
Report E: TAX EXPENDITURES

Introduction

A tax expenditure is defined as the reduction in tax revenues that results when government programs or benefits are provided through the tax system rather than reported as budgetary expenditures. Tax expenditures are usually made by offering special tax rates, exemptions, or tax credits to program beneficiaries. Governments introduce tax expenditures primarily to achieve social policy objectives such as transfers to lower income families or to promote economic development and job creation.

The major reason for reporting tax expenditures is to improve government accountability by providing a more complete picture of government spending. It is for this reason that British Columbia's major tax expenditures are presented in the following tables. Reporting tax expenditures is also consistent with recommendations contained in the 1994/95 Report of the Auditor General.

Tax expenditure reporting is relatively common. The Canadian federal government, the American federal government, some American states, several European national governments, and on occasion other Canadian provinces issue reports on tax expenditures. The British Columbia government has reported tax expenditures each year since 1995. The report provides estimates of the cost of tax expenditures for the 1998/99 fiscal year.

The Role of Tax Expenditure Programs

The main reason governments use the tax system to deliver programs is to reduce administration costs and to reduce compliance costs for recipients. In certain situations, the tax system allows intended beneficiaries to be readily identified from information that is already collected. In these cases, setting up a separate expenditure program would result in costly overlap and duplication of effort. An example is the provincial sales tax credit, which is delivered through the income tax system. If this were a direct provincial expenditure program, a provincial agency or office would have to be established to duplicate much of the work already done by Revenue Canada. In addition, it would require individuals to undergo a separate, time-consuming application process in order to qualify for the benefit.

There are, however, several drawbacks to tax expenditure programs. First, their overall cost receives less public scrutiny than is the case for spending programs because annual budget approvals are not typically required. Second, some tax expenditure programs confer the greatest benefits on those who pay the most taxes, which means that the major beneficiaries are often high income earners. Sales tax exemptions, for example, often provide a greater absolute benefit to those with higher incomes because they have more to spend on consumer products. This can run counter to the objective of incorporating progressiveness into the tax system. Finally, costs are often more difficult to control under a tax expenditure program because the benefits tend to be more open ended and enforcement is often more difficult than for spending programs.

Tax Expenditure Reporting

Three criteria were used to choose those features of the tax system that should be reported as tax expenditures. First, the emphasis is on tax reductions, exemptions and refunds that are close equivalents to spending programs. Under this approach, the focus is on items that would not be out of place on a list of spending programs. By implication, the list does not include tax measures designed to meet broad tax policy objectives such as improving fairness in the tax system, or measures designed to simplify the administration of the tax. The list also does not include items that are generally excluded from a particular tax base. An example is the non-taxation of most services under provincial sales taxes, which are primarily designed to apply to purchases of goods. Finally, tax remission orders are not included, because they are not equivalent to an expenditure program, but are granted on a case-by-case basis.

Second, revenues raised under provincial government authority that are turned over to agencies outside of government are not reported as tax expenditures in this report. This includes, for example, horse racing tax revenues transferred to the Racing Commission and fuel tax revenues transferred to the BC Transportation Financing Authority.

Third, smaller items of less than \$2 million are not included. Where practical, smaller items have been presented together as an aggregate figure. For example, sales tax exemptions for farmers, fishers and aquaculturists are reported on a combined basis.

As a result, in this report, tax expenditures include major government programs delivered through the tax system, but do not include all items commonly considered to be tax expenditures in other reports. Many items, such as the basic personal income tax credit, are excluded because they are designed primarily to improve fairness in the tax system and are not comparable to spending under budgetary programs.

Future tax expenditure reports will continue to refine and clarify the criteria used to report provincial tax expenditures.

British Columbia Tax Expenditure Programs

The following tables report 1998/99 tax expenditure estimates.

Several new tax expenditures were introduced in *Budget '98*. The major new tax expenditures introduced were corporate income tax credits for domestic and foreign film productions, exemptions from the social service tax for "1-800" and equivalent telephone services, and a motor fuel tax exemption for coloured fuel used by *bona fide* farmers.

For presentation purposes, British Columbia tax expenditures have been broken into three broad categories.

- *Social and Income Transfer Programs (Table E1)*: These mainly include tax expenditures that are offered as part of the government's mix of health, education, housing and income transfer programs. Examples include the BC Family Bonus, the home owner grant, the sales tax exemption for school supplies and the income tax credit for medical expenses.
- *Economic Development and Business Assistance Programs (Table E2)*: This category mainly includes tax preferences for farmers and small businesses and measures to encourage new investments.
- *Environmental Protection Programs (Table E3)*: There are relatively few tax expenditures in this category because environmental protection is now generally based on the principle of "polluter pay." However, environmental tax expenditures include, for example, a sales tax exemption for bicycles and a fuel tax exemption for certain alternative fuels.

Each category has its own table of tax expenditure estimates. Within each table, the list of tax expenditures delivered through the income tax system has been separated into two sub-categories.

- *Provincial Measures*: This includes all major tax expenditures that are under provincial policy control.
- *Federal Measures*: British Columbia shares the cost of some federal income tax expenditure programs because, under the tax collection agreement between British Columbia and the federal government, the province has agreed to give up policy control of the income tax base in the interest of reducing administration and compliance costs and maintaining a consistent income tax system across the country.

This means the province has no direct control over income tax preferences delivered through changes to the income tax base or in the calculation of basic federal tax. As a result, federal measures to provide tax relief for certain groups such as very low income individuals and students will automatically reduce provincial income tax revenues.

The personal income tax expenditures that have been included in the following tables cover a range of policy objectives, including support for charitable activities, health care and education.

Meanwhile, most corporation income tax expenditures are intended to achieve economic development objectives.

The cost of individual tax expenditures cannot be added together to reach a total tax expenditure figure for two reasons. First, in some cases the programs interact with one another so that eliminating one program could increase or decrease the cost of another. Second, eliminating certain tax expenditure programs could change the choices taxpayers make, which in turn would affect the cost estimates.

TABLE E1 — SOCIAL AND INCOME TRANSFER PROGRAMS
TAX EXPENDITURE

1998/99
Estimated Cost

PROVINCIAL SALES TAX

(\$ millions)

Exemptions for the following items:

• Food (basic groceries, snack foods, candies, soft drinks and restaurant meals)	703
• Residential fuels (electricity, natural gas, fuel oil, etc.)	102
• Prescription and non-prescription drugs, vitamins and certain other health care products and appliances	60
• Children's clothing and footwear	21
• Clothing patterns, fabrics and notions	6
• Specified school supplies	9
• Books, magazines and newspapers	52
• Basic telephone and cable service	51
• "1-800" and equivalent telephone services	7
• Exempt safety equipment	8
• Labour to repair major household appliances, clothing and footwear	6
• Miscellaneous consumer exemptions (e.g. used clothing under \$100)	3

PERSONAL INCOME TAX

Provincial Measures

BC Family Bonus ¹	112
Sales tax credit	41
Political contributions tax credit	2

Federal Measures²

Deduction and inclusion of alimony and child support payments	17
Charitable donations tax credit	84
Tax credits for tuition and education ³	66
Tax credits for disabilities and medical expenses	49
Pension income tax credit	25
Credit for persons older than 65 years	100
Exemption from capital gains up to \$500,000 for small businesses and family farms	71
Deduction for residents of northern and isolated areas	15
Non-taxation of employer-paid insurance premiums for group private health and welfare plans	114
Registered Retirement Savings Plans ⁴ :	
exemption for — contributions	595
— investment earnings	385
taxation of — withdrawals	(193)
Total	787
Registered Pension Plans ⁴ :	
exemption for — contributions	381
— investment earnings	679
taxation of — withdrawals	(401)
Total	659



TABLE E1 — SOCIAL AND INCOME TRANSFER PROGRAMS —
Continued

TAX EXPENDITURE	1998/99 Estimated Cost
	(\$ millions)
CORPORATION INCOME TAX⁵	
Charitable donations deduction	8
SCHOOL AND RURAL AREA PROPERTY TAXATION⁶	
Home owner grant	478
Exemption for places of worship	8
Municipal discretionary exemptions	15
PROPERTY TRANSFER TAX	
Exemption for first-time home buyers	29
Exemptions for the following items:	
• Property transfers between related individuals	28
• Property transfers to municipalities, regional districts, hospital districts, library boards, school boards, water districts and educational institutions	3
• Property transfers to charities registered under the <i>Income Tax Act</i> (Canada)	2

¹ The above estimate of \$112 million represents the tax expenditure portion of the program's cost. The tax-expenditure portion represents family bonus payments that effectively reduce the recipient's personal income tax. The remaining cost of the program, including recoveries and administration costs, \$240 million for 1998/99, is presented in the BC Benefits Vote because it represents payments to families which exceed their provincial income tax liabilities. Thus the total cost of the program is \$352 million.

² The estimates show provincial revenue losses only. They are based on estimates of projected federal losses contained in *Government of Canada: Tax Expenditures, 1998*. British Columbia personal income tax expenditures for the federal measures are estimated by applying British Columbia's share of basic federal tax to the federal estimates for the relevant period and then applying the relevant provincial tax rates. (Prior to 1997, federal tax expenditure reports did not include projections; previous estimates of provincial revenue losses were based on historical federal estimates.) Certain tax expenditure items have been excluded where no data were available or the amounts were immaterial.

³ The estimate includes the total provincial revenue losses from the federal tuition fee credit, education credit, student loan interest credit, and the carry-forward and transfer of tuition fee and education credits.

⁴ Registered retirement savings plans and registered pension plans are treated in the same way as in the federal tax expenditure report. The tax expenditure associated with these schemes is presented as the amount of tax that would otherwise be paid in the year of deferral, were the deferral not available. However, this type of estimate overstates the true costs of these preferences because taxes are eventually paid, including tax on investment earnings. An estimate that does not overstate these costs would, however, be difficult to develop and would require some largely speculative assumptions.

⁵ The deduction offered for corporate charitable donations is a federal measure, but the estimate shows only the provincial revenue loss. This is calculated from the federal revenue loss by applying British Columbia's share of corporate taxable income and the relevant tax rates to the federal estimate. (Prior to 1997, federal tax expenditure reports did not include projections; previous estimates of provincial revenue losses were based on historical federal estimates.)

⁶ The property tax estimates, except for the home owner grant amount, are for the 1998 calendar year, and include only school and rural area property taxes levied by the province.

TABLE E2 — ECONOMIC DEVELOPMENT AND BUSINESS
ASSISTANCE PROGRAMS
TAX EXPENDITURE

1998/99
Estimated Cost

	(\$ millions)
PROVINCIAL SALES TAX	
Commissions paid to retailers and hotel operators	24
Exemptions for the following items:	
• Livestock for human consumption and agricultural feed, seed and fertilizer	35
• Exempt purchases by farmers, fishers and aquaculturists	20
• Magnetite for processing coal, eligible exploration equipment and drill bits for mineral exploration and production	2
FUEL TAX	
Tax exemption for international flights carrying cargo	5
Tax exemption for family farm trucks (on road)	2
PERSONAL INCOME TAX	
Venture capital tax credit	6
Employee venture capital tax credit	6
CORPORATION INCOME TAX	
Provincial Measures	
Film and video tax credit	10
Production services tax credit	13
International financial business tax refund ¹	4
Two-year corporate income tax holiday for small business	2
Federal Measures²	
Earned depletion	3
Allowable business investment losses	4
CORPORATION CAPITAL TAX	
Exemption for family farm and cooperative corporations	3
Two-year tax holiday for eligible British Columbia investment expenditures	22
SCHOOL AND RURAL AREA PROPERTY TAXATION³	
School tax assessment reduction on current values for farm buildings and farm land, and residences in the agricultural land reserve	16
Assessment of farm land at farm use values ⁴	84
Assessment exemption of \$10,000 for industrial and business properties	6
Overnight tourist accommodation assessment relief	3
Managed forest land classification	8
OTHER TAXES	
Oil and gas royalty holiday	6

¹ Includes employee income tax refunds.

² The provincial revenue loss estimates for federal measures are based on estimates of the federal losses contained in *Government of Canada: Tax Expenditures, 1998*. The federal estimates are based on 1998 estimated incomes. British Columbia corporate income tax expenditures are estimated by applying British Columbia's share of corporate taxable income to the federal estimates, and then applying the relevant tax rates. Certain tax expenditure items have been excluded where no data were available. (Prior to 1997, federal tax expenditure reports did not include projections; previous estimates of provincial revenue losses were based on historical federal estimates.)

³ Estimates are for the 1998 calendar year and include only school and rural area property taxes levied by the province.

⁴ Currently, the values of farm land and residential land in the Agricultural Land Reserve are reduced by 50 per cent for school tax purposes. The \$84 million estimate assumes that farmland would be assessed at 100 per cent of market value.

TABLE E3 — ENVIRONMENTAL PROTECTION PROGRAMS	1998/99
TAX EXPENDITURE	Estimated Cost

(\$ millions)

PROVINCIAL SALES TAX

Exemptions for the following items:

- | | |
|---|----|
| • Bicycles | 6 |
| • Specified energy conservation equipment | 10 |

FUEL TAX

Tax exemption for alternative fuels	17
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SCHOOL AND RURAL AREA PROPERTY TAXATION¹

Exemption for property used for pollution abatement ²	8
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¹ Estimates are for the 1998 calendar year and include only school and rural area property taxes levied by the province.

² The property tax exemption for most land and improvements used in pollution abatement equipment was removed for 1997, but existing properties which were exempt in 1996 remain exempt under grandparenting provisions.