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Effects of U.S. and Canadian Tax Legislation: A Canadian Perspective

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I. Introduction

My discussion on the competitive aspects of the tax systems of Canada and the United States starts and ends with one simple theme: if we want to survive, we must start looking over our shoulders, and not at our belly buttons.

In a global context, the need for each country to become and to remain internationally competitive is more and more an economic imperative. International trade in goods and services continues to increase, and international capital flows and capital markets are becoming both more significant and more sophisticated. In our global village, each of our countries must recognize that its tax and regulatory system is not just a matter of domestic political considerations, but is, in fact, a prime determinant of how well that country will do in an increasingly competitive and unforgiving world.

In the area of taxation, the dizzying wave of tax reforms that have swept the developed world in the last five years makes the issue of the tax competitiveness of countries both more urgent and more complex. In Canada and the United States, as well as in the United Kingdom, West Germany, France, Australia and many other countries, important changes in the tax environment have taken place or are in progress, with a general thrust toward more neutral systems with lower marginal rates, reduced incentives and special treatment, and, in some but not all cases, an increases reliance on consumption taxation. Countries that ignore these developments do so at their own peril.

II. Comparisons of Tax Systems

Like Alice in Wonderland, we are best advised to begin at the beginning, which would be looking at the different economic effects of the present tax systems of Canada and the United States. This may sound logical enough, but in fact all comparisons of the influence of different tax systems are inherently complex and inevitably ambiguous.

Both Canada and the United States have tax structures that are typical of technologically advanced and sophisticated economies, where considerable efforts have been made by the legislators, economists, public

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finance experts, and others to ensure that the tax systems are a logical, consistent and integrated approach to the raising of government revenue. The inevitable result is that in each country the tax system is a hodgepodge of special pleading, economic illiteracy, illogical reasoning, blind prejudice, and historic accident. Each system has accumulated new tax provisions each year in the same way that a ship gathers barnacles, to the point where both the Canadian and U.S. tax systems are so overlaid with special and complex rules that the dimensions of the original ship are hard to make out. The results are structures that, to use the words of one recent U.S. President, are a disgrace to the human race or, to use my own words from an earlier article, appear to be a rather incomplete translation from the Gaelic of a demented leprechaun. The complexity, uncertainty, and hence the instability of both tax systems were only shaken up, not changed, by the recent waves of tax reform in each country, and we remain with the inherent difficulty of coming to grips with tax rules whose incomprehensibility, aimlessness, and perversity begger description.

In both Canada and the United States, effective overall tax burdens vary substantially from year to year, industry to industry, region to region, firm to firm, asset to asset, and business structure to business structure. There are far larger differences in the tax burden between firms and industries within each country than in average tax burdens between our two countries.

Even if it were possible to know precisely how the taxes paid by particular industries differed between the two countries, this would still not answer the question of how the tax systems affect competitiveness. It is not only the amount of taxes paid, but the structure of the system that influences economic activity. To give a simple example, the economic results of collecting a stated amount of tax revenue from an industry by way of an income tax on its profits will differ substantially from the results of collecting an equivalent amount through a value-added tax ("VAT") on its sales.

To pose even further difficulties of interpretation, in order to determine the effects of the tax system in each industry and country, it is necessary to consider who bears taxes in an economic (as opposed to a legal) sense. This involves dealing with some of the most imponderable problems of public finance, such as who really bears the burden of the corporate tax.

The tax system is, of course, only part of the total system of government finance. To get to the bottom of the issue, it is also necessary to deal with a number of other thorny questions, such as how do government expenditures, particularly those relating to the support of research, the training and supply of labour, and other factors affect competitiveness? Also, how does the size and method of financing government deficits affect the price and supply of capital to private industry? Finally, we must remember that taxation and fiscal concerns are just one of a host of issues that affect international competitiveness — and frequently are not the most important issues. However, tax policies are subject, at least theoretically, to our control and may be one of the few effective levers that governments have to influence competitiveness.

A. Total Tax Burdens

The simplest way to compare the burden of taxation in Canada and the United States is to use aggregate numbers, and to look at total tax revenues in each country as a percentage of the gross domestic product ("GDP"). Not unexpectedly, this type of analysis using Organization for Economic Cooperation and Development ("OECD") data shows that Canada does in fact have significantly higher taxes than the United States. Taxes, including social security contributions, consumed 33% percent of Canadian gross domestic product in 1986, as contrasted to about 29% in the United States.[1]

As shown by Table 1, Scandinavian countries, led by Sweden, have tax revenues which are at, or in excess of, one-half of GDP, and many European countries have ratios well over 40%, making both Canada and the United States relative tax pikers. However, both Canada and the United States use a far higher proportion of their national incomes to support government activities than does Japan, or any of the emerging Pacific Rim tigers such as Taiwan, Korea, and Singapore.

Table 1 shows total tax revenues including and excluding social security contributions. The United States has social security levies that are about twice as large as those in Canada. But again, as in other areas, it is necessary to look at offsetting factors. To the extent that the higher rate of U.S. social security levies results in some reduction in private employer or even employee expenditures on retirement benefits, then the higher level of contributions to government plans could be offset by a lower level of private sector costs.

The ratio of tax revenue to GDP in a country can, in some sense, be regarded as a measure of how much its government is interfering in or controlling the allocation of resources in that economy. However, taxes can vary from relatively neutral measures to highly directional intervention. Yet, taxes are not the only mechanism that governments use to influence the economy.

B. Composition of Tax Revenues

In a comparison of the breakdown of individual tax revenues in Canada and the United States, as shown in Table 2, it is possible to see that personal income taxes in Canada, as a percentage of the GDP, are appreciably higher than in the United States, while corporate income

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[1] *See* OECD, REVENUE STATISTICS OF OECD MEMBER COUNTRIES, 1965-86 (1987). For a discussion of these and other comparative tax revenue figures, *see* Perry, *Fiscal Figures*, CAN. TAX J. 1550 (Nov.-Dec. 1987).

taxes are also substantially higher — 2.7% of GDP in 1985 in Canada, almost 30% higher than the 2.1% of GDP in the United States. Canada, with its federal sales tax that has no counterpart in the United States, also has taxes on goods and services that are double those in the United States, and Canadians also suffer from somewhat higher taxes on property. Furthermore, the United States tends to raise a somewhat higher proportion of its total income taxes from individuals, and a lower percentage from corporations, than in Canada and in a number of other developed countries. Finally, in Canada the provinces and local governments raise more in taxes than does the federal government, and the decentralization of the Canadian fiscal system is even more remarkable when account is taken of the fact that a substantial portion of federal revenues are redirected through equalization and other grants to the provinces. In the United States, the federal government continues to dominate the total tax scene.

Of course, there is one other statistic which reflects badly on Canada, and that is in the level of total government deficit as a percentage of GDP. The relative level of tax revenues, expenditures and deficits is shown on Table 3 for a few countries. In 1984, the last year for which general global figures were available, Canada had a deficit that was 7.7% of GDP, the fourth highest of all countries listed in an International Monetary Fund survey, and over twice as high as the 3.5% indicated for the United States.

The reason why tax burdens in Canada are and have been higher than the United States is simple: Canadians tend to have a greater appetite for government services, particularly those relating to health, education, and the arts, and Canada therefore spends more in relative terms on social programs than the United States does. The United States spends far more proportionally on defense and related activities than Canada. But the United States also has a higher per capita income than Canada, and accordingly the United States can absorb its higher defense and other expenditures and still maintain lower tax burdens.

III. Tax Reform

Tax reform, like some new social disease, has recently swept both Canada and the United States, and in both cases businesses seem to have the greatest risk of infection. But regardless of what we might think in North America, tax reform is, in the 1980s, a global trend. In country after country, tax systems are being fundamentally reshaped as governments juggle the new economic imperative of competitiveness with the old problems of burgeoning government deficits, perverse tax structures, and ever-swelling expenditures.

Around the world, there is a growing appreciation that the tax systems of the 1950s and 1960s have been found wanting. These systems typically involved high marginal rates of tax, well meant but generally misguided attempts to redistribute income, and a predilection for direct government intervention in economic activity through a variety of tax incentives and preferences. The global trend toward more neutral and less interventionist tax systems with lower tax rates rests on important changes in attitudes about taxation theory and practice.

A. Increased Reliance on Markets

We used to think it was appropriate for governments to use subsidies, tax incentives, and preferences in order to encourage investment and activity that had, in the first instance, been discouraged by high tax rates. But as I remarked from this platform a year ago, the continuous flow of money down the insatiable drain of misguided government incentives, industry bailouts, social bribery and tax boondoggles has convinced some that the appropriate role for direct government intervention in the economy is more limited than we previously might have supposed.

The result is that, in many countries, there is a renewed although cautious faith in the market, not because anyone thinks that the market does such a superb job of allocating resources, but more on the pragmatic grounds that no matter how bad the markets are, governments tend to be even worse. We now seem to be moving toward systems whose incentives come not from a plethora of misguided preferences and fuzzy schemes, but from lower tax rates in a neutral tax environment.

B. Taxation of Consumption, Not Income

Another trend in modern tax theory is an emphasis on consumption taxes, rather than on income taxes. It has been argued, in various reports such as the recent Macdonald Commission Reports in Canada and the Meade Committee in the United Kingdom,[2] that tax burdens should be based more on what people take out of a society, in the sense of what they consume, and less on what they contribute, which in part can be measured by income. In economic terms, income taxation drives a wedge between savings and consumption because both the income flow out of which capital investment comes, and the profits from that capital investment, are subject to tax. It is therefore argued that a broadly based income tax distorts economic choice away from investment and in favour of current spending. This trend toward efficient consumption taxation, while clearly evident in Europe and elsewhere, has been recognized but not fully acted upon in Canada, and has received relatively little support in the United States.

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[2] For a discussion on the relative effects of income and expenditure taxation, *see e.g.*, REPORT OF A COMMITTEE CHAIRED BY JAMES MEADE, THE STRUCTURE AND REFORM OF DIRECT TAXATION (1978); DEPT. OF THE TREASURY, BLUEPRINTS FOR BASIC TAXATION (1977); REP. OF THE ROYAL COMMISSION ON THE ECON. UNION AND DEV. PROSPECTS FOR CAN., II MACDONALD REPORT (1985) [hereinafter MACDONALD REPORT].

C. *Redistribution and Fairness*

There is also a growing question as to the effectiveness of using unsophisticated tax policies as a means of redistributing income and providing relief to lower-income individuals. A more integrated approach using both tax and welfare measures may be preferable. On the other hand, there is a growing appreciation that high marginal tax rates simply cater to the politics of greed and envy, and make very little sense. There is evidence, for example, that top personal tax rates over 40% may collect relatively little additional net revenue.[3]

D. *Think Smarter, Work Harder*

The final and ultimate reason behind the revision of tax systems around the world has been a desire on the part of many countries to improve their economic performance through reducing the perverseness of existing tax systems. Country after country has come to realize that the design of a tax system cannot be based entirely on domestic preferences as to how people want to divide up the apparent burden of taxation. Instead, domestic tax policies must also reflect the need to maintain the international competitiveness of an economy.[4]

IV. TAXATION CHANGES AROUND THE WORLD

Tax policies, like hem lengths or the width of neckties, tend to go in cycles. Over the past five years, many countries have undertaken major overhauls of their tax systems, with the direction of change showing remarkable similarity.

In France, the corporate tax rate has been cut from 50% to 42%, with accompanying reductions in personal income taxes. West Germany, with Teutonic thoroughness, is taking its time considering proposals to cut its top personal and corporate tax rates by about 6 percentage points in 1990, which would reduce the rate of German corporate tax on distributed income to 36%. Australia has cut its personal tax rates, and has provided the equivalent of a 100% dividend tax credit for dividends from Australian companies. New Zealand, under a socialist administration, has cut income taxes by introducing a comprehensive 10% VAT, applicable to all goods and services including food. Japan is currently studying,

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[3] *See* TASK FORCE ON TAX'N POL'Y OF THE BUS. COUNS. ON NAT'L ISSUES, TAXATION POLICY REFORM IN CANADA app. 4 (1986), where an analysis of taxes paid by high income earners before and after the 1984 U.S. tax cuts shows that after the substantial reductions in top marginal rates in each country, total income taxes paid by high tax bracket individuals actually increased.

[4] The Macdonald Report specifically pointed this out when it said, "The tax system is one of the most importnat determinants of economic growth over the longer term. When the Royal Commission on Taxation (The Carter Commission) reported in 1966, one of the foremost goals of policy analysis was the establishment of a tax system that was equitable in its treatment of different groups. While equity remains an important goal, tax specialists now stress the need for a system that is calculated to encourage economic efficiency." MACDONALD REPORT, *supra* note 2, at 206.

with difficulty, proposals to reduce its corporate taxes and bring in new consumption taxes.

The most notable achievement over the past year has been in the United Kingdom, which began overhauling its tax system in 1984 when the corporate tax rate was cut to 35% at the cost of some corporate write-offs and deductions. Even before this, the United Kingdom had cut its sky high personal tax rates by doubling its VAT. In the U.K.'s 1988 budget, Maggie Thatcher's government has taken the second major step, cutting the maximum rate of personal income tax from 60% to 40%. Some personal tax concessions were also cut back, and 100% of post-1982 capital gains, fully indexed for inflation, will be included in the personal tax base. These U.K. changes, with lower personal tax rates now joining reduced corporate rates, together with the corresponding U.S. changes, are bound to put more pressure on European governments to take a hard look at their systems.

While the changes are varied in detail, in each case there has been a significant reversal of the previous trend toward increasingly higher marginal tax rates and more directional policies, back toward more neutral systems with lower tax rates. Unfortunately, it seems to be beyond the wisdom of any of our legislatures to achieve these objectives without adding more complexity, more incomprehensibility, and more poundage to our tax laws.

It is also worth noting in passing that the VAT is now a standard part of almost all European tax systems, where it has been successful not only in raising vast amounts of revenue for national governments and for the European Community ("EC") itself, but also in helping the overall competitiveness of EC industries. The increasing popularity of VATs around the world, with over thirty-five countries now using this style of taxation, is in part due to the VAT's contribution to economic efficiency and international competitiveness. The burden of income taxes in business cannot be readily removed from export sales under GATT rules, and inevitably the cost of domestic production is increased. VATs, on the other hand, can be readily eliminated on exports, and imposed on imports, thus ensuring that domestic producers have the best opportunity to achieve competitiveness in both domestic and foreign markets.

V. Canadian Tax Reform

The following is a brief overview of the more important tax reform proposals announced in December 1987 by Canadian Finance Minister Wilson: first, Canada is making cuts in personal income tax rates, with the reductions being more modest than in the United States. Also, lower corporate tax rates are to be phased in, with typical combined rates of federal and provincial taxes in Canada being reduced to 45% or lower.

These lower personal and corporate rates are accompanied by substantial base broadening measures, including a conversion of most personal deductions into tax credits, and the inclusion of two-thirds of capital gains (increasing to three-quarters in 1990) in income. For businesses, the most substantial adverse change is the cutback in depreciation rates for tax purposes, with the slowdown being more severe than what the United States implemented in its reforms. The Canadian changes, when fully effective, will mean that for the first time in decades the effective depreciation rates on most machinery and equipment in Canada for tax purposes would be below those in the United States.

A second very major change that was discussed in the 1987 tax proposals in Canada, but which is yet to be implemented, is the so-called "Stage 2" reform of the federal sales tax structure. Canada has a 12% federal sales tax, levied at the national manufacturer to wholesaler level. It is a relic of a 1920s style of taxation, and is now very definitely showing its age. The tax is perverse in the extreme. It discriminates against domestic producers and in favour of importers, since the tax base for domestically produced goods is generally a manufacturer to wholesaler or retailer price level, while the tax base for imported goods is the duty paid value, a value that frequently excludes distribution and marketing costs that are included in the prices charged by Canadian manufacturers. Also, a substantial portion, nearly half, of the sales tax is collected from producer inputs, that is goods and services purchases by Canadian manufacturers. As such, the tax adds to the costs of Canadian producers, making them less competitive both in the Canadian domestic market and abroad. Because the tax only applies to a limited range of goods, and because the tax varies substantially as a percentage of the final selling price of the goods it does apply to, it distorts economic choice for Canadians.

Some of the faults of the present Canadian federal sales tax can be illustrated by looking at the partial and interim changes that were proposed in the February 1988 budget of Finance Minister Wilson. Mr. Wilson brought forward interim changes, generally to be effective beginning November 1988, to deal with only some of the sales tax problems. These changes alone, however, will frequently add almost 2% to the cost of imported goods, and this adjustment far from fully redresses the adverse implications of the present tax on Canadian produced goods in competition with imported goods.

The Canadian Government is committed to fundamentally reforming the sales tax structure, and to replacing the outmoded federal sales tax with a new, broadly based VAT. But, these changes have been deferred to the indefinite future, that is, until after the next federal election.

A. *Why Canadian Tax Reform?*

It is important to see the Canadian reforms for what they really are: a response to the tax reform initiatives in the United States (and to a much lesser extent, the tax changes elsewhere) rather than any bold, new and independent action by Canada. It is a trite saying that whenever the United States gets a cough, Canada comes down with the flu. Given the huge volume of transborder investment and trade, the massive changes in the U.S. tax systems unexpectedly adopted by the United States in 1986 required Canada to accelerate and change its reform processes.

First, because of the large volume of reciprocal investment between the two countries, Canada was faced with the immediate necessity of reducing its tax rates, and most particularly its corporate tax rates, to levels that would roughly match those proposed in the United States. If Canada failed to do this, international corporations could readily shift, through a variety of means, substantial parts of the Canadian tax base to the United States in order to cut their overall tax liabilities. This international arbitrage required Canada to sharply cut its nominal tax rates to closely approximate the U.S. rates, even though Canada, left to its own devices, might have preferred other approaches to the reform of its corporate system. For example, Canada might well have wished to achieve a more modest reduction in corporate tax rates but also wished to leave in place some level of incentives, such as generous capital cost allowances, for new Canadian investment. By doing so, it would have avoided the problem, now inherent in Canadian tax reform, that the cuts in corporate tax rates provide a bonus to the earnings on old investment while the other parts of the package provide penalties for new spending. But the necessity of reducing marginal rates in Canada appeared to preclude other options.

The second major influence that the U.S. changes have had on Canada arises from the complex changes in the U.S. foreign tax credit rules. Basically, the U.S. changes have made it more difficult for U.S. corporations to obtain credit for foreign taxes generally, and in particular for foreign taxes that are levied under tax systems that do not roughly track the U.S. tax system. To put it another way, had Canada retained a number of its corporate tax benefits untouched, it would have found a good part of the inventive effect of these measures blunted because the benefit of Canadian tax concessions would be taken away by higher U.S. taxes in the distributed income of Canadian subsidiaries of U.S. parent companies.

The final reason that the U.S. changes compelled Canada to move faster, and in a different direction than it would have on its own, was the clear necessity of responding to the long-term competitive effects of lower U.S. corporate and personal tax rates. Canada could have lost, in some areas, investment and even people to the United States if it had failed to make moves to, at least, partially match the U.S. changes.

Perhaps another way of summarizing the Canadian tax response to U.S. reforms is to say that Canada does insist on following U.S. innovations in taxation, but only after the United States has first demonstrated that the changes do not work.

B. *What Did the Canadian Reforms Achieve?*

As in the United States, it is difficult to evaluate the impact of the Canadian reform package[5] because it has remarkably different effects on different businesses. The Canadian tax reforms tend to help those businesses with high profits, since the benefits from the proposed corporate rate cuts outweigh the additional costs provided through the base broadening. Conversely, of course, the changes hurt businesses with low rates of return.

As in the United States, the reform proposals will have the most adverse effect on capital-intensive industries, since a number of the changes, including the cutback in depreciation rates for tax purposes, have a particular relevance for new capital investment. Service industries and other businesses relying less heavily on capital investment will tend to come out of the reform process less damaged or with net gains.

Finally, the lower corporate tax rate would generally reduce the tax advantages of borrowing versus equity, as well as the relative advantage of highly levered financial positions. Because of the base broadening and reduced investment incentives, effective corporate tax rates under the reform package will tend to show less divergence in different industries, in investments in different types of assets, and in investments financed through different capital structures. However, a number of important tax incentives remain, of which the most notable is the lower rate of corporate tax on manufacturing and processing profits.

The tax proposals directly affecting businesses have been accompanied by a package of other changes that will make the raising of new investment capital more difficult. The reduced tax credit on Canadian dividends, and the increased proportion of capital gains included in income (two-thirds for 1988-89, and three-quarters thereafter) along with other changes will hurt returns from personal investment.

As expected, and as required by political necessity, business turned out to be a loser in the tax reform process in Canada as in the United States. In the aggregate, Canadian corporations will be called upon to pay approximately $1 billion of additional federal income tax each year over the next 5 years as a result of a combination of the corporate rate reductions and the base broadening exercise. Furthermore, unless there are major cuts in provincial income taxes — a possibility but only a remote one — Canadian corporations could pay almost this much again in additional provincial income taxes as the provinces are expected to follow the federal base broadening. In addition to all of this, businesses expect to get stuck with about three-quarters of the bill for the $1 billion a year that is to be raised in a new federal telecommunications tax, and

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[5] WHITE PAPER ON TAX REFORM, introduction by the Minister of Finance, Michael Wilson, in the House of Commons on June 18, 1987; *see also Draft Income Tax Amendments*, in DEPARTMENT OF FINANCE RELEASE NO. 88-42 (Apr. 14, 1988).

will likely end up bearing some part of the additional costs of the complex interim changes in the federal sales tax.

To recapitulate, the hallmarks of the Canadian tax reform process as far as business goes have been the increase in the effective tax on the return form new capital investment and in the income flowing to the providers of investment capital. There is considerable concern in Canada that these adverse changes have gone too far, and will damage the competitive position of Canadian industry. It is unfortunate that Canada felt compelled by the U.S. changes to cut back so heavily on its investment provisions so as to obtain the revenue to "buy down" its nominal personal and corporate rates, instead of relying on a reformed consumption tax.

VI. U.S. Tax Reform

The U.S. reforms did achieve lower corporate and personal tax rates than Canadians are likely to see, and these reduced tax rates, particularly the maximum 28% personal tax, must have a positive impact on incentives in the U.S. economy. These lower U.S. rates are indeed a vital achievement, beyond the reach of Canada due to its apparent commitment to higher levels of government spending. However, from a Canadian viewpoint, the U.S. reforms do contain some major flaws.

First of all, the United States has maintained its heavy reliance on income tax, and has chosen to get very little of its revenues from consumption taxation. However, consumption taxes may be less damaging to investment and growth than income taxes, and more conducive to international competitiveness. At a time when other countries rely heavily on particular forms of consumption taxation which do not form part of the costs of their exports while the U.S. taxes on capital income do form part of the cost structure of the U.S. economy, the U.S. policies can place American business at a major disadvantage.

The U.S. tax system also contains some structural defects, including a higher rate of tax on corporate income than on personal income, a total lack of integration of corporate and personal tax (with no credit being given to individuals receiving dividends from U.S. corporations for the corporate tax already paid on such income flows) and a high overall tax rate on the distributed income from U.S. corporations.

Finally, the U.S. tax reform has failed to address the continuing massive government deficits in the United States. Equally, the U.S. reforms did not concern themselves with the fundamental problem of an inadequate level of savings, and the related problem of continuing foreign trade deficits. To put the matter gently, there is a question as to whether or not the business and investment bashing approach implicit in the U.S. reforms was the most appropriate policy for a country with a negligible personal savings rate, a massive trade deficit, and fundamental concerns about the competitiveness of U.S. industry.

VII. Comparison of U.S. and Canadian Tax Rates and Structures

Comparing nominal personal and corporate income tax rates is far from the entire story. However, as reflected in Tables 4 and 5, both personal and corporate income tax rates in Canada are and will remain appreciably above those in the United States. In terms of personal income taxes, the top combined rate of federal and provincial income taxes in Ontario this year will be about 45%, and depending on how the U.S. federal clawback of lower rates is counted, a corresponding top personal rate in the United States could be around 35%. Even though people are less mobile than money and businesses, the sharply lower U.S. personal tax rates do pose a competitive threat for Canada in that they could lead to the loss, through emigration, of skilled workers and entrepreneurs.

For corporations, a typical combined federal and provincial effective corporate rate in Canada will be in the range of 44-46%, beginning July 1, 1988, with Quebec having a significantly lower burden. This contrasts with what might be a typical combined federal and state corporate rate of about 39% in the United States, leaving Canada at a net 5 or 6 percentage point disadvantage.

However, Canada does have a continued lower rate of corporate tax on manufacturing and processing income — that part of corporate profits that is deemed to arise from direct processing activities in Canada. This incentive, a feature of the Canadian tax scene for many years, has been specifically designed to ensure that corporate taxes on the food producing sectors of the Canadian economy remain competitive with those in the United States, even if the government lacks either the funds or the will to reduce general corporate rates in Canada to the same extent. Effective corporate tax rates on manufacturing income in Canada from July 1, 1988 will be about 41%, and are scheduled to fall to approximately 37% over the next 3 years. Canada's manufacturing and processing sector is the most exposed to international competition, and Canada has managed to keep its corporate rates somewhat comparable to U.S. rates at the moment, and potentially below U.S. rates when the Canadian reforms are fully implemented.

There are, of course, a host of special tax rules relating to the computation of income and the calculation of allowances, deductions, and credits, all too lengthy to summarize here, but of vital importance in the calculation of true effective tax burdens in the two countries. At the corporate level, U.S. businesses continue to benefit from LIFO inventory valuation methods, resulting in substantial deferrals of tax, and from foreign sales corporations which reduce the tax bite on exports. In Canada, on the other hand, Canadian businesses enjoy a broad range of regional industry incentives. Canada also has a package of incentives for research and development that is now significantly superior to that provided in the United States, as well as having the developed world's most favourable income tax treatment of small businesses.

The importance of differences in the tax base cannot be overemphasized, even though it is not possible to show such differences in a simple table. To take an easy example relating to personal tax burdens, if we assumed a situation where an individual taxpayer had substantial amounts of state and local bond interest, interest that is taxable in Canada but would not be taxable in the United States, then the effective advantage of the U.S. system would be even more marked than shown on the table. Equally, if the individual has significant home mortgage interest and realty taxes, costs that are deductible in the United States but not in Canada, the advantage of the United States would widen even farther.

However, if it is assumed that the individual has capital gains, then the fact that Canada still has a $100,000 lifetime capital gains exemption, and taxes only two-thirds of the remaining gain (three-quarters after 1989) would tend to redress the balance. If it is also assumed that the individual has substantial Canadian dividend income, on which a dividend tax credit is available in Canada but not in the United States, or was taking maximum advantage of retirement deductions, the computation would also shift in Canada's favor. The answer you get depends on the question you ask.

A. Specific Comparisons of Canada-U.S. Tax Burdens

In the wise belief that it is better to criticize the work of others than to attempt anything original, I will refer to three current studies on the competitive position of Canadian and U.S. businesses.

In the first of these articles, by David Broadhurst,[6] the overall impact of the U.S. tax reforms of 1985 and 1986 is assessed in comparison with the corresponding changes in Canada, taking into account not only the 1987 tax reform changes but the 1986 phase-out of the investment tax credit and other adjustments. The comparison is based on the impact of the respective tax changes in each country on the internal rate of return earned on an assumed investment in manufacturing assets.

Broadhurst's calculations show that the net results of the 1986 U.S. reform changes were to lower the average rate of return on the investments by under one percentage point, based on the assumptions used. The relative reduction in rates of return was smaller in situations that assume a small rate of return, because the advantage of lower tax rates under U.S. reform is relatively more important to a project that yields a higher return than to one with a more marginal investment. In examining the reasons for the reduction in after-tax rates of return, Broadhurst identifies the loss of the investment tax credit as the most significant

[6] Broadhurst, *Tax Reform: Raising the Cost of Capital*, CAN. TAX J. (July-Aug. 1987).

change by far, with changes in depreciation rates having only a modest effect.

In analyzing the comparable situation in Canada, the calculations first show that, in the pre-1986 situation, the Canadian income tax system did provide a significant advantage over the U.S. system. However, the full implementation of the Canadian reform proposals caused after-tax rates of return in Canada to decline more dramatically than was the case in the United States with the U.S. reforms. Overall, after-tax rates of return in Canada fell by 1.75%, over twice the relative decline in annual yield shown for the United States. Broadhurst's calculations show that in Canada, it is the cutback in depreciation rates for tax purposes that has the largest negative impact on rates of return.

The result is still not too unfavorable for Canada, since the analysis would indicate that after-tax rates of return on long-lived assets in Canada are still marginally superior to those in the United States, while rates of return on short-lived assets are equivalent to those in the United States. However, according to Broadhurst's analysis, tax reform in both countries has meant the loss to Canada of a significant part of its previous tax advantage in the manufacturing sector, as shown in these summary figures:

After Tax Rate of Return on Investment in New Machinery[7]

	Canada	United States
Before Tax Reform	12.83%	12.00%
After Tax Reform	11.06	11.20
Reduction	1.77	.80

The second article is by David Timbrell, and appeared in a C.D. Howe Institute publication.[8] Timbrell's analysis starts with a comparison of marginal tax rates, and concludes that these rates, which are significant in dealing with business decisions relating to international arbitrage in the location of the earning of income, provide and will continue to provide a significant advantage to the United States. Timbrell's commentary then reviews computer simulations on the overall impact of a reformed U.S. and Canadian tax system. These simulations were based on assumed debt-equity ratios for a corporate investor, and on the present value of an assumed after-tax cash flow from a new investment.

Timbrell's calculations generally show that, after tax reform, Canada would generally maintain a slight income tax advantage in manufacturing, being very roughly the same slight advantage that it enjoyed prior

[7] Based on a "base case" assuming a 12% return on investment in an asset with a 12 year life; *see id.* for assumptions and methodology.

[8] Timbrell, *Tax Reform: Effects on Canada's Tax Competitiveness with the United States*, in TAX REFORM PERSPECTIVES ON THE WHITE PAPER (1987).

to the recent tax reforms in each country. The simulations also show that in both countries the effect of tax reform changes has been to reduce after-tax cash flows from business investment by about 5%. In assumptions involving high levels of profitability, this adverse impact of tax reform either vanishes or is reversed because rate reductions matter more than broadening the tax base. Equally, in cases involving high levels of debt (high leverage) there is a more significant reduction in cash flow because of the reduced value of leverage under lower tax rates.

The only case where Canada has a significantly reduced measure of advantage after tax reform is in a situation involving high levels of labor as opposed to capital, and high levels of inventory. Here, the loss of the Canadian inventory allowance as well as other changes means that Canada's net advantage is largely eliminated.

Timbrell's simulations also show, not unexpectedly, that the ultimate level of after-tax dividends flowing to Canadian individual shareholders of Canadian companies is appreciably higher than in the corresponding case of dividends received by a U.S. shareholder from a U.S. corporation. The Canadian tax system still includes an important level of dividend tax credits to relieve the double taxation of corporate income, while the U.S. system has no such feature.

Based on this analysis, Timbrell generally concludes that the tax reforms in Canada and the United States have not resulted in any major shift in relative advantage, and that all that can be said is that both countries wind up fairly equal in terms of the overall income tax structure, but relatively worse off against the rest of the world. Timbrell's conclusions are essentially limited to the manufacturing sector, which benefits from reduced tax rates in Canada, and it is likely that the Canadian service sector would not fare as well in similar comparisons with the United States.

The difference in the conclusion in Timbrell's paper and the paper by Broadhurst relates to the assumptions and methodology. Broadhurst's paper is based on equity investment, whereas Timbrell uses leveraged investment. Furthermore, the analysis is very sensitive to a number of factors, among which is the assumed interest rate used in discounting future cash flows.[9]

The final article is a report on the Canadian tax reform by the Conference Board of Canada.[10] A comparison of the effect of U.S. and Cana-

[9] If a relatively low discount rate is used in the analysis, then Canada will tend to come out somewhat better in comparison with the United States. The reason for this is that a good deal of the additional burden inflicted upon Canadian corporations in the reform process comes from a stretching out of depreciation and other deductions; and the cost, in terms of discounted cash flows, of such a change is not overwhelming as long as the discount rate is low. If a higher rate of discount is used, then the postponement of deductions to future years that is a relatively large part of the Canadian changes will tend to make the Canadian system relatively less attractive in comparison with the United States.

[10] CONF. BOARD OF CAN., CANADIAN TAX REFORM: WILL THE CANADIAN CORPORATE

dian tax reforms was made in a computer simulation, using data considered to be typical of a large machinery corporation and a large construction corporation. The Canadian simulation assumed a base in Ontario and the U.S. simulation assumed a location in California. Unlike the previous two commentaries, the database available to the Conference Board enabled it to take into account in the analysis all taxes: income, capital, labour and commodity.

The main conclusions drawn by the Conference Board study was that the total tax burden on the machinery industry would be significantly increased in both Canada and the United States as a result of the reforms, but the relative balance between Canada and the United States would be largely unchanged. The study concluded that the Canadian machinery industry will generally remain competitive with the United States, although the U.S. industry had, and would continue to have, a slight overall advantage over Canadian competitors. This advantage incidentally lies mainly in areas other than income tax, and on an income tax basis alone, the Conference Board felt that the Canadian income taxation of the machinery industry was competitive with that in the United States, both before and after reform.

In the construction industry, the effect of tax reform was to slightly lower the aggregate tax burden on the industry in both Canada and the United States. In this case, the influence of lower corporate tax rates in a basically service industry was more than sufficient to overcome the negative effects of other parts of the tax changes. But while the income tax treatment in Canada and the United States was not too dissimilar, the Canadian construction industry had substantially higher other taxes, including commodity taxes on materials. The result was that the Canadian industry had, and continued to have after reform, substantially higher total taxes than its counterparts in the United States. (Accordingly, one might expect that construction contracts in Canada would be more expensive than in the United States, a conclusion supported by observation.)

Again, the Conference Board concluded that the tax reform packages in Canada and the United States had not significantly altered the competitive tax position of the two countries: the machinery industry in Canada would continue at a major disadvantage which ultimately would be reflected in higher costs that would be passed on to all users of its services in Canada. The conclusion of the Conference Board that tax reforms had worsened after-tax rates of return in both countries means that both Canada and the United States stand at some increased disadvantage to the rest of the world.

TAX SYSTEM BE MORE COMPETITIVE? (1987). For a summary of a previous research program on international tax comparisons, *see* CONF. BOARD OF CAN., INTERNATIONAL TAX COMPARISONS COMPENDIUM REPORT: THE COMPETITIVENESS OF CANADA'S CORPORATE TAX STRUCTURE (1987).

It is of some comfort to note that these broad conclusions about the competitiveness of the Canadian tax system are consistent with a major study in which I was involved in 1973 for the Canadian Government. This study considered the relative tax treatment of the pulp and paper industry in Canada, the United States, Sweden and Finland.[11] The conclusions of this study were that the income tax system in Canada was broadly competitive with those of its major foreign competitors, but that when taxes other than income taxes were considered, the Canadian industry was at a substantial net disadvantage. Despite the many complaints about the Canadian income tax system, the real structural problem facing Canada in 1973, and again today, relates to the high level of other taxes: capital taxes, payroll taxes, realty and business taxes, and federal and provincial sales taxes on inputs. These taxes, whose burden does not vary with profitability, provide a heavy fixed burden on Canadian industry and tend to accentuate the boom and bust cycle that Canada, as a resource reliant country, is subject to in any event. The most fundamental reform of the Canadian system does not lie in further endless refinements to its income tax structure, but in attempting to reform the heavy and perverse burden of these less well known taxes. As many of the taxes are levied by provincial and local governments, and as Canada does not have an outstanding track record for intergovernmental cooperation, this task clearly poses major difficulties.

B. A Tentative Conclusion on Canada-U.S. Competitiveness

What conclusion can be drawn from this sea of conflicting viewpoints and analyses on the relative tax competitiveness of Canada and the United States? The answer to this and all other international tax comparisons must be couched with the usual ambiguity beloved by all tax commentators.

My personal conclusion is that before tax reform in either country, Canada had succeeded in maintaining an income tax system that provided Canadian industry with general parity, or even a slight advantage, relative to the United States. Canada has used its lower tax rate on manufacturing to maintain the income tax competitiveness of this part of its economy, and allowed a heavier burden of Canadian tax to fall on service and other businesses through income taxes, and on all taxpayers through higher other taxes. Overall, the Canadian policy approach before tax reform was not outstanding for its brilliance, but neither was it monumentally stupid. Canada had done reasonably well in starting from a relatively adverse position and in protecting the income tax competitiveness of its industry. Canada had done far less well with respect to the burden of other taxes, and it is these other taxes — capital taxes, real estate taxes, payroll levies and the federal and provincial sales tax

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[11] PRICE WATERHOUSE, A STUDY OF TAXATION PRACTICES RELATED TO THE PULP AND PAPER INDUSTRY (1973).

charged on business inputs — that place a number of sectors of the Canadian economy at a significant international disadvantage.

Tax reform in Canada and the United States will significantly increase the tax burden on many, but not all, business sectors in both countries. As previously noted, the increase in tax burdens will fall most heavily on capital-intensive sectors, with the after-tax return from new investment in machinery falling in each country by 5-10%. My personal view is that Canadian industry came out slightly the worse in the reform process and find that its net tax position opposite U.S. business at least slightly eroded. In specific cases the position of the most capital-intensive sectors of Canada will show a significant relative deterioration. However, the relative adverse change in the overall Canadian position is only moderate, and from an income tax standpoint, most Canadian goods industries are still generally competitive with U.S. industries. But when account is taken of other taxes, then Canadian industry will, in many cases, be shown to be in a significantly worse position than its U.S. competition. This situation was not created nor was it cured in the first stage of Canadian tax reform.

Of equal significance is the fact that the decline in after-tax rates of return on new capital investment in many sectors of the Canadian and U.S. economies places both of our economies at a substantial disadvantage to the rest of the world.

C. *Stage Two of Canadian Tax Reform — the Ultimate Answer*

The assessment that tax reform damaged the position of Canadian industry only slightly worse than the U.S. changes damaged U.S. industry would be radically changed if Canada proceeds with the second stage of its tax proposals — the reform of Canada's antiquated and perverse sales tax system. The White Paper on Tax Reform[12] says all the right things. It argues persuasively for the adoption of a multi-stage sales tax, with a uniform rate on a comprehensive base and with full credits for all business inputs. This tax, essentially modeled on the VAT systems of Europe, would be a well tested and efficient means of raising not only sufficient revenue to replace the present federal sales tax, but to allow some further relief in corporate and personal income tax rates.

The adoption of such a rationalized commodity tax structure would avoid a pyramid of tax on business inputs, remove the present penalties on Canadian made goods that compete with foreign produced goods at home and abroad, and eliminate distortions caused by the present random burden of the federal sales tax. The adoption of such a major reform in our sales tax structure in Canada would produce efficiency gains for the economy of a very substantial magnitude — far greater than in

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12 WHITE PAPER ON TAX REFORM, *supra* note 5.

the first stage of the income tax reforms.[13]

The federal government is even hoping that it may be able to introduce the reformed federal sales tax in conjunction with a similar reform of the retail sales taxes of a number of provinces. This would be achieved by combining both federal and provincial taxes into one "national sales tax" with an appropriate split of revenues to the governments involved. This would represent a further substantial improvement in the competitiveness of the Canadian tax system.

To give a brief indication of the magnitude of the accounts involved, as previously noted, stage one of tax reform in Canada will probably load an additional $2 billion a year or more on Canadian corporations through higher income taxes and other changes. The adoption of a value added sales tax system would remove up to $6-7 billion a year of taxes from the costs of Canadian businesses, a substantially larger adjustment, even when measured on an after income tax basis, than the additional burden imposed by the income tax reforms. Not all of this relief would stick to the ribs of Canadian industry; part of it undoubtedly would be passed on to customers, but the net effect clearly must be to improve the efficiency and competitiveness of the entire Canadian economy.

VIII. Taxation and Competitiveness

As mentioned previously, Canadian tax policy has always sought to maintain the broad competitiveness of Canadian industry in relation to its U.S. competition. Canada has and will continue to have a higher overall tax burden than the United States, making this task more difficult.

However, high aggregate tax burdens do not in themselves necessarily make a country not competitive; inefficient and poorly designed taxes do. It is not only the aggregate weight of taxation in a country, but the system under which the taxes are assessed that will affect the competitiveness of its economy.

It is quite possible for a country to have a relatively high tax burden, and still remain generally competitive if it is prepared to be realistic about that burden, and to recognize, as did the landmark Carter Report in Canada[14] over twenty years ago, that all taxes are ultimately collected from individuals, and not from things, institutions or corporations. If a country recognizes this, and concentrates its tax burdens on individuals, on economic rents, and on other areas that do not inhibit the ability of its economy to raise and invest capital, it can remain competitive even with moderately high tax burdens. Alternatively, even a country with a relatively modest level of taxation can have a tax system which weakens its

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[13] *See* Bossons, *Sales Tax Reform: The Postponed Part of the Package*, in PERSPECTIVES ON THE WHITE PAPER, *supra* note 8.

[14] REPORT ON THE ROYAL COMMISSION ON TAXATION (1966).

competitiveness if it insists on tax measures which raise the cost and lower the availability of capital, reduce incentives, and load costs onto its industries.

At the start of this Paper, I pointed out that Sweden has the highest ratio of government taxes to GDP of any country in the world. But while the Swedish tax system has major flaws, it has not in itself prevented the Swedish economy from being competitive internationally. The secret is that Sweden loads most of its tax burden onto individuals, through personal tax rates that can reach above 70% for factory workers, with a VAT of 24% that applies to all goods and services including food,[15] and with other tax measures. For example, one of these taxes results in a bottle of scotch costing $70 in Stockholm. Sweden's corporate tax system goes relatively easy on Swedish corporations, especially on those that reinvest most of their earnings, by allowing deductions for a bewildering variety of reserves. In the past, the Swedish corporate tax system has been so generous as to effectively approach only a tax on distributed profits. In 1985, for example, corporate income taxes provided 3.5% of total tax revenue in Sweden, as opposed to 8.2% in Canada and 7.1% in the United States.[16] Equally, despite its long-term socialist leanings, Sweden has never taxed accumulated personal wealth heavily.

I do not want to leave the impression that I am an enthusiastic supporter of the Swedish tax system. To my mind, among its fundamental flaws is the fact that it stratifies society: the rich can keep their wealth, but it is very difficult for others to accumulate capital out of income. The high marginal rates encourage evasion and discourage personal initiative, and the entire tax structure leads to a rather incestuous relationship between government and industry that is not necessarily helpful to either.

IX. CONCLUSION

To sum it up, these are the general conclusions that I would draw on the tax competitiveness of Canada and the United States. First, free trade between Canada and the United States, in and of itself, will not alter the basic issues in tax competitiveness between the two countries. What it will do is make these issues more immediate, and more urgent. Free trade will provide more of a reward for the country that manages to get its tax system functioning efficiently and more of a penalty for the country that does not.

Second, the previous rough comparability of Canada in some sectors in terms of corporate income taxes was, in many instances, offset by the higher level of other taxes in Canada: capital taxes, realty taxes, and above all, sales taxes on goods and services purchased by businesses. As a result, before tax reform the overall Canadian tax system was, on bal-

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[15] Business inputs are effectively exempt from the VAT.

[16] OECD, *supra* note 1.

ance, imposing slightly heavier burdens than its counterpart in the United States. To provide partial relief, the most exposed sectors of Canadian industry, its manufacturing and producing groups, had special concessions on both income taxes and sales taxes.

Third, the recent reforms in both Canada and the United States have not greatly changed the balance of competitiveness between the two countries, although it is likely that Canadian industry, particularly the capital-intensive parts, has fared worse in the process than has its cousin in the United States. Canada needs to reconsider its sharp cutbacks in tax depreciation rates if its industries are not to be at a disadvantage.

Of greater importance is the fact that tax reform in both countries has substantially lowered after-tax rates of return on capital investment, particularly on machinery, making industry less competitive with rivals from outside of North America. Equally, the returns to individuals from investments have also been lowered.

The Achilles heel of the Canadian tax system has been its over-reliance on hidden and indirect taxes, primarily on businesses. Those hidden taxes have raised the general level of costs in the Canadian economy and hobbled its industries. The biggest single improvement in the Canadian tax structure would be the adoption of a national VAT to replace federal and provincial sales taxes. This change alone would increase Canada's economic efficiency and competitiveness by a major factor, and would give Canadian industry a major advantage over its competitors in the United States.

Canada has always paid attention to the international competitiveness of its tax system, simply because it has had to. The United States has a long history of determining tax issues on essentially domestic political grounds, and ignoring the effects on international trade and investment. Neither country in the future can afford the luxury of neglecting to improve its tax system to increase its competitiveness and facilitate capital investment. The United States, in particular, will have to pay more attention to global economic realities, and less to domestic politics, if its tax system is not to hobble its ability to compete. The United States should take a hard look at how its taxes affect capital formation, and should also try to get over some of its domestic hang-ups about the introduction of consumption taxation and the integration of corporate and personal incomes. (It has been argued in the United States that the adoption of consumption tax is regressive and hurts low income earners at the expense of the rich. This is nonsense because any desired distribution of tax burdens can be achieved through an integrated approach involving consumption taxation, income taxation, and low income credits. The political controversy is really about whether the middle class is going to get stuck with more taxes, and it is the middle class that votes.)

Tax reform in both Canada and the United States was flawed in that it ignored the effects of inflation. As inflation increases, both countries will have to look again to inflation adjustments to prevent capital expropriation and distortion.

Both Canada and the United States have failed to deal with their budgetary deficits and the United States has compounded this error by failing to take into account its inadequate savings rate in the design of its tax structures. Accordingly, the "reformed" tax structures in each country, while more neutral in many aspects, are inherently unstable.

In both Canada and the United States, it is clear that whether we like it or not — and we won't like it — we will have to suffer through further tax changes over the next few years. Because neither country has solved the fundamental problem of government deficits, these changes will almost certainly include significant tax increases. The only way to avoid this would be though a fundamental overhaul of social policies that neither country seems prepared to face. Given this, the real question is not whether taxes are going to increase, but who is going to get stuck with the bill.

The changes that are coming could include further structural shifts in the Canadian and U.S. systems to deal with some of the major problems that have been swept under the rug in the recent tax reform saga. Canada and the United States may well have to look at some inflation adjustments, at measures that would improve the rate of return from new capital investment, and at further improvements in tax efficiency even at the sacrifice of political expediency.

In both Canada and the United States, the taxpaying public has had a long and abiding faith in Santa Claus, the Easter Bunny and the Tooth Fairy when it comes to taxation. In an increasingly competitive world, we have to move away from our belief that somebody else is going to pay. Rather we face the necessity of trying to adapt our tax policies to the realities of the global economy and to the abiding requirement to work harder and think smarter. Just how willing, and how able, each of our countries will be to handle these fundamental changes is a question that remains to be answered.

TABLE 1
TOTAL TAX REVENUES AS A PERCENTAGE OF GDP

Country	Tax Revenues Excluding or Including Social Security Contributions					
	1984		1985		1986	
	Excl.	Incl.	Excl.	Incl.	Excl.	Incl.
Swed.	37.1	50.3	38.0	50.5	38.8	52.2
Fr.	25.7	45.5	25.7	45.6	25.7	45.1
Neth.	25.1	45.2	25.2	45.0	26.4	46.1
U.K.	31.5	38.4	31.4	38.1	32.1	39.1
W. Ger.	23.9	37.5	24.0	37.8	23.5	37.4
Can.	29.0	33.2	28.7	33.1	29.5	33.9
Swtiz.	22.0	32.3	21.8	32.1	21.2	31.1
Austl.	30.5	30.5	30.3	30.3	—	—
U.S.	20.1	28.4	20.6	29.2	—	—

— = not available

Source: OECD, REVENUE STATISTICS OF OECD MEMBER COUNTRIES 1965-86 (1987). For a report and discussion of data, *see also* Perry, *Fiscal figures*, CAN. TAX J. 1550 (Nov.-Dec. 1987).

TABLE 2
MAJOR TAX REVENUES BY SOURCE, AS PERCENTAGE OF GDP, 1985

	Personal Income Taxes	Corporate Profits Taxes	Social Security Levies	Taxes on Goods and Services	Taxes on Property
Aus.	13.7	2.8	—	9.8	2.3
Can.	11.7	2.7	4.4	10.4	3.1
Fr.	5.8	1.9	19.9	13.4	2.1
W. Ger.	10.8	2.3	13.8	9.7	1.1
Japan	6.9	5.9	8.5	3.9	2.7
Neth.	8.8	3.1	19.7	11.6	1.6
Spain	6.5	1.6	12.0	7.6	.8
Swed.	19.5	1.8	12.5	13.3	1.2
U.K.	9.9	4.9	6.7	12.0	4.6
U.S.	10.4	2.1	8.6	5.2	2.9
OECD Average	11.7	3.0	9.1	11.2	1.8

Source: As in Table 1

TABLE 3
GOVERNMENT REVENUE, EXPENDITURES AND DEFICITS, 1984

	% of GDP		
	Deficit	Government Revenues	Government Expenditures
Aust.	(4.2)	35.0	39.2
Can.	(7.7)	39.7	47.5
Fr.	(3.8)	47.0	51.0
Ger.	(2.9)	45.8	48.7
Neth.	(6.1)	54.4	60.5
Spain	(6.3)	30.7	37.3
Switz.	—	37.9	38.0
U.K.	(3.2)	44.2	47.3
U.S.	(3.5)	33.0	36.5

Source: INT'L MONETARY FUND, GOVERMENT FINANCIAL STATICS YEARBOOK (1986). IFM definitions and approaches differ from those used in the OECD tables.

TABLE 4
COMPARISON OF GENERAL CORPORATE TAX RATES CANADA AND UNITED STATES

General Corporate Rate	1986		1988		1991	
	Canada	U.S.	Canada(1)	U.S.	Canada(1)	U.S.
Federal tax (2)	36.00	46.00	28.00	34.00	28.00	34.00
Surtax	1.80		.84			
Provincial/state tax (3)	15.50	4.32	15.50	5.28	15.50	5.28
	53.30	50.32	4.34	39.28	43.50	39.28
Manufacturing income:						
Federal tax	30.00	(as	26.00	(as	23.00	(as
Surtax	1.50	above)	.78	above)	—	above)
Provincial tax	14.50		14.00		14.00	
	46.00	50.32	40.78	39.28	37.00	39.28

Notes and Assumptions:

1) Canadian rates shown for 1988 and 1991 are only effective from *July 1*, and do not apply to entire year. "General" federal rate is current 35%.

2) It is assumed that the Canadian federal surtax is repealed by 1991, and replaced with revenues from a revised sales tax.

3) Provincial tax shown are those in effect or anticipated in Ontario. For the United States, a "typical" state corporate tax of 8% has been assumed, fully deductible for U.S. federal tax: only the net cost of the state tax is shown. Provincial and state taxes vary widely: the general provincial rate on active business income in Quebec is less than 6%, and other provincial rates range up to 17%.

4) It is assumed that small business and other special reliefs are not applicable.

TABLE 5
TOP PERSONAL INCOME TAX RATES 1988

	Canada	United States
Top federal rate (includes 3% surtax in Canada)	29.87%	28.00%
Provincial/state tax	15.08	5.76
	44.95	33.76

Notes and Assumptions:

1) Canadian top rates apply to taxable income over $55,000; U.S. rates apply to income over $71,900 (married, joint return).

2) U.S. rates do not reflect "clawback" of lower tax rates on bottom brackets, which will add 5% to effective rates in a band above the point where the 28% rate commences. For example, effective federal rate for joint return is 33% from $71,900 to $149,250 of taxable income.

3) Canadian provincial rate is shown for Ontario; top rates in other provinces (combined federal and provincial) range from a low of 42.34% to a high of 49.1%. The U.S. state tax is an assumed 8%, shown as net after taking account of deductibility for federal purposes.

4) No recognition is given to important differences in tax base, such as deductibility of home mortgage interest and taxes in U.S. dividend tax credit in Canada, etc. Both the United States and Canada have alternative minimum taxes and new restrictions on tax shelters, but the U.S. rules are somewhat more severe. The United States includes 100% of capital gains in income; Canada includes 2/3 (3/4 after 1989).