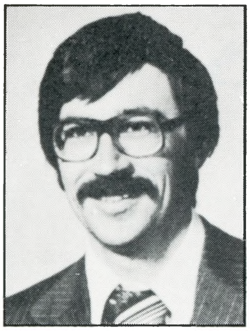

Comments On "White Paper On Tax Reform"

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FINANCE MINISTER Michael Wilson released his White Paper on Tax Reform on June 18, 1987. The event was long awaited but unlike the reform of 1972 did not substantially change the nature of the tax system. However, the proposals will significantly influence how Canadians will save, invest and consume in the future.

The reform process will be undertaken in two distinct stages. Phase I includes changes to the personal and corporate income tax structures, generally beginning in 1988 while Phase II will replace the current federal sales tax with an all-new sales tax applied to a broad range of goods and services. No specific date for Phase II implementation has been established.

Phase I: Its Impact on You and Your Business

The top personal federal tax rate will drop from 34% to 29% effective January 1, 1988. The existing ten tax brackets will be reduced to three - see Table. The benefit of reduced rates will be offset by the conversion of income deductions to tax credits which will benefit only lower income taxpayers. Taxes will likely be higher for high income individuals especially those with investment income. Tax reductions for those in middle income brackets will not be substantial.

The capital gains exemption has been capped at $100,000 except for farm property and small business corporation shares where the limit will be $500,000.

Revenues from personal taxes are expected to drop by eleven billion dollars over the next five years with more reliance placed on corporate income taxes and sales taxes.

While corporate income tax rates will drop - see Table, there will be reductions in tax depreciation, reserves available for financial institutions and insurance companies and other measures to broaden the corporate tax base. Many companies may find reported earnings increasing but cash flows decreasing.

Phase II: Sales Tax Reform

The second phase will be designed to:

(a) replace the existing federal sales tax
(b) enhance refundable sales tax credits for lower income families
(c) permit further income tax reductions for middle income families
(d) eliminate individual and corporate surtaxes.

Sales tax reform is badly needed due to its current negative impact on business activity. The current system actually favours imports over domestic goods with the tax characterized by Wilson as a "silent job killer".

While there are three alternate methods proposed for the calculation of the tax, the key points are:

(1) it will be a consumption tax applied to a broad range of goods and services

(2) tax will be collected in stages based on taxable sales with refunds available for taxes paid on goods and services purchased. No deduction will be permitted for renumeration of employees.

The current sales tax is a single incidence tax, generally applied to the manufacturer's sale price and is hidden, being passed on to consumers in the form of increased selling price. Sales tax is a big part of government revenues. A corporation that currently earns profit at 10% on sales would remit five times as much sales tax as corporate income taxes. It is suggested that a tax of 3% to 5% on goods and services will generate the same revenues as the current 12% sales tax. It is proposed that the new rate will be 6% to 8% thereby generating additional revenues with the perception of a lower tax.

The new sales tax will be applied to the value added by each business as goods and services move through the production chain. Each business in the chain would be responsible to collect tax on the sale of goods or services, but would be entitled to a refund of the tax it paid on purchases of goods and services from others.

The new multi-stage sales tax is supposed to be simple, keeping down the cost of doing business. However, the administration and new procedures will be foreign to all but the current 60,000 taxpayers under the current system. It is estimated that over 1.5 million businesses will become sales tax remitters.

Rather than allowing for tax exemptions, the government would prefer to provide tax credits to lower income families. Tax exemptions can mean higher consumer costs in any case as tax exempt sales also means the supplier must bear the full cost of sales tax on its purchases - no refund credits are granted. However, tax exempt sales also means your customer can't obtain credits for sales taxes since none were paid.

Examples of sales tax impacts follow:

(1) Residential rentals and resale of homes will generally be exempt.

(2) Purchase price of a new home including sales commission will be taxable.

(3) Tuition fees to non-profit organizations will not be taxable. Fees for technical and skills training by private businesses will be taxable.

(4) Commercial activities of governments - e.g. Canada Post - will be taxable.

(5) Professional fees, membership fees for clubs, drycleaning, tickets for theathre will all be taxable items.

General Business Considerations

The sales tax will be payable when the amount charged for the goods or services becomes receivable or when it is received, whichever is earlier. Tax on purchases is recoverable at the earlier of the time of payment and at the time at which the amount becomes payable. Where there is a large labour component to the service, as in the surveying profession, there is no recovery and the tax is therefore payable when the work is invoiced.

Most firms will be required to file returns and account for taxes quarterly. The timing of payments and refunds will be crucial to the cash flow of the business.

Service businesses will need to increase fees substantially to maintain profit factors. Salaries and wages will not give rise to tax refunds while costs such as real estate rentals will be taxable. Resistance will be encountered if fees are increased to recover the sales tax charge. It will not be uncommon for a tax payable on fee revenue at 8% to represent 25% or more of the net profit of a service business.

For small business, the largest worry will be the cost of administration and compliance. The inclusion of small businesses will recover a marginal net amount after considering the administration cost. A study in England concluded that the costs of collecting sales tax from 70% of all businesses in 1978 exceeded revenues collected by 13%.

What will be the effect on the surveying business? Besides the negative impact on small businesses and cash flows, there will be additional costs on real estate transactions. The tax will apply to commercial property rentals and sales and the sale of new residential dwellings. What will be the impact on real estate development of an automatic increase in cost of 8%, not fuelled by supply and demand?

It will be imperative that we monitor the evolution of this tax and the response from all sectors of the economy to adequately forecast the effect on our profession.

PERSONAL CHANGES

1. Federal Tax Rates

1987		Post Tax Reform	
Taxable Income	**Tax Rate**	**Taxable Income**	**Tax Rate**
0	6%	0	
1,320	16%		
2,639	17%		
5,279	18%		17%
7,918	19%		
13,197	20%		
18,476	23%		
23,755	25%	27,500	26%
36,952	30%		
63,347	34%	55,000	29%

2. Deductions/Credits

	1988 Estimate Deductions	1988 Tax Credit
Basic Personal	4,270	1,020
Married Exemption	3,740	850
Child Under 18	388	65
Child 18 and Over	1,000	0
Age (65)	2,670	550
Pension	1,000	170
Employment	500	0
Investment	1,000	0
CPP/UIC	419/605	17% of Contributions

Tuition becomes credit at 17%
Charitable Donations in 1987
First $250 - 17%
Next 29%

CORPORATE TAX RATE REDUCTION
Proposed July 1

	Current	July 87	1988	1989	1990	1991
General	36	35	28	28	28	28
Manufacturing	30	28	26	25	24	23
Small Business	15	14	12	12	12	12
Small Manufacturing	10	8	12	12	12	12