3	26.7	4.4	11.5
United States	10.2	35.3	2.1	7.2
OECD average	11.7	31.8	2.9	7.9

Source: Revenue Statistics of OECD Member Countries (Paris: OECD, 1986).
Extracted from: Canadian Tax Journal, Vol. 34, No. 6, November-December 1986, p. 1505.

Table 3, prepared by the influential European Management Forum using 1983 data, shows that the tax burden borne by Canadian corporations is relatively high by international standards.

TABLE 3

An International Comparison of Fiscal Receipts from Corporations¹

	<u>Corporate Tax/all tax²</u> %	<u>Rank</u>	<u>Corporate Tax/GDP³</u>	<u>Rank</u>
Greece	2.46	1	0.81	1
Austria	2.86	2	1.17	2
Denmark	2.98	3	1.38	4
Sweden	3.41	4	1.72	8
Ireland	3.79	5	1.49	5
France	4.29	6	1.91	10
Finland	4.42	7	1.56	6
Spain	4.92	8	1.34	3
Germany	5.14	9	1.92	11
United States	5.52	10	1.60	7
Belgium	5.97	11	2.71	15
Switzerland	6.01	12	1.90	9
Netherlands	6.09	13	2.88	16
New Zealand	6.28	14	2.04	12
Canada	7.46	15	2.46	13
Australia	8.77	16	2.63	14
Italy	9.34	17	3.79	17
United Kingdom	10.84	18	4.10	18
Turkey	10.87	19	2.04	12
Norway	14.59	20	6.79	20
Japan	19.62	21	5.44	19

¹ Definition: Taxes on income, profits and capital gains, as a percentage of total taxation, 1983

² World Competitiveness Report (Geneva, European Management Forum, 1986), p. 126

³ *ibid*, p. 167

Table 4 shows that Canada ranked in 9th spot in 1985 with regard to the perceived (positive) influence of its system of capital depreciation on capital investment (with the proposed sharp reductions in capital depreciation allowances Canada's ranking would no doubt decline significantly).

TABLE 4

An Assessment of the Influence of Capital Depreciation on Investment¹

<u>Country</u>	<u>Score</u>	<u>Rank</u>
Sweden	83.27	1
Norway	77.33	2
Austria	73.18	3
Ireland	72.44	4
Turkey	71.14	5
Denmark	70.00	6
Finland	69.52	7
United States	69.32	8
Canada	67.20	9
Netherlands	67.06	10
Switzerland	62.89	11
Belgium	55.00	12
Germany	54.71	13
United Kingdom	54.05	14
Japan	53.25	15
Greece	52.14	16
Spain	50.50	17
Italy	49.33	18
Portugal	47.53	19
New Zealand	42.50	20
Austria	42.22	21
France	41.97	22

¹ Definition: Extent to which depreciation allowances and similar tax benefits are perceived to encourage growth and capital expansion: 0= very little, to 100= very encouraging (note that this ranking is subjective and based on survey data).
Source: World Competitiveness Report, (Geneva, European Management Forum, 1986), p. 145

