Saskatchewan's Tax Expenditures

INTRODUCTION

Although the primary purpose of taxation is to raise revenue, governments also attain some of their social and economic goals by reducing the taxes paid by certain taxpayers. These reductions are commonly called "tax expenditures" and include such measures as exemptions, deductions, tax credits, preferential tax rates or deferrals. Each provides special or preferential treatment to certain taxpayers or to certain types of activity. Taken together, they provide assistance to a variety of individuals and businesses, including families, farmers, senior citizens and small businesses.

While tax expenditures are usually absorbed in the overall revenue estimates and are not presented in the same way as direct spending programs, they reduce the amount of revenue generated by a government and they affect a government's fiscal position in the same way as direct expenditures.

THE RATIONALE FOR TAX EXPENDITURES

Tax expenditures can achieve a number of objectives, such as enhancing the fairness of the tax system or promoting certain types of economic activity. In pursuing these objectives, some tax expenditures have become fundamental elements of the tax system.

Saskatchewan's sales tax does not apply to certain basic items such as food, residential natural gas, residential electricity, children's clothing and reading materials, thereby reducing the taxes paid by families consuming these basic items. This treatment is in contrast to the federal Goods and Services Tax (GST) and the sales taxes of provinces that have harmonized their sales taxes with the GST, since those taxes apply to a much broader range of goods and services purchased by families.

In recognition of the importance of agriculture to Saskatchewan, the Province's Fuel Tax exemption provides tax-free treatment to farm-use diesel fuel, through a fuel-coloring program, and a partial exemption of farm-use gasoline when purchased in bulk.

In 2001, Saskatchewan's personal income tax shifted from a complex system of taxes, surtaxes and a low income reduction to a simplified tax structure applied directly to taxable income as defined for federal income tax purposes. Deductions that contribute to the federal determination of taxable income, such as the deduction for Registered Retirement Savings Plan contributions, continue to affect Saskatchewan income tax revenue. The impacts of several of these deductions are estimated in this paper.

The Government of Saskatchewan improved the fairness of its personal income tax system by introducing a progressive three-rate tax structure on taxable income along with distinct provincial non-refundable tax credits. For the 2006 taxation year, the Saskatchewan basic and spousal tax credit amounts are $8,589. In addition, the provincial tax system provides a supplement to the age amount, which has increased to $1,074 for the 2006 tax year, and a dependent child amount, which has increased to $2,684 per child for 2006. This paper also provides estimates of the revenue impacts of several of the provincial non-refundable tax credits.

To improve the distribution of corporate taxes, Saskatchewan levies a lower income tax rate on small businesses. The current small business corporate income tax rate of five per cent is significantly lower than the general corporate income tax rate.

The corporate income tax rate on manufacturing and processing (M&P) profits is reduced to as low as ten per cent, depending upon the level of a corporation's business activity in Saskatchewan. Saskatchewan also provides an Investment Tax Credit to assist M&P companies that invest in qualifying new or used M&P assets for use in Saskatchewan.

ASSOCIATED COSTS

While tax expenditures serve important social and economic objectives, the introduction of any tax expenditure results in associated costs. These costs take several forms.

- First, there is the cost of forgone revenue. Tax expenditures result in the reduction of revenue collected and have a significant impact on a government's financial position.
- Second, tax expenditures may add to the complexity of the tax system, leading to increased administrative effort by both taxpayers and governments.
- Third, tax expenditures may create distortions in consumer and other economic behaviour. For example, the exemption for restaurant meals and snack foods provides preferential treatment for this category of consumer expenditure.
- Finally, tax expenditures may create increased compliance costs for both businesses and consumers.

GOVERNMENT OF CANADA TAX EXPENDITURES

The federal government produces a detailed presentation on tax expenditures that are part of the federal tax system. The 2005 estimates of federal tax expenditures include projections to the year 2007 as well as historical data.

Since Saskatchewan's personal and corporate income taxes are based upon the federal definition of taxable income, many of the federal tax expenditures have an impact on Saskatchewan's revenue. Readers interested in examining the federal government's presentation of tax expenditures are invited to contact the Finance Canada Distribution Centre in Ottawa or visit the website www.fin.gc.ca (and click on "Publications").

2006 SASKATCHEWAN TAX EXPENDITURES

Saskatchewan's personal income tax system for 2006, including Saskatchewan's family tax credits and income tax brackets, is indexed to the national rate of inflation of 2.2 per cent. This is reflected in the estimates that follow, as is the 2006 enhancement to the Post-Secondary Graduate Tax Credit.

Effective for the 2006 taxation year, an income tax credit is being introduced in respect of the cost of an employee's eligible tools purchased as a requirement of his or her employment. This tax credit has two components: a one-time trade entry tool amount that recognizes the high cost of the initial purchase of work-related tools, and an annual maintenance tool amount that recognizes the ongoing cost of maintaining tools. Details of this initiative are presented at the end of this paper.

The Mineral Exploration Tax Credit expired on December 31, 2005. The expenditure period for funds raised under the program concludes at the end of 2006.

Commencing in 2006, Saskatchewan begins a multi-year reform of provincial business taxes. The following 2006 elements of the reform are reflected in this year's tax expenditure estimates.

- Effective immediately, the current seven per cent Investment Tax Credit for M&P acquisitions is converted from a non-refundable tax credit to a refundable tax credit and the carry forward period for unused credits is extended to 10 years.
- Effective July 1, 2006:
  - ~ the general Corporation Capital Tax (CCT) rate will be cut in half, from 0.6 per cent to 0.3 per cent;
  - ~ the CCT Resource Surcharge rates will be reduced from 3.6 per cent (the general rate) and 2.0 per cent (the special rate for fourth tier oil and gas) to 3.3 per cent and 1.85 per cent respectively;
  - ~ the general Corporation Income Tax (CIT) rate will be reduced from 17 per cent to 14 per cent; and,
  - ~ the income threshold for the current five per cent small business CIT rate will rise from $300,000 to $400,000.

The following tables provide estimates of the major tax expenditures of the Government of Saskatchewan in 2006, calculated using tax collection data and Statistics Canada data.

2006 Government of Saskatchewan
Tax Expenditure Accounts
(Value of Tax Expenditures in Millions of Dollars)

Sales Tax

Exemptions		
1. Children's clothing and footwear	$	8.4
2. Prescription drugs		32.2
3. Electricity		47.4
4. Farm machinery and repair parts		57.7
5. Fertilizer, pesticide and seed		110.2
6. Food		
– Restaurant meals and snack foods		57.5
– Basic groceries		124.6
7. Natural gas		44.9
8. Reading materials		12.5
9. Services		
– Construction		247.9
– Other		34.8
10. Used goods – exemption amounts		6.0
11. Direct agents		11.2
12. Eligible energy efficient appliance, furnaces and boilers		2.4
13. Toll-free telephone services		0.3
14. Municipal fire trucks		0.1
15. Mineral exploration equipment		0.1

Fuel Tax

1. Exemption for farm activity	$	112.3
2. Exemption for heating fuels		19.6
3. Exemption for primary producers		2.5

Personal Income Tax

Deductions from Income		
1. Registered Pension Plan contributions	$	47.1
2. Registered Retirement Savings Plan contributions		94.2
3. Annual union, professional or like dues		10.4
4. Child care expenses		6.5
5. Moving expenses		1.7
6. Carrying charges		7.6
7. Allowable employment expenses		11.4
8. $500,000 capital gains deduction		24.5

Saskatchewan Non-refundable Tax Credits

1. Basic personal tax credit	$	511.9
2. Spousal tax credit		28.8
3. Equivalent-to-spouse tax credit		15.3
4. Age tax credit		37.4
5. Supplement to the age tax credit		10.8
6. Dependent child tax credit		39.9
7. Canada Pension Plan contributions tax credit		49.3
8. Employment Insurance premiums tax credit		18.5
9. Pension income tax credit		9.6
10. Tuition and education tax credit		25.2
11. Student loan interest tax credit		1.2
12. Disability tax credit		8.3
13. Caregiver tax credit		0.7
14. Medical expenses tax credit		19.1
15. Charitable contributions tax credit		30.7

Other Saskatchewan Tax Measures

1. Saskatchewan Sales Tax Credit	$	34.0
2. Labour-sponsored Venture Capital Tax Credit		7.3
3. Post-Secondary Graduate Tax Credit		4.9
4. Employees' Tool Tax Credit		2.9
5. Political Contributions Tax Credit		1.3

Corporation Income Tax

1. Lower tax rate for small business	$	159.8
2. Royalty Tax Rebate		8.0
3. Manufacturing and Processing Profits Tax Reduction		11.8
4. Investment Tax Credit for Manufacturing and Processing		25.4
5. Research and Development Tax Credit		10.0

Corporation Capital Tax

1. General exemption of up to $20,000,000	$	20.1
2. Exemption for co-operatives, credit unions, family farm corporations and insurance companies		8.0

EMPLOYEES' TOOL TAX CREDIT

GENERAL

Skilled tradespeople are able to deduct the cost of their tools for income tax purposes if they are *self-employed.* On the other hand, *employees* generally do not receive tax recognition for the cost of tools that they must supply themselves as a condition of their employment. This can be a significant cost impediment for workers employed in a skilled trade.

Beginning in 2006, a provincial income tax credit is introduced to recognize the costs associated with purchasing, replacing and upgrading eligible tools by qualifying employees as a condition of their employment. The tax credit consists of two components: a one-time trade entry amount and an annual maintenance amount. The maximum amount for each component is dependent upon the trade group that the individual is employed in. The tool tax credit is calculated as 11 per cent of the specified credit amounts for each of the trade groups.

TRADE GROUPS

The four basic trade groupings, as well as the maximum amounts that may be claimed for the one-time trade entry tax credit and the annual maintenance tax credit, are shown in the table below.

ONE-TIME TRADE ENTRY AMOUNT

The one-time trade entry tax credit amount is intended to recognize the high initial cost of tools that are required to be purchased by employees to enter their trade. To be eligible for the one-time trade entry credit, the following conditions apply:

- the employee must be performing a designated task in one of the four trade group categories;
- the employment must represent the employee's primary source of income;
- the tools must be purchased as a condition of employment; and,
- the actual cost of the tools purchased in the year in which the tradesperson commences employment must exceed the gross credit amount for that trade group.

TRADE GROUPS AND TAX CREDIT AMOUNTS

		One-Time Entry		Annual Maintenance	
	Trade Groups	**Amount**	**Tax Credit**	**Amount**	**Tax Credit**
Group 1	Hair stylist, bricklayer, drywaller, roofer, insulator, glazier, painter, floor covering installer	$ 1,350	$ 148	$ 300	$ 33
Group 2	Plumber, pipe fitter, gas fitter, carpenter, electrician, sheet metal worker, boiler maker, iron worker, auto body repairer	$ 5,000	$ 550	$ 1,000	$ 110
Group 3	Vehicle mechanics	$ 9,000	$ 990	$ 1,500	$ 165
Group 4	Heavy-duty mechanics	$ 12,500	$ 1,375	$ 2,500	$ 275

The one-time trade entry credit may only be claimed in the year in which the individual commences employment in a particular trade. The credit may only be earned once in a lifetime. Individuals who are not able to use the entire trade entry amount in their first year of employment can carry forward the unused portion for up to an additional two taxation years.

ANNUAL MAINTENANCE AMOUNT

The annual maintenance tax credit amount is intended to recognize the ongoing cost to a tradesperson of maintaining his or her tools that are required as a condition of employment. To be eligible for the maintenance tax credit, the following conditions apply:

- the employee must be performing a designated task in one of the four trade group categories;
- the employment must represent the employee's primary source of income; and,
- the tools must have been purchased as a condition of employment.

This credit must be claimed in the current taxation year, with no carry forward permitted for unused amounts.

ELIGIBILITY AND ADMINISTRATION

Saskatchewan will be asking the Canada Revenue Agency to assist in administering the employees' tool tax credit by requesting that employees and employers complete a provincial tax form, similar to the existing federal *T2200 Declaration of Conditions of Employment,* declaring that:

- the individual is an eligible employee performing a designated task;
- a legitimate employment relationship exists; and,
- the tools were required as a condition of employment.

Individuals will file this declaration with their income tax return and compute and claim the tax credit as a reduction from their Saskatchewan income tax payable.