



TAX EXPENDITURES
AND EVALUATIONS

2002



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2002



Department of Finance
Canada

Ministère des Finances
Canada

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PREFACE

Since 2000 the tax expenditure report has been separated into two documents. This document, *Tax Expenditures and Evaluations*, is published on an annual basis. It provides estimates and projections for broadly defined tax expenditures as well as evaluations and descriptive papers addressing specific tax measures.

This year's edition includes two papers, "The Impact of the Canada Child Tax Benefit on the Incomes of Families With Children" and "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities," which provide additional information on these two tax measures.

The companion document, *Tax Expenditures: Notes to the Estimates/Projections*, was published in 2000. It is a reference document for readers who wish to know more about how the estimates and projections are calculated and who want descriptions of or information on the objectives of particular tax expenditures. New tax expenditures are described in the relevant section of this document.

PART 1

**TAX EXPENDITURES:
ESTIMATES AND PROJECTIONS**

ESTIMATES AND PROJECTIONS OF TAX EXPENDITURES

The principal function of the tax system is to raise the revenues necessary to fund government expenditures. The tax system is also an instrument of policy that serves to advance a wide range of economic, social, environmental, cultural and other public policy objectives. Tax measures that reflect such objectives include exemptions, deductions, rebates, deferrals and credits, and are typically referred to as “tax expenditures.”

In order to define tax expenditures, it is necessary to establish a “benchmark” tax structure that applies the relevant tax rates to a broadly defined tax base – e.g., personal income, business income or consumption. Tax expenditures are then defined as deviations from this benchmark. It is important to recognize that reasonable differences of opinion exist as to the structure of the benchmark tax system and hence as to what constitutes a tax expenditure. For example, a deduction for expenses incurred in earning income is generally considered as part of the benchmark and thus not as a tax expenditure. But in some cases the deduction may confer some personal benefit, making its classification ambiguous.

This report takes a broad approach and lists as tax expenditures all tax measures that deviate from a basic benchmark tax system. It also includes measures that would not generally be considered to be tax expenditures and would therefore be included in the benchmark tax system. These are shown as “memorandum items.” For instance, the dividend tax credit is listed under this heading because its purpose is to reduce or eliminate the double taxation of income earned by corporations and distributed to individuals through dividends. This approach – listing both broadly defined tax expenditures and memorandum items – provides maximum information to the reader.

Caveats

Care must be taken in interpreting the estimates and projections of tax expenditures in the tables for the following reasons.

- The estimates and projections indicate the potential revenue gain from removing individual tax measures. They are developed assuming the underlying tax base would not be affected by removal of the measure – an assumption that is unlikely to be true in practice as individual behaviour, overall economic activity and other government policies could change along with the specific tax provision.
- The cost of each tax measure is determined separately, assuming that all other tax provisions remain unchanged. Many of the tax expenditures do, however, interact with each other, so the impact of several tax provisions at once cannot generally be calculated by adding up the estimates and projections for each provision.
- The federal and provincial income tax systems interact with each other to various degrees. As a result, changes to tax expenditures in the federal system may have consequences for provincial tax revenues. In this publication, however, any such

provincial effects are not taken into account – that is, the tax expenditure estimates and projections address strictly the federal tax system.

- In the case of the harmonized sales tax in effect in Nova Scotia, New Brunswick, and Newfoundland and Labrador, only the federal cost of the tax expenditures is reported.
- The tax expenditure estimates and projections presented in this document are developed using the latest available taxation data. Revisions to the underlying data as well as improvements to the methodology can result in substantial changes to the value of a given tax expenditure in successive publications.

It should also be noted that, on occasion, the estimated or projected change in the value of a tax expenditure in this report does not coincide with the fiscal impact of a measure estimated in the budget. For example, this report shows that the cost of the partial inclusion rate for capital gains increased by \$1 billion between 2000 and 2001. This increase is due to the reduction in the inclusion rate from three-quarters to one-half over the same period. However, the 2000 *Economic Statement and Budget Update* estimated that the change would reduce revenues by only \$300 million in 2001. For a defined set of transactions, the reduction in the capital gains inclusion rate *raises* tax expenditures and *lowers* budgetary revenues by the same amount. But the lower inclusion rate is expected to induce additional realizations, which increases both revenue and the tax expenditure. In other words, the rate reduction and the additional realizations have offsetting impacts on budgetary revenues (estimated in the budget) while they both raise the tax expenditure estimates and projections (reported in this document).

A second example is the change in the partial exemption of scholarship, fellowship and bursary income that was announced in the 2000 budget. In the budget, the cost of this change was estimated at \$30 million for the 2000 tax year. In contrast, the associated tax expenditure provided in this document shows an increase of only \$22 million in 2000 compared to the previous year (to \$28 million from \$6 million). In this case, the apparent disparity is largely a matter of presentation. The 2000 budget estimate of \$30 million consists of an additional \$21 million that would be claimed by students and a further \$9 million that would either be carried forward or transferred to parents and claimed by them. The amount claimed directly by students and the amount either carried forward or transferred are shown separately in this report.

WHAT'S NEW IN THE 2002 REPORT

A number of new tax measures have been introduced since last year's report and others have been modified. These are described below.

Personal Income Tax

Apprentice Vehicle Mechanics' Tools Deduction

- Effective January 2002 apprentice vehicle mechanics are eligible to receive an income tax deduction for the portion of the cost of new tools acquired for the on-the-job component of their apprenticeship that exceeds \$1,000 or 5% of the apprenticeship income, whichever is higher.
- Any part of the eligible deduction that is not taken in the year in which the tools are acquired can be carried forward and deducted in subsequent taxation years.

Increasing Assistance to Students

- After 1996, students can deduct from their income tuition assistance provided under Part II of the Employment Insurance Act and certain government programs for adult basic education to the extent that these amounts are included in their income.
- Moreover, effective January 2002 students who receive financial assistance for post-secondary education under certain government training programs are eligible to claim the education tax credit.

Promoting Sustainable Woodlot Management

- Commercial woodlot operations that are farming businesses are eligible to make an intergenerational transfer of farm property on an income tax-deferred rollover basis after December 10, 2001.

Donations of Certain Publicly Traded Securities

- On October 12, 2001, the Government announced that it would make permanent the 1997 budget measure that provided special tax assistance for donations of certain publicly traded securities to public charities. The measure was originally set to expire on December 31, 2001.
- Similar treatment is accorded to employment benefits in respect of donations of eligible securities acquired through stock options, to parallel the treatment of donations to eligible charities. This measure was also made permanent.

Corporate Income Tax

Improving Tax Incentives for Renewable Energy and Energy Efficiency

- The definition of a small hydroelectric project in Class 43.1 has been expanded from projects with an annual average generating capacity of up to 15 megawatts (MW) to projects with a maximum annual rated capacity of up to 50 MW, effective after December 10, 2001.
- Class 43.1 now includes equipment used to generate electricity from “blast furnace gas,” effective after December 31, 2000.

DESCRIPTION OF NEW TAX EXPENDITURES

All tax provisions introduced since *Tax Expenditures: Notes to the Estimates/Projections* was last published in September 2000 are described below.

Personal Income Tax

Education

Apprentice Vehicle Mechanics' Tools Deduction

<p><i>Objective:</i> To allow apprentice vehicle mechanics to deduct from their income the extraordinary portion of the cost of new tools they have to provide as a condition of their on-the-job training. (<i>The Budget Plan, 2001</i>)</p>
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Starting in 2002 apprentice vehicle mechanics can deduct the extraordinary portion of the cost of new tools they purchase in the taxation year or in the last three months of the previous taxation year if the apprentice is in his or her first year.

In order to be eligible, the apprentice must be registered with a provincial or territorial body in a program leading to designation as a mechanic licensed to repair automobiles, aircraft or any other self-propelled motorized vehicle.

The eligible deduction is the portion of tool costs that exceed \$1,000 or 5% of the individual's apprenticeship income for the year, whichever is greater. Any part of the eligible deduction that is not taken in the year can be carried forward and deducted in subsequent taxation years. The apprentice's employer must certify that the tools are required as a condition of, and for use in, the apprenticeship.

The cost of the individual's tools for other income tax purposes will be the acquisition cost less the deductible portion of that cost. If an individual (or a non-arm's-length person) disposes of the tools for proceeds in excess of this reduced cost, the excess amount will be included in income in the year of disposition. However, tools will be eligible for the existing rollovers that apply to transfers of property to a corporation or a partnership.

The individual will also be eligible for a rebate of the goods and services tax/harmonized sales tax paid on the portion of the purchase price of the new tools that is deducted in computing employment income.

These measures apply to the 2002 and subsequent taxation years.

Adult Basic Education – Tax Deduction for Tuition Assistance

Objective: To provide a taxable income deduction for tuition fees for adult basic education. (*The Budget Plan, 2001*)

Individuals may deduct, in computing their taxable income, the amount of tuition assistance received for adult basic education or other programs that are ineligible for the tuition tax credit, to the extent that this assistance has been included in their income. In order to be eligible, the tuition assistance must be provided under:

- Part II of the Employment Insurance Act (or a similar program provided by a province or territory under a Labour Market Development Agreement); or
- another training program established under the authority of the Minister of Human Resources Development, such as the Employability Assistance for People with Disabilities initiative or the Opportunities Fund for Persons with Disabilities.

This measure was made retroactive to 1997 and subsequent taxation years.

Employment

Canada and Quebec Pension Plan Deduction for the Self-Employed

Objective: This measure ensures that self-employed individuals are not disadvantaged relative to an owner-operator who is also an employee of the corporation. (*Economic Statement and Budget Update, October 2000*)

Under the Canada Pension Plan and Quebec Pension Plan (C/QPP), self-employed individuals are required to pay both the employer and employee portion of C/QPP contributions. As of January 1, 2001, self-employed individuals are permitted to deduct the portion of C/QPP contributions that represent the employer's share.

Farming and Fishing

Promoting Sustainable Woodlot Management

Objective: To facilitate intergenerational rollovers of commercial woodlot operations that are farming. (*The Budget Plan, 2001*)

A taxpayer may make an intergenerational transfer of farm property in Canada on an income tax-deferred rollover basis, if the property was principally used in a farming business in which the taxpayer or a family member was actively engaged on a regular and continuous basis. Similar rules apply to intergenerational transfers of shares of family farm corporations and interests in family farm partnerships.

The operation of a commercial woodlot may, in certain circumstances, constitute a farming business. However, the intergenerational rollovers are generally not available for commercial woodlots because, aside from monitoring, the management of a woodlot may not demand regular and continuous activity. As a result, many commercial woodlot owners are subject to income tax on intergenerational transfers of their woodlots. This can be detrimental to the sound management of the resource if woodlots are harvested prematurely to pay the tax.

Where the regular and continuous activity test set out in the existing rollover rules cannot be met, a new test will be implemented strictly for the purpose of applying those rules to commercial woodlot operations. The new test allows an intergenerational rollover where the conditions of the existing rollover rules are otherwise met and the transferor or a family member is actively involved in the management of the woodlot to the extent required by a prescribed forest management plan.

Specific criteria for prescribed forest management plans will be developed in consultation with interested parties. For transfers that occur before these criteria are developed and prescribed, there must exist a plan providing for the necessary attention to a woodlot's growth, health, quality and composition.

This measure applies to transfers that occur after December 10, 2001.

Small Business

Federal Tax Credit for Flow-Through Share Investors

<p><i>Objective:</i> To promote mineral exploration activity, particularly in rural communities across Canada that depend on mining. (<i>Economic Statement and Budget Update</i>, October 2000)</p>
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This temporary investment tax credit is available to individuals (other than trusts) at a rate of 15% of specified surface "grass root" mineral exploration expenses incurred in Canada pursuant to a flow-through share agreement. The flow-through share investor can use this tax credit to reduce federal tax otherwise payable. This new credit applies to specified expenses incurred by an individual pursuant to a flow-through share agreement made after October 17, 2000, in respect of expenses incurred by the corporation after that day and before 2004. This non-refundable credit reduces the cumulative Canadian exploration expense pool for years following the year in which it is claimed.

THE TAX EXPENDITURES

Tables 1 to 3 provide tax expenditure values for personal income tax, corporate income tax and the goods and services tax (GST) for the years 1997 to 2004.

Estimates and projections are developed using the methodology set out in Chapter 1 of *Tax Expenditures: Notes to the Estimates/Projections*.¹

In this case, however, the economic variables used to develop the estimates and projections are based on the private sector average forecast presented in the December 2001 budget.

Personal income tax expenditures are grouped according to functional categories. This grouping is provided solely for presentational purposes and is not intended to reflect underlying policy considerations.

All estimates and projections are reported in millions of dollars. The letter “S” indicates that the cost is less than \$2.5 million, “n.a.” signifies that data is not available to support a meaningful estimate/projection, and a dash means that the tax expenditure is not in effect. The inclusion in the report of items for which estimates and projections are not available is warranted given that the report is designed to provide information on measures included in the tax system even if it is not always possible to provide their revenue impacts.

Work is continuing to obtain quantitative estimates and projections where possible. For example, in prior editions of this publication, the corporate income tax expenditure relating to gifts of cultural property and ecologically sensitive land was included with gifts to the Crown and was reported under “Deductibility of gifts to the Crown.” For 1997 and subsequent years it is possible to determine the tax expenditure for gifts of cultural property and ecologically sensitive land separate from gifts to the Crown. As a result, in this publication a new corporate income tax expenditure has been introduced under “Deductibility of gifts of cultural property and ecologically sensitive land.” At this time similar data is not available in respect of personal income tax.

¹ Available on the Department of Finance Web site at www.fin.gc.ca.

Table 1
Personal Income Tax Expenditures* †

	Estimates			Projections				
	1997	1998	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Culture and recreation								
Deduction for clergy residence	58	55	56	56	52	52	52	52
Deduction for certain contributions by individuals who have taken vows of perpetual poverty	S	S	S	S	S	S	S	S
Deduction for Canadian art purchased by unincorporated businesses	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Assistance for artists	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction for artists and musicians	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of capital gains on gifts of cultural property	7	11	16	14	10	10	10	10
Education								
Tuition fee credit ^{1,2}	240	260	295	295	255	260	275	295
Education credit ^{2,3}	77	120	130	125	220	235	255	265
Transfer of education and tuition fee credits ^{2,4}	300	335	330	335	445	460	485	505
Carry-forward of education and tuition fee credits ⁵	–	10	74	145	265	340	405	420
Student loan interest credit ⁶	–	46	59	60	61	62	62	62
Registered education savings plans (RESPs) ⁷	32	30	40	80	78	105	130	165
Partial exemption of scholarship, fellowship and bursary income ⁸	5	6	6	28	24	25	25	25
Deduction of teachers' exchange fund contributions	S	S	S	S	S	S	S	S
Adult basic education – tax deduction for tuition assistance	–	–	–	–	–	10	5	5
Apprentice vehicle mechanics' tools deduction ⁹	–	–	–	–	–	10	10	10

* **The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See the publication *Tax Expenditures: Notes to the Estimates/Projections*, published in 2000 and available on the Department of Finance Web site (www.fin.gc.ca), for a discussion of the reasons for this.**

† The February 2000 budget fully indexed, effective January 1, 2000, those parameters that were previously only partially indexed. The *Economic Statement and Budget Update* of October 2000 reduced all personal income tax rates and eliminated the deficit reduction surtax, effective January 1, 2001. These rate reductions lower the value of exemptions and deductions, as well as those non-refundable tax credits whose values depend on a tax rate, in the year the change was introduced, but this is generally followed by growth in their value over time in line with increases in the size of incomes.

Table 1
Personal Income Tax Expenditures (cont'd)

	Estimates				Projections			
	1997	1998	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Employment								
Canada and Quebec Pension Plan deduction for the self-employed ¹⁰	-	-	-	-	165	180	190	200
Deduction of home relocation loans	S	S	S	S	S	S	S	S
Tax-free amount for emergency service volunteers ¹¹	4	14	14	14	14	14	14	14
Northern residents deductions	130	135	135	130	120	120	120	120
Overseas employment credit	37	62	53	54	55	56	56	56
Employee stock options ¹²	200	215	295	395	565	575	585	595
Non-taxation of strike pay	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of salary through leave of absence/sabbatical plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Employee benefit plans	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain non-monetary employment benefits	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Family								
Spousal credit ¹³	1,155	1,100	1,125	1,240	1,205	1,260	1,300	1,350
Equivalent-to-spouse credit ¹³	425	430	465	500	485	500	510	525
Infirm dependant credit ¹⁴	7	7	7	8	10	10	10	10
Caregiver credit ¹⁵	-	24	29	35	45	48	50	50
Canada Child Tax Benefit (CCTB) ¹⁶	5,325	5,625	5,930	6,610	7,360	7,870	8,050	8,405
Deferral of capital gains through transfers to a spouse, spousal trust or family trust	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Farming and fishing								
\$500,000 lifetime capital gains exemption for farm property ¹⁷	355	365	365	325	225	230	235	235
Net Income Stabilization Account								
Deferral of tax on government contributions ¹⁸	93	76	94	86	77	80	79	78
Deferral of tax on bonus and interest income	22	30	35	40	39	43	47	50
Taxable withdrawals	-37	-60	-100	-100	-100	-99	-100	-100
Deferral of income in drought regions ¹⁹	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral of income from destruction of livestock	S	S	S	S	S	S	S	S
Deferral of income from grain sold through cash purchase tickets ²⁰	6	12	51	8	-29	9	9	9
Deferral of capital gains through 10-year reserve	9	S	S	S	S	S	S	S

Table 1
Personal Income Tax Expenditures (cont'd)

	Estimates				Projections			
	1997	1998	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Deferral of capital gains through intergenerational rollovers of family farms ²¹	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemption from making quarterly tax instalments	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Cash-basis accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Flexibility in inventory accounting	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Federal-provincial financing arrangements								
Quebec abatement ²²	2,560	2,730	2,860	3,175	3,040	3,140	3,230	3,340
Transfers of income tax room to provinces ²²	11,215	12,105	12,920	14,105	13,540	13,980	14,395	15,115
General business and investment								
Partial inclusion of capital gains ²³	925	935	970	1,515	2,505	2,395	2,315	2,340
Deduction of limited partnership losses	185	110	145	150	140	140	150	155
Investment tax credits	24	25	20	20	21	21	22	22
Deferral of capital gains through five-year reserve	17	28	15	15	11	11	11	11
Deferral of capital gains through rollovers ²⁴	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deferral through billed-basis accounting by professionals	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Deduction of accelerated tax depreciation ²⁵	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
\$1,000 capital gains exemption on personal-use property ²⁶	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
\$200 capital gains exemption on foreign exchange transactions	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Taxation of capital gains upon realization ²⁷	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Health								
Non-taxation of business-paid health and dental benefits ²⁸	1,625	1,650	1,735	1,850	1,690	1,725	1,725	1,725
Disability tax credit (DTC) ²⁹	270	265	270	310	395	400	400	400
Medical expense tax credit ³⁰	355	405	495	545	550	580	625	665
Medical expense supplement for earners ^{31, 32}	23	26	34	38	48	52	55	58

Table 1
Personal Income Tax Expenditures (cont'd)

	Estimates			Projections				
	1997	1998	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Income maintenance and retirement								
Non-taxation of Guaranteed Income Supplement and spouse's allowance benefits	290	290	280	280	275	270	280	280
Non-taxation of social assistance benefits ³³	455	395	325	300	270	255	245	235
Non-taxation of workers' compensation benefits	630	620	610	615	570	565	560	585
Non-taxation of amounts received as damages in respect of personal injury or death	18	17	17	18	16	16	16	15
Non-taxation of veterans' allowances, civilian war pensions and allowances, and other service pensions (including those from Allied countries) ³⁴	S	S	S	S	S	S	S	S
Non-taxation of veterans' disability pensions and support for dependants	155	155	160	160	145	140	140	140
Treatment of alimony and maintenance payments ³⁵	240	215	170	155	165	165	165	165
Age credit	1,350	1,350	1,340	1,355	1,315	1,365	1,410	1,445
Pension income credit	385	405	415	415	395	400	410	415
Saskatchewan Pension Plan	S	S	S	S	S	S	S	S
Registered retirement savings plans (RRSPs) ³⁶								
Deduction for contributions	6,635	6,560	6,965	7,180	6,930	7,395	7,930	8,360
Non-taxation of investment income ³⁷	4,960	4,530	6,005	5,550	5,560	6,055	7,095	7,645
Taxation of withdrawals	-2,425	-2,795	-2,665	-2,760	-2,715	-2,915	-3,140	-3,335
Net tax expenditure	9,170	8,295	10,305	9,970	9,775	10,535	11,885	12,670
Registered pension plans (RPPs) ³⁶								
Deduction for contributions	5,170	4,490	5,030	4,890	4,430	4,470	4,525	4,495
Non-taxation of investment income	8,305	8,200	10,690	9,320	8,755	8,975	9,865	9,910
Taxation of withdrawals	-5,540	-5,985	-6,695	-6,985	-6,925	-7,485	-8,155	-8,725
Net tax expenditure	7,935	6,705	9,025	7,225	6,260	5,960	6,235	5,680
Supplementary Information:								
Present value of RRSPs and RPPs ^{38, 39, 40}	8,030	7,515	8,245	8,380	7,930	8,270	8,650	8,950

Table 1

Personal Income Tax Expenditures (cont'd)**Notes:**

- ¹ The 1997 budget extended this credit to most mandatory ancillary fees imposed by post-secondary institutions, beginning in 1997.
- ² Projections for 2003 and 2004 reflect Ontario's "double cohort" of high school graduates in 2003.
- ³ The 1997 budget increased this credit to \$150 per month for 1997 and \$200 per month thereafter. The 1998 budget allowed part-time students to claim a part-time education amount of \$60 per month. The October 2000 *Economic Statement and Budget Update* increased this credit to \$400 per month for full-time students and \$120 per month for part-time students, effective January 1, 2001. The 2001 budget introduced a measure that extends the education tax credit, beginning in 2002, to people who receive taxable assistance for post-secondary education under certain government programs.
- ⁴ The 1997 value reflects a 50% increase in the average claim in that year.
- ⁵ The 1997 budget introduced this measure, effective for 1997 and subsequent years.
- ⁶ The 1998 budget introduced this measure, effective for 1998 and subsequent years.
- ⁷ The 1998 budget supplemented annual contributions to RESPs with a 20% grant, the Canada Education Savings Grant, beginning in 1998. While this enhancement does not represent a tax expenditure, it increases the cost of the tax expenditure to the extent that it encourages participation in the RESP program. Human Resources Development Canada's method of obtaining this information has changed. The estimates for 1998 and 1999 have been revised to include more recent information on 10-year government bonds, which is used to calculate the return on net assets.
- ⁸ The 2000 budget raised the exemption for scholarship, fellowship and bursary income from \$500 to \$3,000 for students eligible for the education credit. In addition, for 2000 and later tax years, the tax expenditure reflects the additional funds made available to students under the Canada Millennium Scholarship Foundation.
- ⁹ This tax expenditure was introduced in the 2001 budget and applies to the 2002 and subsequent tax years.
- ¹⁰ This measure was introduced in the October 2000 *Economic Statement and Budget Update*, effective 2001. The tax expenditure estimates the incremental cost of allowing self-employed individuals to deduct the employer share of their Canada/Quebec Pension Plan contributions paid for their own coverage, relative to a benchmark system in which no such deduction is provided. Prior to this measure, self-employed individuals could claim a non-refundable credit on this share of their Canada/Quebec Pension Plan contributions. As a result, the actual cost of the change is lower than shown in this report.
- ¹¹ The 1998 budget replaced the \$500 tax-free allowance for volunteer firefighters with an exemption of up to \$1,000 for emergency service volunteers. The tax expenditure estimates and projections for the emergency service volunteer exemption include claims by firefighters after 1997.
- ¹² This tax expenditure reflects only the stock option deduction and not the deferral from income inclusion. The 2000 budget increased the stock option deduction from one-quarter to one-third. The October 2000 *Economic Statement and Budget Update* further increased this deduction from one-third to one-half.
- ¹³ The 1998 budget raised the amounts used to determine basic personal and spousal/equivalent-to-spouse credits by \$500 for low-income taxpayers. The 1999 budget increased the amount by a further \$175 to \$675 and extended it to all taxpayers, effective July 1, 1999. The 2000 budget fully indexed these amounts, effective January 1, 2000, raising their credit value for the following years.
- ¹⁴ The October 2000 *Economic Statement and Budget Update* increased the amount on which this credit is based from \$2,386 to \$3,500 for 2001.
- ¹⁵ This measure was introduced in the 1998 budget.
- ¹⁶ Payments are reported on a calendar-year basis. The 1996 through 1999 budgets increased this tax benefit through increases to per-child benefit amounts, as well as through increases in the income threshold at which the National Child Benefit supplement (NCB supplement) is fully phased out and the CCTB base benefit begins to be phased out. The 2000 budget fully indexed the CCTB starting January 2000. The 2000 budget and October 2000 *Economic Statement and Budget Update* increased the CCTB base benefit by \$70 per child, including indexation, in July 2000, increased the NCB supplement by \$300 per child, including indexation, in July 2001, and increased the income threshold at which the NCB supplement is fully phased out and the base benefit begins to be phased out to \$32,000 in July 2001.
- ¹⁷ The 2000 budget reduced the capital gains inclusion rate from three-quarters to two-thirds, effective February 28, 2000. The October 2000 *Economic Statement and Budget Update* further reduced the capital gains inclusion rate from two-thirds to one-half, effective October 18, 2000. The decline in this tax expenditure after 1999 reflects, in part, these reductions to the inclusion rate, which reduce the value of the exemption.
- ¹⁸ This tax expenditure is highly volatile. It is projected at its historical average.

Personal Income Tax Expenditures (cont'd)

- ¹⁹ A deferral of income is available when the herd has been reduced by at least 15% in certain prescribed drought regions. This tax expenditure was included under "Deferral of income from destruction of livestock" in previous years. However, it was not factored into the tax expenditure calculation.
- ²⁰ Estimates are based on Statistics Canada data available up to 2001, which includes cash purchase tickets for wheat, barley, oats, canola, flax and rye. Projections after 2001 are calculated as a fixed three-year historical average due to volatility of this series.
- ²¹ The change introduced in the 2001 budget for woodlots is part of this tax expenditure.
- ²² The increase from 1999 to 2000 is a result of increases in employment wages and realizations of capital gains.
- ²³ The value of this tax expenditure for 1997 reflects a 33% increase in the amount of taxable capital gains reported in that year and a 30% increase in the number of claimants. The 2000 budget reduced the capital gains inclusion rate from three-quarters to two-thirds, effective February 28, 2000. The October 2000 *Economic Statement and Budget Update* further reduced the capital gains inclusion rate from two-thirds to one-half, effective October 18, 2000. Increases in this tax expenditure after 1999 reflect these reductions as well as anticipated increases in capital gains realizations resulting from changes to this measure.
- ²⁴ This tax expenditure does not include measures in the 2000 budget or the October 2000 *Economic Statement and Budget Update* for rollovers of eligible small business investments.
- ²⁵ Data for unincorporated businesses is not available to estimate this tax expenditure with precision.
- ²⁶ The 2000 budget amended the rules so that the \$1,000 deemed adjusted cost base and deemed proceeds of disposition for personal-use property will not apply if the property is acquired after February 27, 2000, as part of an arrangement in which the property is donated as a charitable gift.
- ²⁷ Capital gains are taxed upon the disposition of property and not on an accrued basis, which results in a tax deferral. No data is available, as it is difficult to estimate the value of unsold assets.
- ²⁸ The 1998 budget allowed unincorporated owner-operators to deduct premiums for supplementary health care coverage against their business income to a maximum amount of \$1,500, beginning in 1998. Data upon which this tax expenditure is estimated was available up to 2000.
- ²⁹ The 2000 budget enhanced the DTC by extending eligibility to individuals requiring extensive therapy, and by expanding the list of relatives to whom the DTC can be transferred. The 2000 budget also provided a supplement of up to \$500 for children eligible for the DTC. The October 2000 *Economic Statement and Budget Update* increased the amount on which the DTC is based from \$4,293 to \$6,000 effective 2001.
- ³⁰ The 1997 budget broadened this credit to cover additional expenses, beginning in 1997. The 1999 budget further broadened this credit to include the care and education of persons with disabilities, beginning in 1999.
- ³¹ This measure was introduced in the 1997 budget.
- ³² Estimates and projections have been revised using a new methodology.
- ³³ The decline in this tax expenditure after 1997 reflects changes in the 1998 to 2000 budgets and the October 2000 *Economic Statement and Budget Update* to reduce tax rates on low-income individuals (e.g., increases in the personal amounts and the reduction in the low-income tax rate).
- ³⁴ Public Accounts data used for this tax expenditure was available up to 1999.
- ³⁵ The 1996 budget eliminated the income inclusion for recipients of child support payments and disallowed the deduction to payers for agreements made after April 30, 1997.
- ³⁶ Projected values vary from those given in last year's report due to changes in tax rates, projected contribution levels and bond rates.
- ³⁷ The estimates and projections in this report reflect new data from Statistics Canada's Survey of Financial Security (SFS), which is more comprehensive than the previous data used. The SFS provides data on asset levels in RRSPs and registered retirement income funds (RRIFs). Estimates and projections in previous reports were based on data contained in the Statistics Canada publication *Pension Plans in Canada* (PPIC), which provides an estimate of assets in non-self-administered RRSPs only – it does not capture assets in self-administered RRSPs or RRIFs. In 1999 the SFS indicated that RRSP and RRIF assets totalled \$408 billion, compared to the PPIC RRSP asset estimate of \$260 billion. Using the SFS data increases the annual tax expenditure estimates and projections for RRSPs by \$1.5 billion to \$2 billion compared to using the lower PPIC RRSP asset estimate.

Personal Income Tax Expenditures (cont'd)

- ³⁸ The present-value estimates reflect the lifetime cost of a given year's contributions. This definition is different from that used for the cash-flow estimates, and thus the two sets of estimates are not directly comparable. Further information on how these estimates are calculated is contained in the paper "Present-Value Tax Expenditure Estimates of Tax Assistance for Retirement Savings," which was published in the 2001 edition of this report.
- ³⁹ The tax expenditure per dollar of contribution is relatively stable from 1997 to 2000, then it drops sharply in response to lower tax rates. This causes the total value of the tax expenditure to fall in 2001, despite a rise in contributions. By 2003, however, growth in contributions is projected to raise the value of the tax expenditure above its level in 2000.
- ⁴⁰ The estimates and projections presented in this year's report are higher than those presented last year due to higher actual and projected contribution levels and an adjustment in the calculation of tax rates.
- ⁴¹ This tax expenditure cannot be estimated with precision.
- ⁴² Although this measure does provide tax relief for individuals, there are interactions with the corporate income tax system. See the corporate income tax expenditure section of this report under "Interest credited to life insurance policies" for an estimate of the value of this tax expenditure.
- ⁴³ The 1996 budget reduced this credit from 20% to 15% and the purchase amount eligible for the credit from \$5,000 to \$3,500 per year, for purchases made after March 5, 1996. The purchase amount eligible for the credit was increased to \$5,000 in 1998, effective for 1998 and subsequent years.
- ⁴⁴ The value of this tax expenditure in 2000 and 2001 is based on preliminary information on sales of shares of labour-sponsored venture capital corporations for those years. Projections are based on 1999 tax filer data and assume sales remain constant after 2001.
- ⁴⁵ This provision was introduced in the 2000 budget. The October 2000 *Economic Statement and Budget Update* expanded this measure by increasing the size of small businesses eligible for the rollover, and by raising the eligible investment limit from \$500,000 to \$2 million.
- ⁴⁶ This measure was introduced in the October 2000 *Economic Statement and Budget Update*. This new non-refundable investment tax credit is available to individuals (other than trusts) at a rate of 15% of specified mineral exploration expenses incurred in Canada pursuant to a flow-through share agreement. The flow-through share investor can use this tax credit to reduce federal tax otherwise payable. The credit applies to eligible expenses incurred between October 18, 2000, and December 31, 2003.
- ⁴⁷ The decline in this tax expenditure from 1997 to 1999 reflects a decline in the volume of home sales and in the average home value. The tax expenditures after 1999 reflect the reduction in the capital gains inclusion rate from three-quarters to two-thirds, effective February 28, 2000, and from two-thirds to one-half, effective October 18, 2000.
- ⁴⁸ This tax expenditure includes both gifts to the Crown and donations to other charities, as they were treated equivalently in the Income Tax Act beginning in 1997.
- ⁴⁹ On October 12, 2001, the Government announced its intention to make permanent the 1997 budget measure that provided special tax assistance for donations of certain securities to public charities. The 2000 budget proposed the same tax assistance for capital gains arising from donations of ecologically sensitive land. At the time of last year's publication, data was only available for the first of these measures. This year data is available for both measures for tax year 2000, but only in aggregate form. As a consequence, the tax expenditure estimates and projections for these two measures cannot be separated. The tax expenditure shown includes only the impact of the reduced inclusion rate for capital gains arising from donations; there is an additional revenue loss arising from the charitable donations credit. Further information about this measure is provided in a special report included in this document.
- ⁵⁰ The 1997 to 2000 figures are based on income tax data. The lower figure for 2000 relative to last year's publication reflects data for tax year 2000 not previously available. Given recent volatility in capital markets, the capital gains arising from these donations are assumed to be constant after tax year 2000. The decline of the tax expenditure figures after tax year 2000 reflects the reduction in the capital gains inclusion rate from three-quarters to two-thirds, effective February 28, 2000, and from two-thirds to one-half, effective October 18, 2000.
- ⁵¹ Revisions to the Canada Elections Act in May 2000 extended the 75% political contribution tax credit from the first \$100 contributed in a year to the first \$200 contributed. The figures from 2000 onwards reflect these changes. The higher projected value for 2000 reflects evidence from historical data that the level of political contributions, and hence the value of the tax expenditure, rises in the year of a federal election.
- ⁵² This provision was introduced in the 1999 budget, effective for qualifying retroactive lump-sum payments received after 1994. Estimates for 1997 and 1998 reflect the costs associated with qualifying payments received in those years, even though claims were not processed before 2000.

Table 1

Personal Income Tax Expenditures (cont'd)

- ⁵³ Estimates and projections assume that the total amount of lottery and horse racing winnings would be included in income and subject to tax. However, there is some uncertainty regarding the proper benchmark tax system in this area. For example, if the benchmark system included taxation of winnings, it might also have to include a deduction for the purchase cost of tickets. A threshold below which winnings would not be taxable might also be necessary, due to the large administrative cost of taxing very small prizes. In addition, proceeds from the sale of lottery tickets are an important source of funds for provincial governments and not-for-profit organizations. As a result, there is already an element of taxation to lottery and gambling proceeds. This measure is therefore included as a memorandum item.
- ⁵⁴ The increase of this tax expenditure in 1999 reflects the recent availability of data on casino and video lottery winnings, which Statistics Canada began collecting starting with fiscal year 1997-98.
- ⁵⁵ Allowances for members of Parliament and senators are no longer tax-exempt, starting January 2001.
- ⁵⁶ The estimates and projections in this report reflect a new methodology. The 1998 budget increased the child care expense deduction limit from \$5,000 to \$7,000 for children under age 7, and from \$3,000 to \$4,000 for children age 7 to 16. The 2000 budget increased the deduction limit from \$7,000 to \$10,000 for children eligible for the disability tax credit.
- ⁵⁷ The 1998 budget enhanced the moving expense deduction by including certain costs of maintaining a vacant former residence (including mortgage interest and property taxes) and other miscellaneous relocation expenses.
- ⁵⁸ This tax expenditure applies to a subset of resource-related deductions. Data was available for 1997 to 2001 on the volume of reclassified shares, and this data was used to calculate estimates. Due to volatility, the projections for 2002 to 2004 are based on a three-year historical average.
- ⁵⁹ The expected increase in this tax expenditure is in line with the historical trend.
- ⁶⁰ This measure was introduced in the 1998 budget. The 1999 budget extended this measure to all taxpayers, effective July 1, 1999. The 1999 budget increased the tax expenditures associated with the basic personal credit and the spousal/equivalent-to-spouse credits and eliminated the supplementary low-income credit.

Table 2
Corporate Income Tax Expenditures*

	Estimates		Projections ¹					
	1997	1998 ²	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Tax rate reductions								
Small businesses tax rate ³	2,820	2,895	3,255	4,055	3,575	2,605	2,960	2,795
Manufacturing and processing allowance ⁴	1,735	1,720	2,090	2,240	1,935	1,100	775	110
Low tax rate on general income of small businesses ⁵	—	—	—	—	60	60	45	15
Low tax rate for credit unions ⁶	41	39	39	51	44	31	35	33
Exemption from branch tax for transportation, communications, banking and iron ore mining corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemption from tax for international banking centres	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax credits								
Investment tax credits								
Scientific research and experimental development investment tax credit	1,080	1,100	1,205	1,405	1,265	1,335	1,410	1,495
Atlantic investment tax credit	85	79	86	100	92	96	100	105
Investment tax credits carried back	60	36	22	59	46	48	51	53
Investment tax credits claimed in current year but earned in prior years	655	790	860	1,005	865	905	950	990
Political contribution tax credit	S	S	S	S	S	S	S	S
Canadian film or video production tax credit ⁷	80	100	130	140	145	150	160	165
Film or video production services tax credit ⁷	S	26	39	48	50	52	54	57
Exemptions and deductions								
Partial inclusion of capital gains ⁸	1,130	1,200	1,025	2,005	2,015	2,065	2,030	1,995
Net impact of the resource allowance and the non-deductibility of Crown royalties and mining taxes ⁹	23	32	41	77	77	68	70	73

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See the publication *Tax Expenditures: Notes to the Estimates/Projections*, published in 2000 and available on the Department of Finance Web site (www.fin.gc.ca), for a discussion of the reasons for this.

Table 2
Corporate Income Tax Expenditures (cont'd)

	Estimates		Projections ¹					
	1997	1998 ²	1999	2000	2001	2002	2003	2004
	(\$ millions)							
International								
Non-taxation of life insurance companies' world income	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Exemptions from non-resident withholding tax ²¹								
Dividends	200	200	215	205	225	215	220	270
Interest								
On deposits	390	405	410	500	470	440	460	480
On long-term corporate debt	140	145	150	130	120	115	120	125
Other ²²	340	355	360	385	360	335	350	370
Rents and royalties								
Copyright royalties	20	24	23	22	25	26	28	30
Royalties for the use of, or right to use, other property	15	17	21	20	19	21	22	23
Research and development royalties	S	S	S	S	S	S	S	S
Natural resource royalties	S	S	S	S	S	S	S	S
Rents from real property	S	S	S	S	S	S	S	S
Management fees	38	43	43	43	48	51	54	58
Estate or trust income	15	15	16	32	33	34	36	39
Exemption from Canadian income tax of income earned by non-residents from the operation of a ship or aircraft in international traffic	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Other items								
Transfer of income tax room to provinces in respect of shared programs	860	895	935	1,160	1,120	1,000	1,215	1,375
Interest credited to life insurance policies ²³	93	97	98	91	72	75	78	80
Non-taxation of registered charities	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of other non-profit organizations ²⁴	88	76	83	90	91	90	94	96
Income tax exemption for provincial and municipal corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-taxation of certain federal Crown corporations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Aviation fuel excise tax rebate ²⁵	n.a.	n.a.	n.a.	n.a.	—	—	—	—
Surtax on the profits of tobacco manufacturers ²⁶	-68	-74	-70	-70	-80	-85	-85	-85
Temporary tax on the capital of large deposit-taking institutions ²⁷	-55	-61	-61	-51	—	—	—	—

Table 2

Corporate Income Tax Expenditures (cont'd)

Notes:

- ¹ Unless otherwise indicated in the footnotes, changes in the projections from those in last year's edition of this document result from changes in the explanatory economic variables upon which the projections are based. Projections for 2001 and subsequent years reflect the impact of the reduction in the general corporate tax rate from 28% to 27% on January 1, 2001, 25% on January 1, 2002, 23% on January 1, 2003, and 21% on January 1, 2004. The corporate surtax raises these rates by 1.12 percentage points.
- ² 1998 estimates are based on preliminary data.
- ³ The increase in the tax expenditure from 1997 to 2000 is attributable to a large increase in projected taxable income during this period. The reduction in the tax expenditure starting in 2001 results from reductions in the general corporate tax rate. The significant decrease in 2002 results from an expected decrease in income eligible for this lower rate.
- ⁴ Although this tax expenditure will be effectively eliminated on January 1, 2004, when the general corporate tax rate is reduced to 21%, many firms reporting income in the 2004 tax year will earn a portion of that income in the 2003 calendar year, before the tax expenditure is effectively eliminated.
- ⁵ This measure was announced in the 2000 budget and became effective January 1, 2001. On that date the general federal corporate income tax rate on income between \$200,000 and \$300,000 earned by a Canadian-controlled private corporation from an active business carried on in Canada was reduced to 21%. The lower rate on the general income of small businesses and the change in the general federal tax rate effective January 1, 2001, only partially affect the projection for tax year 2001 since many firms reporting income in the 2001 tax year earned a portion of that income in the 2000 calendar year, before the rate reductions were introduced. Although this tax expenditure is effectively eliminated on January 1, 2004, when the general income tax rate is reduced to 21%, many firms reporting income in the 2004 tax year will earn a portion of that income in the 2003 calendar year, before the tax expenditure is effectively eliminated.
- ⁶ Credit unions are eligible for the lower general federal tax rate of 12% provided to small businesses.
- ⁷ The variations from last year's estimates and projections are attributable to the availability of new data.
- ⁸ The increase of the expenditure in 2000 reflects a projected increase in capital gains and the reduction in the capital gains inclusion rate from three-quarters to one-half during 2000.
- ⁹ A benchmark tax system would allow deduction of Crown royalties and provincial mining taxes paid, but would not include a resource allowance. Therefore, a net tax expenditure has been calculated based on the non-deductibility of Crown royalties and provincial mining taxes and the provision of a resource allowance.
- ¹⁰ Additions to depletion pools were eliminated as of January 1, 1990. As a result, the declining value of this tax expenditure reflects the fact that these pools are being drawn down, albeit subject to successor rule limitations where applicable.
- ¹¹ The decline in this tax expenditure starting in 2001 results from the reduction in the general corporate tax rate and fluctuations in projected taxable income.
- ¹² In prior editions of this publication, the tax expenditure relating to gifts of cultural property and ecologically sensitive land was reported under "Deductibility of gifts to the Crown."
- ¹³ This treatment should result in a negative tax expenditure since the deduction of an expense incurred to earn income is denied. Under the benchmark tax system, advertising expenses in foreign media incurred to gain or produce income from a business or property would be deductible whether targeted at foreign or domestic markets.
- ¹⁴ The tax measures in this section allow a deferral of income taxes from the current to a later tax year. The publication *Tax Expenditures: Notes to the Estimates/Projections* provides details on the content of each deferral item.
- ¹⁵ The amount of this tax expenditure can fluctuate from year to year depending upon the amount of current-year losses and the availability of income against which to apply these losses.
- ¹⁶ The amount of this tax expenditure can fluctuate significantly from year to year depending primarily upon the level of construction activity.
- ¹⁷ This item was referred to in earlier tax expenditure publications as "Available for use."

Corporate Income Tax Expenditures (cont'd)

- ¹⁸ The tax deferral associated with taxation of capital gains upon disposition of property, rather than on an accrual basis, represents a deviation from the benchmark tax system, and is therefore a tax expenditure.
- ¹⁹ The amount of this tax expenditure can fluctuate significantly from year to year depending upon advertising expenses claimed.
- ²⁰ This measure was introduced in 1998. The numbers are now based on data for 1998, 1999 and 2000 received from the Office of the Superintendent of Financial Institutions.
- ²¹ Estimates and projections were computed on the basis of an analysis of payments to non-residents and withholding tax collections available for 1999 and 2000, the last two years for which complete data is available. Figures for 1997 and 1998 and from 2001 to 2004 are, respectively, backward and forward projections based on the 1999 and 2000 projections. Projections for 1999 have been revised in order to reflect methodological improvements. A more detailed breakdown of payments has also been adopted, and the list of exemptions covered under each category has been reviewed.
- ²² This category includes interest paid to non-resident persons or organizations that would be exempt from income tax in Canada were they residents in Canada. Also included is interest paid under certain securities-lending arrangements exempt under subparagraph 212(1)(b)(xii) of the Income Tax Act, and interest exempt under certain other domestic and treaty provisions.
- ²³ Estimates are higher than in the last year's report because of a new methodology that better reflects modifications to the personal income tax system. The projection declines in 2000 due to lower investment income in the year. Projections are lower after 2000 due to personal income tax reductions.
- ²⁴ Estimates and projections after 1997 are lower than in last year's report due to lower interest rates and the phased-in reductions in the general corporate income tax rate.
- ²⁵ The aviation fuel excise tax rebate, which was effective for calendar years 1997 to 2000, provided an excise tax rebate on the aviation fuel used by airline companies. The rebate was limited to \$20 million per year per associated group of companies. In order to receive a rebate, a company had to agree to reduce its income tax losses by \$10 for every \$1 of rebate.
- ²⁶ The increase in this tax expenditure from 2000 to 2002 results from the increase in the tobacco manufacturers' surtax from 40% to 50% of the Part I tax on profits from tobacco manufacturing, effective April 6, 2001.
- ²⁷ This measure was first introduced in the 1995 budget and extended in subsequent budgets. The temporary tax was not extended beyond its scheduled expiry date of October 31, 2000.
- ²⁸ Estimates and projections are generally higher than in previous publications due to the availability of data for all corporations. Those in previous years had been based on a sample of corporations.
- ²⁹ This tax expenditure includes the additional 6 2/3% refundable tax on investment income as well as, for years after 2000, the Part I tax paid on investment income in excess of the benchmark rate. The increase in this expenditure after 2001 results from the increase in the difference between the Part I tax on investment income and the benchmark rate.
- ³⁰ The increases in 1998 and 2000 are due to an important increase in the capital gain dividends distribution. The projections are lower after 2000 due to the phased-in reductions in the general corporate income tax rate and the reduction in the capital gains inclusion rate.
- ³¹ The impact of loss carry-overs can fluctuate significantly from year to year depending upon the amount of current and prior years' losses and the availability of income against which to apply these losses.
- ³² Patronage dividends vary from year to year depending on decisions made by cooperatives. The projections are generally lower after 2000 due to the phased-in reductions in the general corporate income tax rate.
- ³³ The cost of the Syncrude Remission Order ("Order Respecting the Remission of Income Tax for the Syncrude Project," P.C. 1976-1026, May 6, 1976 [C.R.C. 1978 Vol. VII, c. 794]) is published annually in the Public Accounts of Canada (ISBN 0-660-177792-7).

Table 2

Corporate Income Tax Expenditures (*cont'd*)

³⁴ Bill C-22 (An Act to Amend the Income Tax Act and Related Statutes), which contained an amendment to repeal the NRO provisions for elections made after February 27, 2000, received Royal Assent on June 14, 2001 [S.C. 2001, c. 17, s. 131]. To allow for an orderly restructuring of their operations, existing NROs are entitled to retain their status until the end of their last tax year that begins before 2003. However, existing NROs are not allowed to issue new shares, other than by way of reorganization, or increase debt levels, to finance new investments, subject to grandfathering of arrangements in writing entered into before February 28, 2000.

³⁵ This measure constitutes a tax expenditure because it allows a public corporation that qualifies as an investment corporation to benefit from elements of the integration system, which are usually available only to private corporations.

³⁶ The taxation of capital gains is affected by provisions that permit taxpayers to defer realization for tax purposes through various rollover provisions. Since the benchmark tax structure includes various rollover provisions that permit the deferral of capital gains when a corporate structure is changed, this item is identified separately for information purposes.

Table 3
GST Tax Expenditures*

	Estimates				Projections			
	1997	1998	1999	2000	2001	2002	2003	2004
	(\$ millions)							
Zero-rated goods and services								
Basic groceries ¹	2,780	2,970	3,065	3,190	3,325	3,440	3,660	3,890
Prescription drugs ¹	250	270	285	295	310	320	340	360
Medical devices ¹	95	105	110	115	120	125	130	140
Agricultural and fish products and purchases	S	S	S	S	S	S	S	S
Certain zero-rated purchases made by exporters	S	S	S	S	S	S	S	S
Non-taxable importations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Zero-rated financial services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Tax-exempt goods and services								
Residential rent (long-term) ¹	1,060	1,105	1,150	1,175	1,240	1,310	1,385	1,460
Health care services ^{1,2}	405	430	450	460	490	515	545	575
Education services (tuition) ^{1,3}	240	240	255	270	285	295	315	335
Child care and personal services ¹	130	130	140	140	150	155	165	175
Legal aid services	20	15	15	20	20	20	20	25
Ferry, road and bridge tolls ^{1,4}	10	10	10	10	10	15	15	15
Municipal transit ¹	75	75	80	90	95	95	105	110
Exemption for small businesses	120	125	140	150	155	160	170	180
Quick method accounting	160	165	175	190	195	195	210	225
Water and basic garbage collection services ¹	90	90	80	80	85	90	95	100
Domestic financial services	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Certain supplies made by non-profit organizations	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

* The elimination of a tax expenditure would not necessarily yield the full tax revenues shown in the table. See the publication *Tax Expenditures: Notes to the Estimates/Projections*, published in 2000 and available on the Department of Finance Web site (www.fin.gc.ca), for a discussion of the reasons for this.

GST Tax Expenditures (cont'd)

Notes:

- ¹ The national GST base model used to generate these estimates and projections has been updated and is now based on the 1998 national input-output tables from Statistics Canada (based on the North American Industry Classification System) and the latest release of the National Income and Expenditure Accounts. In some cases, these updates can cause significant changes in the estimates and projections.
- ² This tax expenditure was revised downward as a result of a change in National Accounts methodology.
- ³ This tax expenditure was revised downward as a result of a change in the proportion of commodities subject to tax.
- ⁴ The upward revision of this tax expenditure may reflect the opening of the Confederation Bridge in 1997.
- ⁵ Rebates paid to governments are not recorded as tax expenditures – the Crown's constitutional immunity from taxation is part of the benchmark tax system.
- ⁶ The housing rebate is based on information provided by Statistics Canada.
- ⁷ The new residential rental property rebate was introduced in the 2000 budget for new construction or substantial renovations commencing after February 27, 2000.
- ⁸ The book rebate was introduced in October 1996.
- ⁹ The methodology for estimating this tax expenditure, which was derived as part of a review of the Visitor Rebate Program conducted during 1997, has been updated to reflect more recent information.
- ¹⁰ The public sector body rebates are based on Canada Customs and Revenue Agency administrative data. In some cases, the use of more recent administrative data lead to revisions of these rebates.
- ¹¹ Since the value of these rebates is influenced by provincial budgetary decisions, the projected values for the relevant years are simply the values estimated for 2000.
- ¹² These rebates are offered to Aboriginal governments that have an agreement providing for a GST refund for goods and services acquired for self-government activities. The rebates are based on Canada Customs and Revenue Agency administrative data.
- ¹³ These estimates and forecasts are based on personal income tax data.
- ¹⁴ The numerical approach used to derive the tax expenditure figures is tightly integrated with the tax expenditure estimates and projections reported for the personal and corporate income tax system.
- ¹⁵ This item includes the apprentice vehicle mechanics' tools deduction.

PART 2

TAX EVALUATIONS AND RESEARCH REPORTS

**THE IMPACT OF THE CANADA CHILD TAX BENEFIT
ON THE INCOMES OF FAMILIES WITH CHILDREN**

EXECUTIVE SUMMARY

Since July 1998 the Canada Child Tax Benefit (CCTB) has been the key element of federal assistance to families with children. It has two components: a base benefit and the National Child Benefit supplement (NCB supplement).

In 2002 families with net income under the threshold of \$32,960 receive a base benefit of \$1,151 per child, with additional amounts for children under age 7 and for families with more than two children. With income over the threshold, the benefit is reduced, though at a rate low enough to ensure that middle-income families receive a measurable benefit.

The NCB supplement is the federal component of the National Child Benefit (NCB), a joint federal-provincial-territorial initiative. The supplement is targeted at low-income families, providing over \$1,000 per child for families with net income under the \$22,397 threshold in 2002. It is reduced with income above the threshold, and is fully phased out when family net income exceeds \$32,000.

This paper illustrates the direct effect of the CCTB on the incomes of Canadian families with children. The 1996 Child Tax Benefit (CTB) is compared with the 1999 and 2004 configurations of the CCTB. The parameters of each system are applied to the 1999 population, enabling a comparison while holding everything else constant.

Using this methodology, this paper shows that:

- The CCTB substantially increases the level of federal child benefits going to Canadian families. Between 1996 and 1999 benefit increases were focused on low-income families. For example, families with income under \$20,000 receive benefits of about \$3,000 under the 1999 CCTB, about 50% more than under the 1996 system. Between 1999 and 2004 benefits continue to rise, but this time enrichments extend further up the income range.
- The CCTB has a positive – and growing – impact on income distribution. As a result of the 1996 CTB, over 30% of the families with under \$10,000 in income (before child benefits) move into the \$10,000 to \$20,000 income group. With the 1999 CCTB, this increases to over 38% and with the 2004 parameters it reaches 42%.
- The CCTB reduces the incidence and depth of low income for Canadian families. Without child benefits, 16.8% of families would have been below Statistics Canada's After-Tax Low Income Cut-Off (AT-LICO) in 1999. The 1999 CCTB reduces the share to 13.1%, and the 2004 CCTB further reduces it to 12.4%. In addition, with the 2004 CCTB the average income increase for families remaining below the AT-LICO is \$3,445.

Introduction

Since July 1998 the Canada Child Tax Benefit (CCTB)¹ has been the key element of federal assistance to families with children. It is an income-tested benefit that has two components: the CCTB base benefit for low- and middle-income families, and the National Child Benefit supplement (NCB supplement), which provides low-income families with additional benefits on top of the base benefit.

The CCTB base benefit assists both low- and middle-income families with the expenses of raising children.

The NCB supplement is the federal component of the National Child Benefit (NCB), which is a joint federal-provincial-territorial initiative. The NCB initiative has three main objectives: to help prevent and reduce the depth of child poverty; to promote attachment to the labour market; and to reduce overlap and duplication by harmonizing program objectives and benefits across governments.

The purpose of this paper is to illustrate the direct effect of the CCTB on the incomes of Canadian families with children. A more comprehensive evaluation of the NCB – both the federal NCB supplement and the provincial/territorial component of the program – is currently in progress, coordinated by Human Resources Development Canada. Appendix 2 provides a brief description of the NCB evaluation.

This paper describes the evolution of the CCTB, from the previous system of assistance to families with children through to the mature CCTB system that will be in place by 2004. It then presents simulation results from Statistics Canada's Social Policy Simulation Database and Model demonstrating the impact of the child benefit systems in 1996, 1999 and 2004 on the level and distribution of family income.

Evolution of the CCTB

The Child Tax Benefit

In 1993 the Government of Canada consolidated the previous system of child tax credits and the Family Allowance into the Child Tax Benefit (CTB), which provided a monthly payment based on the number of children and the level of family income. The CTB had two parts: a base benefit, available to most Canadian families,² and the Working Income Supplement (WIS), which applied to family earnings over a limited income range. The WIS helped offset some additional costs that low-income earners with children incurred when working. Unlike the base benefit, the WIS was payable on a per family basis.

¹ Appendix 1 contains a list of acronyms and their definitions.

² Throughout this paper, "families" refers to families with children.

The 1997 budget restructured the WIS by providing benefits on a per child basis. It was also enriched: the maximum amount paid for the first child exceeded the previous 1996 maximum WIS per family benefit.

The Canada Child Tax Benefit

In July 1998 the CTB (the base benefit and the WIS) was replaced by the CCTB, consisting of the CCTB base benefit and the NCB supplement. The CCTB base benefit is identical in structure to the CTB base benefit that it replaced, but the NCB supplement is quite different from the WIS. Whereas receipt of the WIS required employment income, the NCB supplement provides a universal benefit per child to all families with incomes below a threshold, above which it is phased out.

The NCB supplement is the federal component of the NCB – a joint initiative of federal, provincial and territorial governments.³ The NCB was designed with the following three objectives:

- a) To help prevent and reduce the depth of child poverty.
- b) To promote attachment to the labour market by ensuring that NCB recipients are better off as a result of working.
- c) To reduce overlap and duplication through closer harmonization of program objectives and benefits and through simplified administration.

Under the NCB the federal government provides supplemental benefits to low-income families with children. For families receiving social assistance in most provinces and territories, these federal benefits replace part of their social assistance payments.⁴ This maintains the level of cash transfers going to families on social assistance, while increasing payments to low-income working families. Provinces and territories reallocate the newly available social assistance funds into benefits and services that further the goals of the NCB. Examples include supplementary health benefits and day care initiatives. The provinces and territories also spend additional funds – on top of the social assistance reinvestments – on these NCB programs and services.

³ i) The Government of Quebec has stated that it agrees with the basic principles of the NCB. It chose not to participate in the NCB because it wanted to assume control over income support for children in Quebec; however, it has adopted a similar approach to the NCB. Throughout this report, references to provincial positions do not include Quebec.

ii) Many First Nations also participate in the NCB.

⁴ In 1998-99 New Brunswick and Newfoundland and Labrador chose not to reduce social assistance payments by the amount of the NCB supplement. New Brunswick continued this policy in 1999-2000. In 2000-01 and 2001-02, Newfoundland and Labrador, New Brunswick and Manitoba did not recover the NCB supplement increase.

As part of the Budget 2000 Five-Year Tax Reduction Plan, the CCTB was fully indexed for inflation effective January 2000, and further enhancements to both the base benefit and the NCB supplement will continue to be made until 2004. As a result of indexation and other enhancements, CCTB expenditures for the 2004 benefit year are estimated at \$8.7 billion, up from \$5.1 billion in 1996.⁵

Structure of Benefits

Table 1 indicates the structure of the federal child benefit programs for the 1996, 1999, 2002 and 2004 benefit years. To supplement the table, Appendix 3 contains a chronology of changes to federal child benefits from 1997 to 2004.

The Base Benefit

The top panel of Table 1 describes the base benefit in each system. For example, the first column indicates that the 1996 CTB provided a maximum base benefit of \$1,020 per child, with an additional \$75 for the third and each subsequent child, and an additional \$213 for each child under age 7. Families with net income below the threshold of \$25,921 received the maximum benefit. Benefits were phased out at a rate of either 2.5% (for one-child families) or 5% (for families with two or more children) of each dollar of family net income above the threshold.

For instance, a two-child family with one child under age 7 could have received a maximum base benefit of \$2,253. If this family had net income of \$26,921, (\$1,000 above the threshold) it would have had its base benefit reduced by \$50 (5% of \$1,000), resulting in a total base benefit of \$2,203. If the family had net income of \$70,981 (\$45,060 above the threshold) it would have had its base benefit reduced by \$2,253 (5% of \$45,060). That is, this family's base benefit would have been completely phased out.

The base benefit, threshold and reduction rates were the same in the 1999 CCTB as they were in the 1996 CTB. By 2004 the maximum benefit per child 7 years of age and over will increase to \$1,195⁶ for a two-child family. The threshold will increase to \$35,000 and the benefit reduction rate will be reduced to 2% for one-child families and 4% for families with two or more children.

⁵ The CCTB benefit year is not on a calendar-year basis: benefits are adjusted each year in July based on income reported on the preceding year's income tax return. Therefore, the estimate of \$8.7 billion refers to the period from July 2004 to June 2005. The estimate of \$8.4 billion shown in the tax expenditure tables is based on the 2004 calendar year.

⁶ Annual inflation of 2% is assumed for 2002 and subsequent years. This is in the midpoint of the Bank of Canada's target inflation band.

Supplemental Benefits

The bottom panel of the table describes the WIS and the NCB supplement. For example, the first column indicates that the WIS added 8% to employment earnings above \$3,750, up to a maximum of \$500 per family, and that the supplement was reduced with income above \$20,921.

By 2004 the NCB supplement will provide a maximum benefit of \$1,342 for the first child, \$1,128 for the second child and \$1,048 for each additional child. Families will receive the maximum benefit until family net income reaches \$23,256. After that the NCB supplement will decline at a rate of 11.4%, 21%, and 30% for one-, two- and three- (or more) child families respectively. As a result, for families with three or fewer children, the 2004 NCB supplement will be completely phased out once net income exceeds \$35,000.

Table 1
Federal Child Benefit Program Parameters

	1996	1999	2002	2004
Base benefit	CTB		CCTB	
Benefit per child ^a	\$1,020	\$1,020	\$1,151	\$1,195
Supplement for third and each additional child	\$75	\$75	\$80	\$83
Supplement for children under age 7 ^b	\$213	\$213	\$228	\$237
Threshold ^c	\$25,921	\$25,921	\$32,960	\$35,000
Benefit reduction rate ^d				
One child	2.5%	2.5%	2.5%	2.0%
Two or more children	5.0%	5.0%	5.0%	4.0%
Supplement	WIS	NCB supplement		
First child	8% of employment	\$785	\$1,293	\$1,342
Second child	income above \$3,750, up	\$585	\$1,087	\$1,128
Each additional child	to a maximum of \$500	\$510	\$1,009	\$1,048
Threshold	\$20,921	\$20,921	\$22,397	\$23,256
Supplement reduction rate				
One child	10.0%	11.5%	12.2%	11.4%
Two children	10.0%	20.0%	22.5%	21.0%
Three or more children	10.0%	27.5%	32.1%	30.0%

Note: Amounts shown are in current dollars. Annual inflation of 2% is assumed for 2002 and subsequent years.

- a The CCTB base benefit is slightly different in Alberta, where the amount per child varies by age. Total benefits paid are the same.
- b This is reduced by 25% of child care expenses claimed for these children.
- c Families with family net income under the threshold receive the full benefit. Each dollar of family net income above the threshold reduces the amount of benefits received.
- d This is the rate at which income above the threshold reduces benefits. For example, in 2002 a family with two children and an income of \$33,060 would have its benefits reduced by \$5 (5% of \$100).

The combination of the base benefit and the supplement will be much higher in 2004 than it was in 1996. For example, the maximum benefit for a two-child family with one child under age 7 is \$5,097 with the 2004 configuration of the CCTB. This is nearly double the maximum 1996 CTB benefit of \$2,753.

Diagrams 1 and 2 illustrate the 1996 CTB and the 2004 configuration of the CCTB. These diagrams make clear the progressive nature of federal child benefits in Canada: low-income individuals receive an extra benefit (the WIS or NCB supplement), which is phased out quickly after net income exceeds approximately \$20,000. The base benefit is also progressive, although the phase-out rate is much more gradual.

The diagrams also provide a visual comparison of the level of federal child benefits under the 1996 CTB and 2004 CCTB. The average benefits paid to recipient families increase significantly in 2004; in addition, many more families are eligible for benefits.

Diagram 1: CTB (1996) Benefits as a Function of Family Net Income
(Two-child family with one child under age 7)

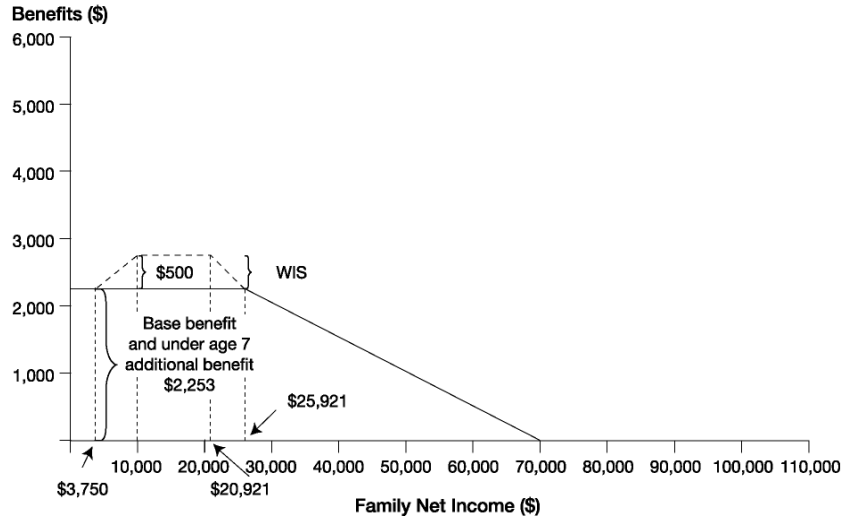
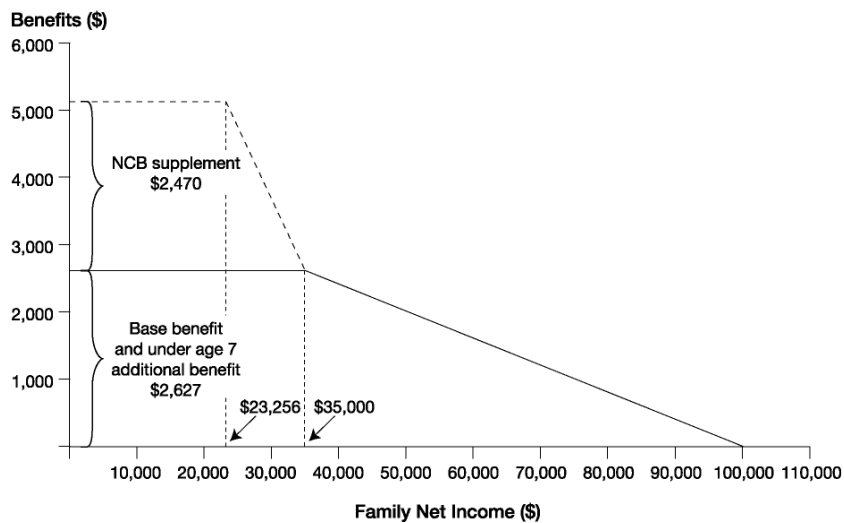


Diagram 2: CCTB (2004) Benefits as a Function of Family Net Income
(Two-child family with one child under age 7)



Amount and Distribution of the CCTB

This section compares the 1996 CTB with the 1999 and 2004 configurations of the CCTB according to the average benefits paid to various income classes, and the resulting change in the income distribution of families with children.

The comparison points were chosen for the following reasons:

- The starting point is the last year before federal child benefits began to be enriched in the late 1990s. In 1996 the WIS was still in place; there was no NCB supplement.
- The midpoint, 1999, is the final year before full indexation of the CCTB and other enhancements came into effect.
- The end point represents the mature CCTB – all changes to benefits, income thresholds and reduction rates legislated after 1999 will be in effect by 2004.

The numbers in the charts and tables in this section were produced by Statistics Canada, using the Social Policy Simulation Database and Model (SPSD/M), a micro computer-based product designed to assist in the analysis of the financial interactions of governments and individuals in Canada.⁷ It can assess the cost implications and income distribution effects of changes in the personal taxation and cash transfer system. The SPSD is a non-confidential, statistically representative database of hypothetical individuals in their family context, with enough information on each individual to compute taxes paid to and cash transfers received from the Government. The SPSM is a static accounting model (i.e. it does not consider behavioural feedback effects) that processes each individual and family on the SPSD, calculating taxes and transfers using legislated or proposed programs.

Throughout this section, families are classified by income group. The income measure includes all forms of revenue received by a family except for CCTB (or CTB) benefits.⁸

The definition of “family” is a nuclear family: a married couple, a common-law couple or a lone-parent living together with their children under the age of 18. A married child and his or her spouse living in the household constitute a separate nuclear family, as does a child with his or her own children living in the household.

⁷ The simulations were performed by Statistics Canada, but the assumptions and calculations underlying the simulation results were specified by the Department of Finance. Therefore, the responsibility for the use and interpretation of these data is entirely that of the Department of Finance.

⁸ Note that CCTB payment amounts, as displayed in the previous section, are calculated based on family net income for tax purposes. Net income is obtained by deducting certain work-related expenses from total income.

How Are the Child Benefit Programs Being Compared?

In order to isolate the effects of the three benefit programs (1996 CTB, 1999 CCTB and 2004 CCTB), the sample population is kept constant, based on 1999 demographic data. That is, the analysis applies the parameters of each of the benefit programs to the 1999 population, enabling a comparison of the three programs while holding everything else constant. All program parameters and other amounts are converted to 1999 dollars.

Since 1999 demographic data is used, the results for the 1996 CTB and 2004 CCTB are hypothetical. They represent what these program configurations would have meant for the 1999 population had the 1996 CTB (or 2004 CCTB) been in place. In the interest of readability, the discussion below is kept almost entirely in the present tense, despite the conditional nature of the analysis.

Amount and Share of Benefits to Various Income Classes

Chart 1 displays the average amount of federal transfers in support of children provided to families in various income groups. It clearly illustrates the increase in federal support to low- and middle-income families resulting from the replacement of the CTB with the CCTB, and its subsequent enrichment.

Chart 1
Average Federal Child Benefits to Families With Children

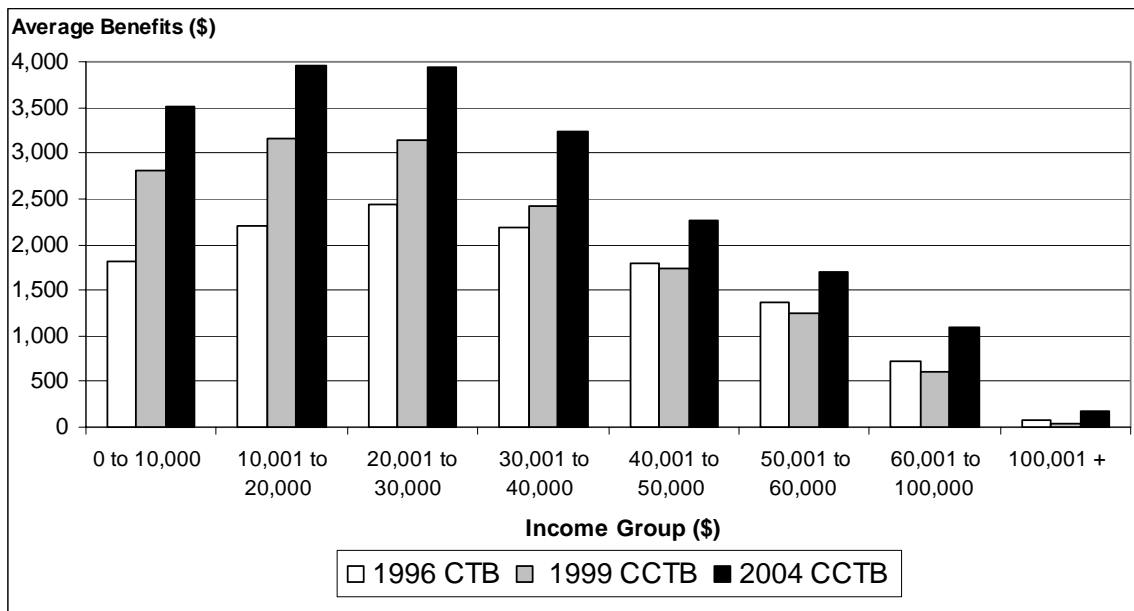


Chart 1 also demonstrates the impact of the benefit reduction rate for families above the threshold. After family net income exceeds the threshold (\$35,000 in 2004), CCTB benefits gradually decline. The reduction rate is low enough, however, to ensure that middle-income families receive a measurable benefit. This is consistent with the role of government in promoting taxation fairness and equity among individuals with different family circumstances.

The chart indicates that families with between \$10,000 and \$30,000 of annual income receive more federal aid than families with less than \$10,000 of annual income. However, this is not due to the parameters of the CCTB. It occurs simply because families with incomes between \$10,000 and \$30,000 have slightly more children, on average, than families with incomes of under \$10,000 in the 1999 population that is used.

Since the NCB supplement is targeted at low-income families, the proportion of aggregate CCTB benefits received by this group is much higher than its share of the population. Table 2 compares the share of families in four different income classes with the amount and share of aggregate benefits paid to those families under each of the program configurations.

Table 2
Share of Families With Children and Share of CTB or CCTB Benefits by Income Class

Total income	Share of families	Share of 1996 CTB		Share of 1999 CCTB		Share of 2004 CCTB	
	(%)	(\$ billions) ^a	(%)	(\$ billions) ^a	(%)	(\$ billions) ^a	(%) ^b
Up to \$20,000	15.3	1.2	23.1	1.8	29.8	2.2	27.5
\$20,001 to \$40,000	21.7	1.9	36.1	2.3	38.0	2.9	36.3
\$40,001 to \$60,000	21.9	1.3	25.0	1.2	20.7	1.6	20.2
Above \$60,000	41.1	0.8	15.8	0.7	11.5	1.3	15.9

Note: Shares are based on a 1999 population distribution.

^a Amounts are in 1999 dollars, so benefit increases due to inflation are not shown.

^b Numbers may not add to 100% due to rounding.

The table is read as follows: the first row indicates that 15.3% of Canadian families have income (net of child benefits) up to \$20,000 in 1999. Those families receive a total of \$1.2 billion in 1996 CTB transfers, or 23.1% of the 1996 total. They receive \$1.8 billion in 1999 CCTB transfers, or 29.8% of that year's total. Finally, they receive \$2.2 billion in 2004 CCTB transfers, or 27.5% of the total. The first two rows of Table 2 indicate that families with income up to \$40,000, who make up less than 40% of Canadian families with children, receive about 60% of aggregate benefits under the 1996 CTB and about two-thirds of benefits under the 1999 and 2004 CCTB.

Table 2 illustrates how federal child benefits paid to various income classes evolve over the 1996 to 2004 period. Between 1996 and 1999 the introduction of the NCB supplement increases both the amount and share of total federal child benefits going to families with up to \$40,000 income. Between 1999 and 2004 benefits continue to increase; this time the enrichments extend further up the income range, bringing more families into the program. This necessarily reduces the share of total benefits paid to

families with income up to \$60,000. As Table 2 indicates, however, all families are better off as a result of these enrichments.

Impact of Child Benefits on the Income Distribution of Families With Children

This section demonstrates the direct effect of the child benefit programs in 1996, 1999 and 2004 on the distribution of income among families with children. Since the provincial/territorial component of the NCB also affects income distribution, it is more informative to consider the joint effect of the CCTB and the NCB than to consider the CCTB benefits in isolation. Recall that the NCB supplement replaces part of the social assistance payments made by the provinces and territories. The social assistance recoveries are then reinvested in programs that benefit low-income families with children while promoting attachment to the labour market.⁹

Results reflecting both the CCTB and the provincial/territorial component of the NCB are labelled “CCTB/NCB.” The analysis considers only the direct effect of the cash transfers. The impact of the NCB on family incomes due to increased participation in the labour market is not taken into account.

Chart 2 shows the distribution of family income excluding all federal child benefits and the provincial/territorial component of the NCB (the “No Child Benefits” case), and under each of the three child benefit program configurations. It indicates that the direct effect of the CCTB/NCB is to raise families out of the lowest income classes and into the \$30,000 to \$60,000 income range.

While it shows the final net impact of child benefits on income distribution, Chart 2 masks a lot of the underlying movement up the income scale. To illustrate the extent of this movement, Chart 3 shows the shares of families that move into a higher income group as a result of each of the three benefit programs. For example, the first three columns of Chart 3 indicate that 30.5% of the families who have under \$10,000 in income in the “No Child Benefits” case move into the \$10,000 to \$20,000 income group as a result of the 1996 CTB; with the 1999 CCTB/NCB, 38.5% of the families with under \$10,000 in income excluding child benefits move into the \$10,000 to \$20,000 income group; and the 2004 CCTB/NCB raises the share of families moving out of the under \$10,000 income group to 42%.

⁹ Approximately two-thirds of the social assistance recoveries are reinvested in direct cash transfers (such as employment income supplements). These cash transfers are considered in the income distribution analysis, but in-kind benefits, such as supplementary health benefits and child/day care initiatives, are not. As a result, the improvements in income distribution resulting from the CCTB and NCB somewhat understate the improvement in the financial situation and well-being of low-income families.

Chart 2

Income Distribution of Families With Children

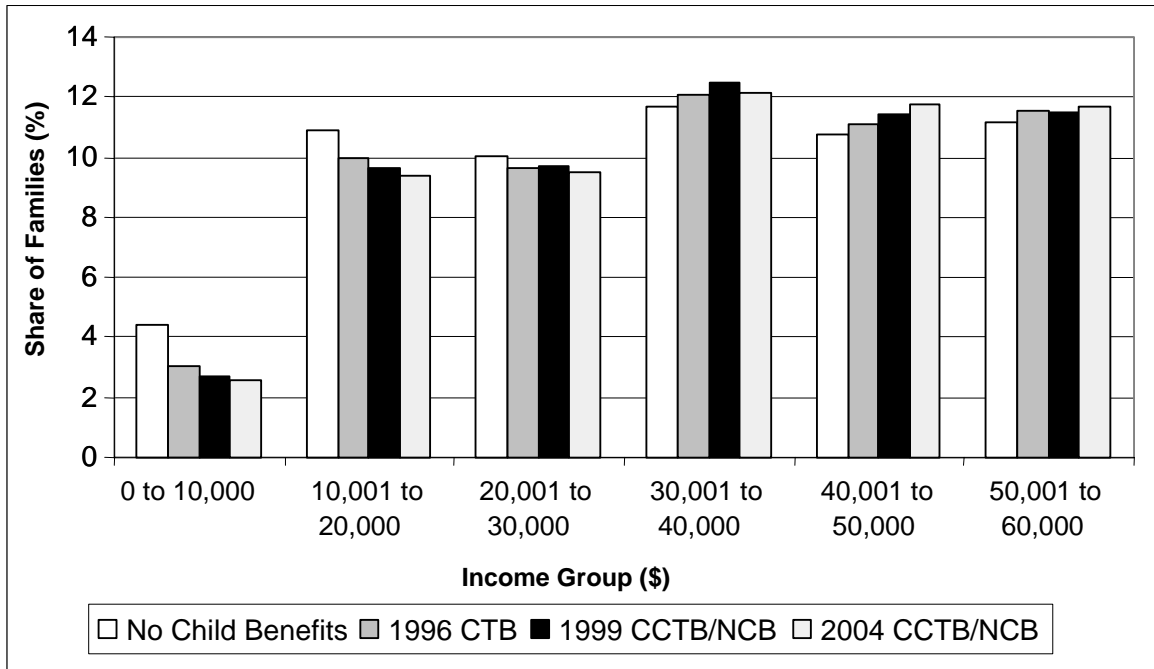
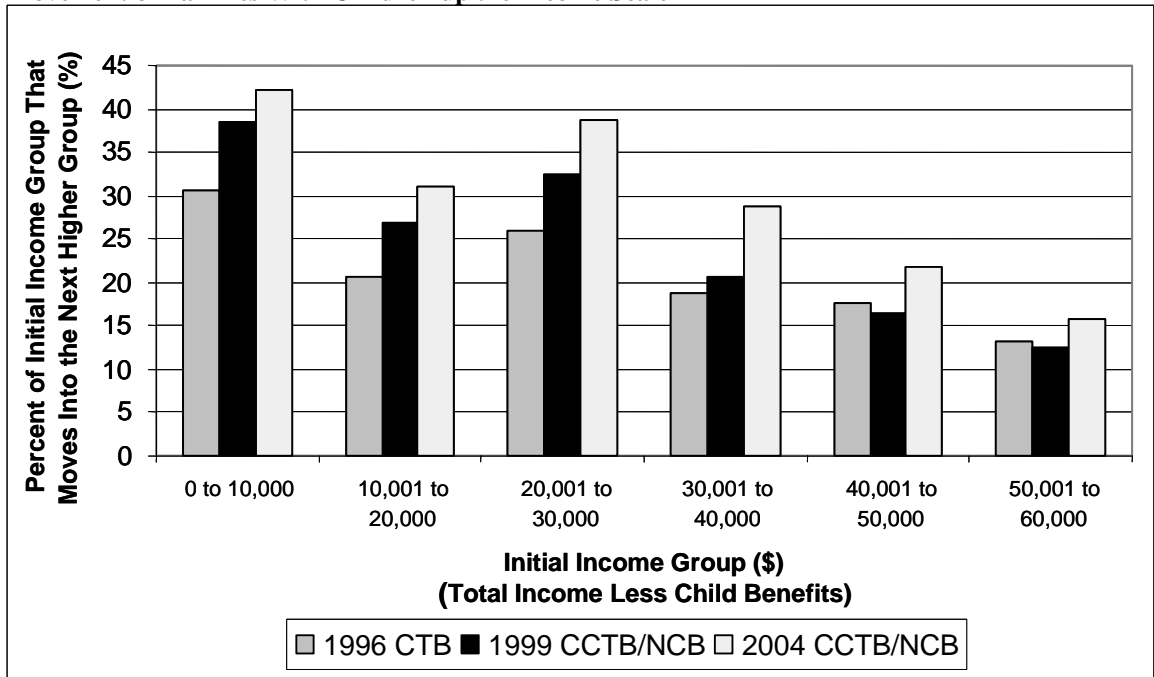


Chart 3

Movement of Families With Children up the Income Scale



Impact of Child Benefits on the Incidence and Depth of Low Income

While the goal of the CCTB is to provide income assistance to low- and middle-income families, it is designed so that a greater share of benefits goes to lower-income families. In particular, the NCB explicitly targets low-income families with a view to preventing and reducing poverty.

There is no universally accepted definition of “poverty,” so a quantitative analysis of this NCB objective is not possible. However, we can study the impact on families at the lower end of the income scale. This is most readily done using Statistics Canada’s After-Tax Low Income Cut-Off (AT-LICO).

Statistics Canada defines the AT-LICO as “the income threshold below which a family will likely devote a larger share of its after-tax income to the necessities of food, shelter and clothing than the average family would.”¹⁰ The AT-LICO varies by family type and location, ranging in 1999 from \$11,817 for a two-person family in a rural area, to \$38,416 for a seven- (or more) person family in a large city.¹¹

The incidence of low income is measured as the percentage of families living below the AT-LICO. The first row of Table 3 shows that 16.8% of families in 1999 would be below the AT-LICO if there were no child benefits. This can be compared with the shares of families below the AT-LICO under the 1996 CTB, the 1999 CCTB/NCB and the 2004 CCTB/NCB as a partial measure of the success of these programs. For example, the 2004 CCTB/NCB reduces the number of families living below the AT-LICO by 4.4 percentage points, to 12.4%.

Table 3 also presents the average income increase of families who remain below the AT-LICO after receiving child benefits. For example, there is a \$3,445 increase in the average income of the 12.4% of families remaining in low income under the 2004 CCTB/NCB. That is, the CCTB reduces both the incidence and the depth of low income.

¹⁰ Families who are expected to spend 20 percentage points more of their income on these necessities than the average family are defined as low-income. See “Low Income Cutoffs from 1990 to 1999 and Low Income Measures from 1989 to 1998,” Statistics Canada, Income Statistics Division, 75F0002MIE – 00017, January 2001.

¹¹ AT-LICOs use “economic families,” while this paper has used “nuclear families” (defined on page 47) up to this point. Economic families are defined as a group of two or more persons who live in the same dwelling and are related to each other by blood, marriage, common-law or adoption. By definition, all persons who are members of a nuclear family are also members of an economic family. However, economic families can also include children over the age of 18, elderly parents and other relations living in the same dwelling.

Table 3

Incidence of Low Income and Change in the Depth of Low Income

		All families with children
No child benefits	Percent of families below AT-LICO	16.8%
1996 CTB	Percent of families below AT-LICO	13.9%
	Average income increase of families remaining in low income ^a	\$2,382
1999 CCTB/NCB	Percent of families below AT-LICO	13.1%
	Average income increase of families remaining in low income ^a	\$2,991
2004 CCTB/NCB	Percent of families below AT-LICO	12.4%
	Average income increase of families remaining in low income ^a	\$3,445

Note: Based on 1999 population distribution.

^a As compared with the base case of no child benefits.

Conclusion

Through the CCTB, the federal government assists low- and middle-income families with the expenses of raising children. It has two components: a base benefit and the NCB supplement. The base benefit is available to most families – although the amount is reduced as family income increases. The NCB supplement, a component of the intergovernmental National Child Benefit initiative, provides extra assistance to low-income families.

Since its inception in 1998, several enhancements have been made to the CCTB. Consequently, by 2004 the benefit available to the typical low-income family will be nearly double the amount paid under the previous Child Tax Benefit system. Middle-income families are also better off with the CCTB.

The CCTB has had a positive – and growing – impact on income distribution. Families with total income under \$40,000, who represent less than 40% of the population of families with children, receive about two-thirds of aggregate CCTB benefits. These benefits raise many families above the low-income cut-off, and reduce the depth of low income for those families still below the cut-off.

Appendix 1 – Program Acronyms Used in This Paper

CTB: The Child Tax Benefit; in place from 1993 to 1997. Provided financial support to low- and middle-income families with children. Consisted of the CTB base benefit and the Working Income Supplement (WIS).

WIS: The Working Income Supplement. As part of the CTB, the WIS provided a benefit to low-income families with children and earned income.

CCTB: Canada Child Tax Benefit. The system of federal transfers in support of families with children after 1997. Consists of the CCTB base benefit and the NCB supplement.

CCTB base benefit: Part of the CCTB. Provides support to low- and middle-income families with children. Identical in structure to its predecessor, the CTB base benefit.

NCB supplement: The National Child Benefit supplement. This is part of the CCTB; it is the extra federal assistance provided to low-income families on top of the base benefit. It is also the federal component of the intergovernmental National Child Benefit.

NCB: National Child Benefit. A joint initiative of the federal, provincial and territorial governments (except Quebec – see footnote 3 on page 43). The NCB also includes a First Nations component. The NCB consists of the NCB supplement and provincial funding of various programs. The provincial NCB initiatives provide assistance to low-income families while promoting attachment to the workforce. Part of the provincial funding is from reinvestments of reduced social assistance made possible by higher federal NCB supplement payments.

CCTB/NCB: The combination of the CCTB base benefit, the NCB supplement and the provincial/territorial income transfer components of the NCB.

Appendix 2 – NCB Evaluation

When the NCB was introduced, the federal, provincial and territorial governments agreed to undertake ongoing evaluations of the program, verifying that it meets its goals of alleviating child poverty and promoting attachment to the workforce. In keeping with this commitment, there is an annual progress report, which can be found on the Internet at www.nationalchildbenefit.ca. In addition, Human Resources Development Canada is currently coordinating a comprehensive evaluation of the NCB. This evaluation has three components.

The first component of the evaluation, “A Net Impact Assessment of the National Child Benefit on Social Assistance Dependency”, is a set of descriptive and quantitative studies attempting to measure the effect of the NCB on child poverty and parental work effort. It also attempts to determine if the NCB is the most cost-effective way to meet its stated goals. To supplement existing data sources, a number of surveys are underway to gather information about the NCB. The survey groups include:

- NCB clients.
- Federal and provincial program managers involved in the delivery of the NCB.
- Social policy experts such as academics.

Using the survey results and other data sources, the study will:

- Measure the effect of the NCB on the incidence, depth and duration of child poverty.
- Measure the impact of the NCB on labour market participation.
- Calculate the change in net income of low-income families who leave social assistance to work full time.
- Analyze the design and delivery effectiveness of the NCB.

The second component, “Provincial/Territorial Reinvestment Case Studies Module – National Child Benefit Evaluation,” is primarily qualitative and consists of a set of studies that look at the programs receiving provincial NCB investments and NCB supplement reinvestments.

This module has two sub-components: a “Program Cluster” sub-component, and a “What Works” sub-component.

There are five major “program clusters” funded with NCB reinvestments:

- Child Benefit/Earned Income Supplements.
- Child Care/Day Care.
- Supplementary Health Benefits.
- Early Childhood Services/Children-At-Risk Services.
- “Other”.

Evaluation planning for each sub-component covers a four-year time frame. Each of the five program clusters are to be evaluated once over the course of four years. “What Works” case studies are also planned in each of the four years.

Each year the Program Cluster sub-component focuses on the reinvestments in a selected cluster or clusters examining rationale/relevance, design/approach, implementation/delivery, and intended/unintended impacts.

In addition, a few programs from within the cluster being examined are selected for the “What Works” sub-component. These programs are examined in additional detail to determine key challenges, issues or obstacles they have faced, the approaches or interventions that have contributed to their success, and the approaches or interventions that “did not work,” but which provide useful information.

The third and final component of the NCB evaluation is an examination of the net impact of the NCB on families on social assistance in British Columbia, Saskatchewan and Manitoba. These provinces have created longitudinal administrative data sets, describing how their NCB initiatives address the barriers to employment facing families on social assistance. The evaluation uses this data to estimate the impact of the programs on the level of dependency on social assistance.

This paper is complementary to the NCB evaluation and to the annual NCB progress reports in that it examines the CCTB – the federal contribution to child benefits in Canada. As described in the section entitled “Evolution of the CCTB,” the CCTB consists of the NCB supplement as well as a base benefit, which is not part of the NCB.

Appendix 3 – Changes to Federal Child Benefits Since 1997

1997

- Increased the maximum Working Increase Supplement (WIS) from \$500 per family to \$605 for the first child, \$405 for the second child and \$330 for each additional child.

1998

- The Child Tax Benefit (CTB) was renamed the Canadian Child Tax Benefit (CCTB). The WIS (part of the CTB) became part of the intergovernmental National Child Benefit (NCB) initiative, and was renamed the National Child Benefit supplement (NCB supplement).

1999

- Increased the maximum NCB supplement by \$180 per child.

2000

- Increased the maximum base benefit by about \$85 per child.
- Increased the base benefit threshold by \$4,083.
- Increased the maximum NCB supplement by about \$190 per child.
- Increased the NCB supplement threshold by \$293.

2001

- Increased the maximum base benefit by about \$13 per child.
- Increased the base benefit threshold by \$1,996.
- Increased the maximum NCB supplement by about \$280 per child.
- Increased the NCB supplement threshold by \$530.

2002

- Increased the maximum base benefit by about \$35 per child.
- Increased the base benefit threshold by \$960.
- Increased the maximum NCB supplement by about \$35 per child.
- Increased the NCB supplement threshold by \$653.

2003

- Indexation for inflation.

2004

- Indexation for inflation.
- The base benefit threshold must be at least \$35,000, an increase of \$2,040 over the 2002 level.
- The base benefit reduction rate will be reduced to 2% (from 2.5%) for a one-child family and 4% (from 5%) for a family with two or more children.

**SPECIAL FEDERAL TAX ASSISTANCE FOR
CHARITABLE DONATIONS OF PUBLICLY TRADED SECURITIES**

EXECUTIVE SUMMARY

Background

This report summarizes the results of the measure that provides special income tax assistance for donations of publicly traded securities to public charities. Under this measure, which was introduced on a temporary basis in 1997, individuals and corporations donating publicly traded securities to public charities include in income for tax purposes only one-half the amount of capital gains realized on the donation that they would include for other capital gains. This measure was to be continued only if it was found effective in both increasing donations and distributing the additional donations fairly among charities. The measure was made permanent in 2001. This report is based on donations of publicly traded securities claimed on income tax returns during the first four years of the measure, that is, 1997 to 2000.

Impact of the Measure

Donations of Publicly Traded Securities Have Increased Substantially

Gifts of publicly traded securities grew almost threefold between 1997 and 2000. The growth in donations of securities was much more rapid than the increase in total donations over this period.

Gifts of Securities Have Benefited a Broad Range of Charities

The data indicate that donations of securities from 1997 to 2000 benefited charities that are widely distributed in terms of size, sector and type (that is, charitable organization or public foundation). However, the main beneficiaries were larger charities, charities in the education sector and public foundations.

Cost

Under an assumption that all donations of publicly traded securities arose as a result of the half inclusion rate measure, the annual cost of the measure to the federal government in forgone revenue grew from \$26 million in 1997 to \$73 million in 2000.

Data Limitations

This report is based on data for donations by individuals for the period 1997 to 2000; data on donations by corporations are not included. Unfortunately, data on donations of securities prior to 1997 are not available. For this study it was not possible to isolate the influence of the half inclusion rate measure on donations from that of other relevant factors, including other policy changes to encourage charitable giving. As well, the results presented here were undoubtedly influenced positively by the evolution of financial markets during the 1997-2000 period.

Introduction

On October 12, 2001, the federal government announced its intention to recommend to Parliament that the reduced capital gains inclusion rate for eligible gifts of publicly traded securities to public charities be made permanent.¹ Legislation reflecting that recommendation (contained in Bill C-49, An Act to implement certain provisions of the budget tabled in Parliament on December 10, 2001) was enacted by Parliament in March 2002. This measure was introduced in the 1997 budget for a period of five years, and was to be continued only if it was found effective in both increasing donations and distributing the additional donations fairly among charities. This report reviews the experience with this tax incentive.

The Half Inclusion Rate Measure

In the 1990s the Government introduced a series of tax measures to encourage Canadians to increase donations to charities (Appendix 1). One of the most notable of these was the half inclusion rate measure for donations of publicly traded securities. Under this measure, individuals and corporations donating publicly traded securities to public charities include in income for tax purposes only one-half the amount of capital gains realized on the donation that they would include for other capital gains. The charitable donations credit already provided a significant tax incentive for all donations including cash, and is generous both in relation to other credits in the Canadian tax system and in relation to the treatment of cash donations in the United States. However, a number of observers from the charitable sector noted that there were fewer large transfers of financial capital in Canada. It was observed that donations of publicly traded securities were treated more generously in the United States, and that enhanced tax assistance in Canada for this type of donation would likely have the largest impact on overall donations to charities.

The effect of the half inclusion rate measure on the amount of tax assistance for donations of publicly traded securities is illustrated in Table 1. Donations of publicly traded securities, like donations of cash, are eligible for a non-refundable charitable donations tax credit (or, for corporations, a tax deduction). In the example, it is assumed that the top federal-provincial tax credit rate is 46%, so that on a \$100 donation the value of this credit is \$46. Since the 1997 budget individuals and corporations donating publicly traded securities to public charities include in income for tax purposes, with respect to any capital gains on those securities, only one-half of the amount included for other capital gains. Under the assumptions used in the table, this results in an additional tax saving of \$7 when a \$100 gift is made in the form of securities rather than cash.

¹ Public charities include charitable organizations and public foundations. A charitable organization primarily carries on its own charitable activities. While a public foundation may carry on some of its own charitable activities, it gives more than half of its annual income to other qualified donees, usually other registered charities.

Table 1

**Tax Assistance for Charitable Donations by Individuals of Cash
Compared to Donations of Publicly Traded Securities (Numerical Example)**

	Type of donation	
	Cash	Publicly traded securities donated to public charities
Fair market value of donation	\$100	\$100
Top marginal tax rate ^a	46%	46%
A Value of charitable donations credit	\$46	\$46
Typical cost base of security ^b		\$40
Capital gain on security		\$60
Capital gains tax if sold but not donated ^c		\$14
B Tax saved due to half inclusion rate		\$7
Total tax assistance (A+B)	\$46	\$53
Cost of donation to donor	\$54	\$47

^a Assumes a typical combined federal-provincial tax rate; rates vary by province.

^b Represents the cost at which the security was acquired, including all costs associated with the acquisition. The \$40 amount is illustrative only.

^c As the capital gains inclusion rate is now 50%, with a top marginal tax rate of 46% the effective capital gains tax rate on cashed securities is 23%.

Data Available

This assessment of the half inclusion rate measure is based on data on gifts of publicly traded securities obtained by the Canada Customs and Revenue Agency (CCRA) from income tax returns for 1997 to 2000. Data used in the analysis were those available as of August 2001. These data have the significant advantage of relying on actual donations claimed for tax purposes. However, several limitations must be noted.

Due to the lack of data on corporate donors, this report focuses only on donations by individual taxpayers. As well, donations made during the period but carried forward beyond tax year 2000 have not been included in the analysis;² similarly, donations pledged but not made and claimed are also not included. Comparisons could not be made with the level of securities donated prior to introduction of the measure, as data on gifts of securities were not collected prior to 1997. Finally, data available for tax year 2000 also include donations of ecologically sensitive land, which since 2000 have benefited from the reduced inclusion rate for capital gains.³

² Donations may be carried forward for up to five years if the donor has insufficient taxable income in the year of the donation to fully take advantage of the charitable donations credit in that year.

³ Although the exact value of such donations in the preliminary 2000 data is not available, it is known to be less than 2% of the total for 2000 shown in Table 2. Accordingly, the remainder of the analysis does not distinguish the two components.

Impact of the Measure

Donations of Publicly Traded Securities Have Increased Substantially

Between 1997 and 2000 the value of publicly traded securities donated to eligible registered charities nearly tripled – rising from \$69.1 million to \$200.3 million. Over this period the number of donors of securities rose nearly five times from 500 to almost 2,400.

As shown in Table 2, the growth in gifts of securities was much faster than the growth in total donations. While publicly traded securities make up a small proportion of total gifts to charities, their share of total donations is estimated to have more than doubled (rising from 1.6% to 3.9%) between 1997 and 2000.

Table 2
Gifts of Publicly Traded Securities in Relation to Total Gifts

Tax year	Total gifts		Gifts of publicly traded securities to public charities		Securities as % of total donations
	Amount	Growth	Amount	Growth	
	(\$ millions)	(%)	(\$ millions)	(%)	(%)
1997	\$4,316	–	\$69.1	–	1.6
1998	\$4,753	10.1	\$83.3	20.6	1.8
1999	\$4,946	4.1	\$135.7	62.9	2.7
2000 ^a	\$5,076	2.6	\$200.3	47.6	3.9
Cumulative		18		190	

^a Total received donations are estimated by the Department of Finance's T1 tax simulation model using sample T1 income tax data provided by the CCRA. The 2000 figure is a projection.

Gifts of Securities Have Benefited a Broad Range of Charities

Donations of publicly traded securities have benefited a wide variety of charities. Beneficiaries included organizations of various sizes, in different sectors and regions, and with different charitable designations.

Distribution by Size of Charity

Charities of all sizes have benefited from donations of publicly traded securities (Table 3). However, large and medium-sized charities received a larger share of donations of securities than their share of total received gifts in 1997 (the only year for which detailed information on received gifts is available).

Nevertheless, total donations of securities going to small and micro charities combined increased significantly between 1997 and 2000. This is partly because, over this period, the value of the average gift of securities to small and micro charities increased. The average value of gifts of securities to micro charities rose from \$18,000 in 1997 to \$34,000 in 2000.

Table 3
Gifts of Publicly Traded Securities by Size of Charity

Size of charity ^b	Distribution (%)					All charities, 1997 ^a	
	Gifts of securities to public charities					Total received gifts	Number of charities
	1997	1998	1999	2000	Four-year average		
Large	56.4	51.7	67.6	30.4	48.8	36.0	1.5
Medium	29.2	27.9	14.5	50.5	32.7	28.4	6.6
Small	11.1	15.7	7.2	15.7	12.3	27.8	30.4
Micro	3.3	4.6	10.7	3.4	6.1	7.8	61.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Numbers may not add to 100% due to rounding.

^a From the T3010 tax return, which all charities are required to file with the CCRA (the Registered Charity Information Return).

^b The size of a charity is measured in this report by the dollar value of its total receipts in 1997, the last year for which detailed tax return data are available. Size classification by total receipts is as follows: large charities, \$10 million and over; medium-sized charities, \$1 million to \$10 million; small charities, \$100,000 to \$1 million; and micro charities, less than \$100,000.

Distribution by Sector

Charities in all sectors have received donations of securities. Over 1997 to 2000 charities in the education sector received the largest portion of such gifts (43%), followed by charities in the welfare (25%) and health (13%) sectors. As Table 4 shows, the education sector's share of donations of securities was far above its share of total received gifts.

Table 4
Gifts of Publicly Traded Securities by Charitable Sector

Sector ^a	Distribution (%)					All charities, 1997	
	Gifts of securities to public charities					Total received gifts	Number of charities
	1997	1998	1999	2000	Four-year average		
Benefits to the community	6.8	7.3	4.4	6.8	6.0	5.8	15.9
Education	42.2	42.0	65.0	25.4	42.9	15.8	17.0
Health	8.5	22.0	15.5	9.3	13.2	12.4	7.6
Religion	11.9	12.8	6.8	16.2	12.1	45.4	38.7
Welfare	30.5	15.2	8.4	41.9	25.4	19.7	18.6
Other	0.1	0.7	0.0	0.5	0.3	0.9	2.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note: Numbers may not add to 100% due to rounding.

^a The "benefits to the community" sector includes charities such as community foundations and art galleries, while the welfare sector includes organizations that provide assistance to economically disadvantaged people.

Distribution by Designation of Recipient Charity

Both charitable organizations and public foundations received gifts of publicly traded securities over the four-year period. However, although public foundations received 15% of total donations in 1997, they received almost 60% of the value of donations of securities (see Table 5).

Public foundations and charitable organizations are similarly distributed in terms of size and sector, so these factors cannot account for the greater donations of securities to public foundations. The data also suggest that the size of donations made only a small contribution to the results: the average value of listed securities donated to public foundations was \$47,400, while that to charitable organizations was \$43,300.

Table 5
Gifts of Publicly Traded Securities by Designation of Charity

Designation	Distribution (%)					All charities, 1997	
	Gifts of securities to public charities					Total received gifts	Number of charities
	1997	1998	1999	2000	Four-year average		
Public foundations	56.0	51.0	65.7	54.0	57.8	15.0	5.6
Charitable organizations	44.0	49.0	34.3	46.0	42.2	85.0	94.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Overall Tax Assistance for Donations of Securities Compared to U.S. Treatment

The half inclusion rate measure effectively makes overall tax assistance for donations to public charities of listed securities in Canada roughly similar to what is available in the United States. This point is illustrated in Table 6.

In comparing the U.S. and Canadian systems, it is necessary to take into account a number of differences in the tax structure in the two countries. In the U.S. the federal government applies different inclusion rates to capital gains depending on the length of the holding period and the type of asset. In the U.S. gains on assets held for one year or less are treated as regular income. If the asset is held for more than one year, the capital gains inclusion rate is reduced to zero on donations of publicly listed securities. However, what matters for donors and charities is the total level of tax assistance on donations. Taking into account the charitable donations credit (in the U.S., a deduction) and other relevant factors such as net income limits and clawbacks on tax assistance, the Canadian and U.S. regimes produce roughly similar results.

Table 6
**Tax Treatment of Gifts of Securities to Public Charities
in Canada and the U.S.**

	Canada (2001)	U.S. (2001) ^b	U.S. (2006) ^b
Fair market value of donation	\$100	\$100	\$100
Top marginal tax rate ^a	46%	44%	40%
A Value of donations tax credit/deduction	\$46	\$44	\$40
Typical cost base of security	\$40	\$40	\$40
B Capital gains on security	\$60	\$60	\$60
Maximum statutory capital gains inclusion rate	50%	100%	100%
C Effective capital gains tax rate^c	23%	25%	23%
Capital gains tax if sold but not donated (= B x C)	\$14	\$15 ^e	\$14 ^e
D Additional tax assistance for gifts of securities	\$7^d	\$15^f	\$14^f
Total tax assistance (A+D)	\$53	\$59	\$54
Possible constraints on claiming tax assistance:			
Net income limit (typical)	75%	30%	30%
Clawback of charitable deduction or credit	None	3% of income over \$133,000 U.S., up to 80% of deduction	Clawback begins to phase out

^a Assumes a typical federal-provincial tax rate, with a typical U.S. state tax rate of 5%. U.S. state tax rates on capital gains range from 0 to 12%. Note that the figures for 2001 differ from those published in the 1997 budget due to recent reductions in tax rates in Canada and the U.S.

^b Reflects the Economic Growth and Tax Relief Reconciliation Act of 2001.

^c The effective capital gains tax rate is equal to the top marginal tax rate times the statutory capital gains inclusion rate. The U.S. has a separate capital gains tax rate regime – gains on assets held for one year or less are treated as regular income, while gains on assets held for more than one year are subject to a 20% rate, and in 2006, an 18% rate if held for five years or more. There is no tax assistance on capital gains arising from donations of short-term assets.

^d Only 50% of the usual capital gains are included in income for capital gains arising from donations of publicly listed securities.

^e In the U.S. tax assistance for donations of short-term assets would be 44% in 2001 and 40% in 2006.

^f Capital gains on business assets held for one year or less and non-business assets held for less than three years are taxed like ordinary income.

As noted in Table 6, the typical value of the charitable donations credit or deduction is similar in Canada and the U.S. (46% vs. 44%). When current capital gains rates are taken into account, the level of tax assistance differs by about 6 points (53% in Canada, 59% in the U.S.). However, claims in respect of relatively large donations may be constrained by annual income limits, which may require donors to carry forward a portion of their tax assistance to a future year. In Canada this limit is usually 75%, whereas in the U.S. it is typically only 30% of income. In addition, the charitable deduction in the U.S. is reduced by 3% of “adjusted gross income” (income from most sources minus certain deductions), up to a limit of 80% of the value of the deduction, when the donor has adjusted gross income over \$133,000 U.S. Canada has no such reduction in tax assistance. The overall effect of these constraints is to reduce the effective rate of tax assistance for larger donations in the U.S. All things considered, therefore, tax assistance for donations of listed securities to public charities is roughly similar in Canada and the U.S.

Cost

The tax expenditure cost to the federal government of the half inclusion rate measure has two components: the revenue forgone as a result of the reduced inclusion rate and the increased cost of the charitable donations credit from any increase in donations that result from the measure. As indicated in Table 7, if all donations of listed securities came about as a result of the 1997 budget measure, and if in the absence of the measure the securities would have been sold instead of donated, then the cost of the measure rose from \$26 million in 1997 to \$73 million in 2000. If, on the other hand, these donations – whether in cash or shares – would have been made in the absence of the measure, the total cost rose from \$6 million to \$15 million over the same period. Actual costs would be between these two ends of the spectrum.

These figures do not include the cost to provincial governments, which have similar credits for charitable donations. On average, for every dollar of federal assistance, there would be almost \$0.50 of provincial assistance. In 2000, for example, the combined federal-provincial cost, at the high end of the spectrum, would be about \$105 million.

Table 7
Tax Expenditure Cost of the Half Inclusion Rate Measure

Component of cost	1997	1998	1999	2000	Total
	(\$ millions)				
Reduction in tax on capital gains	6	6	13	15	40
Increased use of the charitable donations credit ^a	20	24	39	58	141
Total cost	26	30	52	73	181

^a Assumes all donations of listed securities came about as a result of the 1997 budget measure.

It should be noted that, consistent with the standard methodology and presentation, only the cost directly attributable to the reduced inclusion of capital gains by the donor is shown separately in the annual tax expenditure tables (Part 1 of this publication). The total cost of the measure is the sum of that amount and the amount that represents the increased use of the charitable donations credit that resulted from new donations.

Assessment and Conclusion

This report reviews the experience with the capital gains half inclusion rate measure that was introduced in the 1997 budget. At that time the Government stated its intention to continue the measure in five years only if it was effective in increasing donations and distributing the additional donations fairly among charities.

Available data indicate that there has indeed been significant growth in the value of gifts of publicly traded securities. From 1997 to 2000 donations of securities almost tripled, a significantly faster rate of growth than that of other types of donations. These gifts benefited charities that are widely distributed in terms of size, sector and charitable

designation – a finding that is consistent with the results of a study commissioned by the voluntary sector.⁴ Larger charities, charities in the education sector and public foundations benefited proportionately more.

With available data and the relatively short time period the measure has been in place, it was not possible to isolate the influence of the half inclusion rate measure from that of other factors that may have affected donations of securities over 1997 to 2000. Strong economic conditions and positive financial market performances over this period may have stimulated more donations, and larger donations, than could be expected over an entire economic and market cycle. Nevertheless, donations may increase somewhat as the measure becomes better known to potential donors, and smaller charities market it more actively.

An additional factor complicating an assessment of the success of the measure was the impact of other recent tax changes affecting charities, including changes to net income limits and the rules regarding donations of ecologically sensitive land. Furthermore, given the short time period and the absence of data on donations of securities prior to 1997, it is difficult to assess the extent to which individuals who would otherwise have made cash donations may have switched to donations of listed securities.

The introduction of the half inclusion rate measure was prompted, in part, by comparison of the Canadian approach with the U.S. tax system. Since 1997 the reduction of the income inclusion rate for capital gains in Canada has resulted in overall tax assistance that is roughly similar to that in the U.S. for donations to public charities of publicly listed securities held for more than one year.

The Government has stated its intention to continue to work with the charitable sector to determine whether there is an appropriate and cost-effective basis for broadening this measure beyond its current application.

⁴ Deloitte & Touche, Survey of Gifts of Publicly Listed Securities (August 2000).

Appendix 1 – Tax Assistance for Charities and Public Institutions

1994

- Lowered the threshold at which charitable donations begin to earn the 29% tax credit from \$250 to \$200.

1995

- Removed the income limit for tax credits on donations of ecologically sensitive land.

1996

- Increased the limits on charitable donations eligible for tax credits from 20% to 50% of net income, and to 100% of net income in the year of death and the preceding year.
- Expanded zero-rating of hospital beds to all health care facilities, including long-term care facilities.
- Allowed most charitable and public organizations to raise funds without collecting and remitting goods and services tax (GST) on sales.
- Provided a 100% GST rebate on books purchased by public libraries, educational institutions and other specified bodies.

1997

- Provided a half inclusion rate on capital gains arising from donations made before 2002 of certain publicly traded securities.
- Changed the income limit for donations to 75%.
- Allowed 25% of capital cost allowance recapture of donated property to be included in the net income limit.
- Sanctioned a new method of valuation for easements of ecologically sensitive land.
- Increased resources for Revenue Canada to enhance information and compliance from charities.
- Simplified GST accounting, reporting and remittance requirements for charities.

1998

- Increased tax-free allowances for emergency service volunteers.
- Allowed designated charities to treat certain services they supply to business customers as GST/harmonized sales tax (HST) taxable, thereby allowing charities to compete on an equal footing with other suppliers.
- Provided equivalent GST/HST treatment to charities operating authorized bottle return depots vis-à-vis commercial operators.

2000

- Reduced tax on employment benefits in respect of donations of shares acquired through stock option plans to parallel treatment of donations of certain publicly traded securities.
- Extended the charitable donations credit to donations of registered retirement savings plan, registered retirement income fund and insurance proceeds that are made as a consequence of direct beneficiary designations.
- Reduced capital gains income inclusion by one-half in respect of gifts of ecologically sensitive land and related easements, covenants and servitudes.

2001

- Made permanent the measure providing a half inclusion rate on capital gains arising from donations of certain publicly traded securities to public charities.

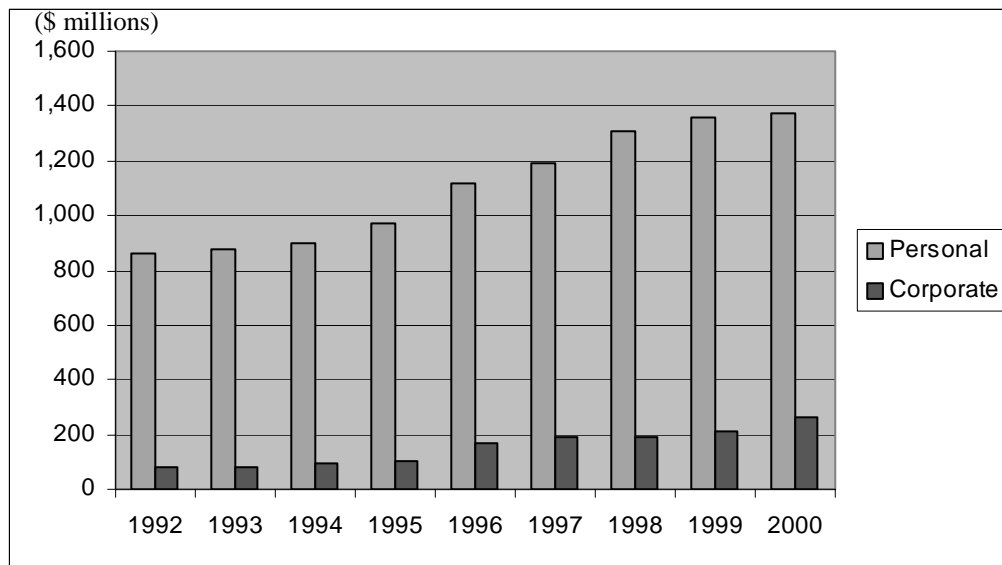
Appendix 2 – Tax Assistance to Registered Charities

The federal government provides tax assistance to registered charities through three vehicles: the charitable donations credit/deduction, their tax-exempt status and partial rebates of the GST. The immediate benefits that charities derive from these three forms of tax assistance are an increased ability to attract donations, no requirement to pay tax on the proceeds from related business activities, and lower operating costs.

From 1994 to 2001 the federal government introduced a number of measures that increased direct and indirect tax assistance to registered charities. For example, in 1994 it lowered the threshold at which charitable donations begin to earn the 29% tax credit from \$250 to \$200. In 1996 it increased the net income limit for donations from 20% to 50%, and then to 75% in 1997.⁵ In 2001 it made permanent the measure studied in this paper, which provides additional tax assistance to eligible gifts of publicly traded securities (for an exhaustive list of measures, see Appendix 1).

The chart below shows the evolving cost of federal tax assistance to registered charities, as measured by federal tax expenditures. Tax expenditures represent the value of tax revenues forgone, due to preferential treatment given to certain taxpayers, to achieve a variety of economic and social objectives.

Charitable Tax Expenditures – Personal and Corporate



Note: These data underestimate total tax expenditures related to charities, primarily because they exclude the effect of tax exempt status, for which no data are available.

Source: *Tax Expenditures and Evaluations*.

⁵ Donations to Crown charities were not subject to a net income limit until 1997, at which time the 75% limit was extended to these organizations as well. The changes in the net income limit were introduced to level the playing field between all registered charities.

The most significant of these measures is the charitable donations credit available to individuals. Individuals receive a non-refundable federal tax credit of 16%⁶ on donations up to \$200 and 29% on donations in excess of \$200, up to a maximum tax credit base of 75%⁷ of their net income. As a result, the credit for donations in excess of \$200 amounts to a deduction for taxpayers in the highest tax bracket, and a “super-deduction” for all remaining donors. In addition, donors can carry forward their donations for up to five years, subject to the net income limit. Corporations receive a deduction for all donations to registered charities – including gifts of publicly traded securities – with other tax provisions that parallel those for individual donors.

⁶ The October 2000 *Economic Statement and Budget Update* reduced the lowest marginal tax rate on individuals from 17% to 16%. Consistent with this change, the first tier of the charitable donations credit was also reduced from 17% to 16%.

⁷ The income limit is increased by 25% of the recapture of the capital cost allowance arising on a gift of depreciable capital property as well as any taxable capital gains arising on donations of capital property. For individuals, the limit increases to 100% of net income in the year of death and the year preceding death.