

January 18, 2005

The Honourable Mr. Greg Selinger  
Minister of Finance  
Room 103 Legislative Buildings  
450 Broadway  
Winnipeg, Manitoba  
R3C 0V8

Dear Mr. Selinger:

We are very pleased to once again have the opportunity to provide you with our comments on taxation matters in anticipation of the 2006 Manitoba Budget. The comments have been prepared by our Taxation Committee, chaired by Mr. Craig Roskos, CA, with input from a number of tax practitioners within our business community.

### **TAX COMPETITIVENESS**

As we have commented previously, both in pre-budget submissions as well as in *MB Check-Up*, tax competitiveness remains one of the most important challenges facing the government of the Province of Manitoba. Based on our discussions with you and your staff over the past few years, we agree that achieving tax competitiveness with “competing” provinces of Ontario, Alberta, British Columbia and Saskatchewan presents some challenges for the Manitoba government. We have noted your comments that middle income families with children pay lower taxes in Manitoba than in many other provinces. We agree that the Manitoba government has introduced some programs that target tax reductions to some specific segments of the population. However, an overall approach that makes Manitoba attractive to people of all income levels, including high net worth individuals and professionals, would create a broader and more stable tax base.

In general it appears that with respect to its tax system, Manitoba continues to remain either in “the middle of the pack” or worse. The notion that we must settle for that position, based on the belief that our resource endowment is considerably less than that of neighbouring provinces, is one with which we disagree. We recognize that Manitoba may not be able to compete on equal footing with a few of the more resource-rich provinces, but we believe that we should not be content to accept the status quo in the long term. As we noted in *MB Checkup 2005*, our economy is one of the most diverse in Western Canada. We are well-positioned to take advantage of that fact if we take bold steps to improve our overall tax competitiveness and attractiveness as a place to live, work and invest. Our long term goal must be to move Manitoba to a more competitive position nearer to the “top of the pack”.

Recently implemented reductions in corporate tax rates are a positive step towards improving tax competitiveness with our neighbouring provinces. We believe, however, that in

order to continue to stimulate economic growth with its attendant benefits for all Manitobans, further measures are necessary to ensure that Manitoba continues to be an attractive place for both families and businesses to call home.

### **Corporate Taxation**

Table A illustrates general and small business corporate tax rates for the four western Provinces and Ontario. Manitoba continues to follow or, at best, approximate its neighbours in this area of taxation. Accordingly, there continues to be no clear tax incentive for business to locate here, although competitiveness is especially important in the case of corporate tax rates. Under the current inter-provincial tax system, there is opportunity and incentive for a Manitoba corporation to maintain a base of operations in Manitoba (and provide its owners and employees with Manitoba's lifestyle advantages) while it also does a significant amount of business and earns a significant amount of corporate income through offices or subsidiaries in other provinces that offer lower corporate tax rates. The result is an erosion of the Manitoba corporate tax base.

In addition to the lack of competitiveness in corporate tax rates, we remain concerned about the existence of two further taxes that act as major irritants, if not deterrents, to doing business in Manitoba - the Corporation Capital Tax and the Health and Post-Secondary Education Tax ("payroll tax"). Several other Canadian provinces have taken steps to eliminate Corporation Capital Tax or provide much higher exemption levels. However, Manitoba continues to impose such a tax on many smaller corporations and our business climate has suffered as result.

With respect to payroll tax, Manitoba remains the only Western Canadian province to impose such a tax. We realize that in British Columbia and Alberta, both employers and employees bear the cost of health premiums, however, based on our professional interactions with the business community and our own experience, we believe that the payroll tax represents a clear disincentive to business investment here in Manitoba.

An attractive tax system for business is essential not just because it builds a broader corporate tax base which generates more overall corporate tax revenue, but because of its impact on job creation and population gains in Manitoba. Business investment means more jobs in Manitoba, more Manitoba taxpayers and a larger personal tax base – all resulting in increased personal tax revenues. While corporate taxes represent an important revenue source, personal tax revenue has a much greater impact on Manitoba's ability to balance its budget. An attractive business climate generates economic spin-offs, with one of the more significant spin-offs being the expansion of Manitoba's population, personal tax base and personal tax revenues.

### **Personal Taxation**

Table B illustrates top marginal personal tax rates for 2005, 2004 and 2003 in Canada and highlights Manitoba's ranking on a national basis. Table C illustrates the amount of personal tax paid by Manitobans at two income levels, \$40,000 and \$100,000, in comparison to the rest of Canada. Both tables illustrate that Manitoba personal tax levels continue to remain in either the upper range or near the "middle of the pack" nationally and to either lag behind or maintain close proximity to those of our main competition, Ontario and Western Canada.

The gap has grown to the point that a taxpayer with income of \$100,000 now pays nearly \$5,000 more combined income tax in Manitoba than in both Alberta and British Columbia. This comparison does not augur well for "brain drain" and will not serve to attract or keep entrepreneurs or expertise such as health care, high tech, biotech or other professionals in Manitoba. Many Manitobans choose to continue to live here because we appreciate the quality of life benefits associated with living in Manitoba, but the attractiveness of those

benefits pales when compared to an extra \$5,000 of disposable income. We suggest that Manitoba is approaching a breaking point – a point at which not only newcomers and some of our youth, but long-time Manitoba residents, need reasons other than “quality of life” arguments to live here. A more competitive personal tax structure provides a persuasive argument in support of a decision to live here.

We would prefer that the Manitoba government introduce overall reductions in personal tax rates in the long term. However, as a short term measure, consideration might be given to providing temporary targeted tax relief or incentives in order to attract those individuals whose skills or knowledge are sought by Manitoba. Examples of such targeted groups might include health care providers or, as part of the overall plan to develop Northern Manitoba’s resources, those who live and work in the North. Coupled with an increase in business investment (and job creation) in Manitoba, the resulting expansion of the population and tax base would, in the longer term, allow for the establishment of the clearly competitive personal tax rates needed to maintain or further expand the provincial economy.

Table D illustrates the combined top marginal rate on dividend income across the country. Manitoba’s marginal rate on such income ranges from 3.5 to 11 percentage points higher than the other Western Canadian provinces and Ontario. Clearly, the Manitoba tax rate on dividend income is at a level that creates a disincentive for a Manitoba corporation to distribute wealth to its shareholders in the form of dividends.

As you are aware, to the extent that a corporation has refundable dividend tax on hand as a result of paying tax on its investment income, it receives a tax refund from the Federal government when it distributes dividends. This refund is fully or partially offset by the tax paid by the shareholder. In a perfectly integrated tax system, the refund to the corporation and the tax paid by the dividend recipient are equal, resulting in an overall tax neutral position where there is no tax benefit or cost related to the payment of a dividend. However, in practice, integration is less than perfect, depending on the level of actual tax rates.

This lack of integration may provide an opportunity to increase provincial revenues by encouraging the payment of dividends to Manitoba shareholders as a result of a decrease in the tax rate on dividends.

Specifically, a corporation is entitled to a Federal dividend refund of  $33\frac{1}{3}\%$  of its dividends paid, to the extent of its refundable dividend tax on hand. If the shareholder’s marginal tax rate on dividends is greater than  $33\frac{1}{3}\%$ , then there is little incentive for the shareholder to direct his or her corporation to pay dividends. By lowering the top tax rate on dividends below  $33\frac{1}{3}\%$ , Manitoba would be more competitive with other provinces and may actually increase provincial revenues as a result of the incentive to increase corporate dividend payouts to Manitoba resident shareholders.

While there may be reasonable integration within the dividend tax credit system for small businesses, the high rate of tax on dividend income in Manitoba encourages investment holding companies to move their wealth to other provinces where lower dividend income tax rates apply. We believe that there is an opportunity for Manitoba to retain that wealth and increase its share of the tax paid on that total wealth by taking advantage of the dividend tax system. By lowering the top tax rate on dividend income below  $33\frac{1}{3}\%$ , Manitoba would encourage the distribution of wealth in the form of dividends to individuals residing in Manitoba and increase the total tax base while it also reaps the economic benefits of greater discretionary spending by those individuals in Manitoba. Encouraging the movement of that accumulated wealth from the corporation to individual owners releases the funds back into the Manitoba economy while also triggering the payment of tax by individual Manitobans.

This concept is illustrated in Appendix I to this letter, which provides numerical examples comparing the effects of the current tax dividend tax credit system to an improved system which achieves better integration. The Appendix demonstrates the advantages of better integration and provides a persuasive argument in support of adopting a competitive improved dividend tax credit system for Manitoba.

And on a final note in this area, the recently announced Federal changes to the dividend tax credit system will exacerbate this lack of integration unless the provincial dividend tax credit system is revised as well. That recent Federal announcement underscores the importance of the need for changes to the Manitoba tax credit system.

### **Debt Reduction/Deficit Spending**

We continue to believe that our attractiveness to businesses, families and individuals is in part dependent on an ongoing disciplined approach to debt reduction. Therefore, we encourage a commitment to a realistic and systematic plan to pay down the provincial debt.

In summary, tax competitiveness and debt reduction must continue to be top priorities for this government. Manitoba offers an excellent quality of life that is dependent on a fair and competitive provincial tax system that supports a strong stable tax base and healthy economy. Balanced budgets and a realistic disciplined plan to reduce Manitoba's debt are imperative. Tax dollars spent on servicing debt are tax dollars that reduce our ability to support important social programs. Responsible debt reduction secures a healthy economy and social safety net for future generations of Manitobans. We support a continued long-term commitment to fiscal prudence and responsibility – a plan that emphasizes efficient and cost-effective service delivery.

Other, more specific issues are outlined below:

### **RETAIL SALES TAX ON CERTAIN SERVICES**

We continue to believe that the introduction of a retail sales tax on accounting and other services, including legal, architectural, engineering and security services is simply bad tax policy. The tax is overly complex, difficult to apply and has a cascading effect on businesses and the ultimate consumer in that taxes are charged on taxes.

The tax also represents yet another deterrent to attracting new businesses to Manitoba and has the potential to cause existing Manitoba businesses to relocate to more competitive provinces. This tax undermines the goal of making Manitoba more competitive with provinces such as Ontario, Alberta and British Columbia as it moves Manitoba closer to the "bottom of the pack".

Our experience since the introduction of the tax, especially as related to accounting services, has proven that the tax is overly complex and cannot be readily and fairly applied to an identifiable group of service providers. There is still a great deal of uncertainty and lack of clarity surrounding its application and confusion remains as to which services are taxable and which are exempt. Service providers' productivity has suffered as a result.

In addition, through our contact with the business community and our own experience we have noted that, as consumers of the taxed professional services, Manitoba businesses must now waste valuable time and human resources examining invoices from both Manitoba and out-of-province service providers. This additional expenditure of time and resources has become necessary in order to ensure that the tax has been applied correctly and to self-

assess when necessary. As a consequence, Manitoba business productivity in general has also suffered as a byproduct of the tax.

### **CORPORATION CAPITAL TAX**

We noted above that the existence and level of Corporation Capital Tax presents an issue related to tax competitiveness with some of our provincial neighbours. We also have two further concerns that are more technical in nature.

The first relates to the fact that the legislation governing corporation capital tax appears to contain an inequity in that interest is payable on a refund to a taxpayer only in certain circumstances (when an assessment has been raised), while interest is payable by a taxpayer in all instances where there is a late payment. The legislation should be revised to correct this anomaly.

The second concern has also been noted previously and continues to cause concern within Manitoba's business community. The lack of provisions to statute bar reassessments of several provincial taxes on business acts as an additional disincentive to do business in Manitoba. We understand that there is no legislated or published administrative policy that statute-bars reassessments of such provincial taxes as corporation capital tax, retail sales tax or "payroll tax". We also understand that notices of assessment are not issued for corporation capital tax unless adjustments are made as a result of an audit. This creates considerable uncertainty for business taxpayers, as filings may remain subject to audit and reassessment for an indefinite period of time. The need for certainty has become even more important, given that penalty rates related to these taxes have doubled in the past few years.

An additional consideration with respect to this issue is that the lack of such statute-barring provisions creates an environment in which there is potential for inefficiency in the audits of those taxes as there is no timeframe within which they must be completed. Such potential inefficiency has a negative impact on the government in two ways - the first being ineffective use of its scarce human and other resources with a resulting reduction in productivity and the second being undue delay in the reassessment and collection of taxes owing with a resulting negative impact on cash flow. From a taxpayer point of view, the lengthy delays create uncertainty, cause inefficient use of taxpayer resources and result in decreased productivity.

We acknowledge that Manitoba has indicated that it would publish the policy with respect to a six year limitation on audits of capital taxes and other taxes. We believe that the policy should be enshrined in the legislation to provide more certainty to Manitoba businesses.

Each of these concerns represents an opportunity for Manitoba to take relatively simple steps to create a more attractive business climate with nominal impact on provincial tax revenues.

### **INVESTMENT TAX CREDITS**

We were pleased to note that in last year's budget, a measure of fairness was introduced with respect to the retail sales tax on used production equipment. The introduction of an investment tax credit system will ease the burden of that tax on Manitoba businesses in the manufacturing sector.

We noted earlier that Manitoba has one of the most diverse economies in Western Canada and we believe that the tax system could be further improved to encourage business investment in other sectors of the economy as well. For example, the high tech and biotech sectors would benefit if scientific research and development tax credits were converted to refundable tax credits. Under the current system, those tax credits only have cash value to a

business if the business is in a taxable position. Many businesses that invest in scientific research are in the start up phase and are not taxable. Therefore, the tax credit generates no cash refund for further investment by these innovative businesses – the very ones that are most likely to benefit from cash to fund the research that will spawn future growth and revenue opportunities for the province.

In *MB Checkup 2005*, we noted that the number of Manitoba patents had dropped from 41.3 patents per million population in 2003 to 29.1 patents per million population in 2004. The report also showed that Manitoba had dropped from its position near the top of this indicator to the bottom when compared to the other provinces included in the study. This statistic is one indicator of the level of investment in research and innovation which creates future productivity gains in Manitoba. A tax system that provides much-needed cash to those businesses that invest in innovation would encourage growth in that sector of the Manitoba economy and contribute to improvements in Manitoba's productivity.

### **PERSONAL INCOME TAX**

We have previously raised some issues related to complexity in the personal tax system that we believe should be addressed.

For example, we continue to recommend that the same brackets should be used for the provincial system as have been established under the Federal system. In addition, we suggest that adopting the Federal basic personal exemption amounts would improve simplicity and transparency of the tax system.

Under our proposal for harmonization of the tax brackets, the Manitoba government would adopt the four Federal brackets, with a rate not higher than the current highest provincial rate being applied to the fourth bracket and a decreased rate being applied to the third bracket. This would ensure that taxpayers in the new fourth bracket would not be any worse off, while taxpayers in the third bracket would benefit from a further decrease in tax.

To underscore our concern, we note that several years have now passed since TONI was introduced and Manitoba's tax brackets and personal exemption levels were "de-linked" from the Federal brackets and exemptions. In that period, the disparity between them has grown to the point where some Manitoba taxpayers are increasingly disadvantaged by the resulting "mismatch".

For example, a Manitoba student is required to claim more tuition in order to offset Manitoba tax than must be claimed for Federal tax purposes. That student would not be at that disadvantage if the basic personal exemptions were harmonized. The impact of the mismatched personal exemptions on students is illustrated in Appendix II, together with an illustration of the difference in tuition tax credits for Manitoba and Alberta students.

The greater the tax disadvantage, the less attractive it is for students to remain in Manitoba and capitalize on the great educational opportunities that Manitoba offers – and students who move elsewhere to obtain their post-secondary education are less likely to work in Manitoba after graduation than those who obtain their education here. While it may seem that this tax disadvantage is a minor factor in comparison to the many factors that go into a Manitoba family's decision regarding a student's post-secondary education options, it is nonetheless an additional deterrent to a decision to stay in Manitoba. It can also be interpreted as an indication of the greater tax burden that the student can expect to face as a working Manitoban upon graduation, suggesting that there is even less reason to stay.

## **COST OF LIVING/ PROPERTY TAX CREDITS - LOW INCOME MANITOBANS**

Finally, one of our longstanding and ongoing concerns is that many low income Manitobans, in particular a large number of persons over 65 years of age, are required to file complicated income tax returns simply to claim the cost of living/property tax credit to which they are entitled.

We recognize that the Manitoba government faces many challenges in attempting to address this issue and that some steps have been taken to address it, but we believe that it is important enough to warrant ongoing consideration and review. We also continue to offer assistance in investigating possible means of simplifying the process of claiming these tax credits.

## **CONCLUSION**

In conclusion, we recognize and support your efforts to reduce the tax burden on Manitobans and to address some of the inequities in the taxation system. We continue to believe that further measures should be taken to address remaining inequities, particularly those related to the lack of integration between the Provincial and Federal brackets and personal exemptions and the dividend tax credit system. We remain concerned, from both policy and implementation perspectives, about the retail sales tax on certain professional services.

We urge you to develop a systematic plan to reduce both taxes and debt. We support a commitment to continued fiscal responsibility, in particular a continued commitment to balanced budgets and enhanced tax competitiveness. We are privileged as Manitobans to enjoy an affordable attractive lifestyle within a culture that has established the social well-being of all Manitobans as a top priority. Balanced budgets and a fair, competitive tax system continue to be the most important factors in developing Manitoba's long-term economic growth – growth which will secure the future of our important social services and affordable attractive lifestyle.

We have been pleased to provide our comments on these issues and we hope that you find them useful. We look forward to discussing these matters with you during our meeting scheduled for February 16 at 10:30 am.

Finally, since this document is provided pursuant to a public consultation process, we will provide it to others upon request. We also plan to make our comments available publicly as a follow up to the previously published *MB Check-Up Edition 2005*.

Thank you once again for your consideration of these matters.

Yours very truly,



Gus Campbell, FCA  
President



Gary Hannaford, FCA  
Chief Executive Officer

**Table A**  
**Corporate Tax Rates For December 31, 2005**

	General Rate %	Small Business Rate from \$300,000 to \$400,000 %	Small Business Rate up to \$300,000 %
Saskatchewan	39.12 <sup>(1)</sup>	39.12 <sup>(1)</sup>	18.12 <sup>(2)</sup>
<b>Manitoba</b>	<b>37.12 <sup>(2)</sup></b>	<b>27.12 <sup>(3)</sup></b>	<b>18.12 <sup>(2)</sup></b>
Ontario	36.12 <sup>(3)</sup>	27.62 <sup>(2)</sup>	18.62 <sup>(1)</sup>
British Columbia	35.62 <sup>(4)</sup>	26.62 <sup>(4)</sup>	17.62 <sup>(3)</sup>
Alberta	33.62 <sup>(5)</sup>	25.12 <sup>(5)</sup>	16.12 <sup>(4)</sup>

Note - For the 2005 taxation year the Federal and Saskatchewan small business income threshold is \$300,000. For the provinces of British Columbia, Alberta, Manitoba and Ontario the small business income threshold is \$400,000. As such, for these 4 provinces small business income between \$300,000 and \$400,000 is taxed at the general rate federally and the small business rate provincially.

**Table B**  
**Individual Top Marginal Tax Rates for 2005, 2004 and 2003**  
**Interest and Ordinary Income**

	2005 %	2004 %	2003 %
Newfoundland	48.64 <sup>(1)</sup>	48.64 <sup>(1)</sup>	48.64 <sup>(1)</sup>
Nova Scotia	48.25 <sup>(2)</sup>	48.25 <sup>(2)</sup>	47.34 <sup>(4)</sup>
Quebec	48.22 <sup>(3)</sup>	48.22 <sup>(3)</sup>	48.22 <sup>(2)</sup>
Prince Edward Island	47.37 <sup>(4)</sup>	47.37 <sup>(4)</sup>	47.37 <sup>(3)</sup>
New Brunswick	46.84 <sup>(5)</sup>	46.84 <sup>(5)</sup>	46.84 <sup>(5)</sup>
<b>Ontario</b>	<b>46.41 <sup>(6)</sup></b>	<b>46.41 <sup>(6)</sup></b>	<b>46.41 <sup>(6)</sup></b>
<b>Manitoba</b>	<b>46.40 <sup>(7)</sup></b>	<b>46.40 <sup>(7)</sup></b>	<b>46.40 <sup>(7)</sup></b>
<b>Saskatchewan</b>	<b>44.00 <sup>(8)</sup></b>	<b>44.00 <sup>(8)</sup></b>	<b>44.00 <sup>(8)</sup></b>
<b>British Columbia</b>	<b>43.70 <sup>(9)</sup></b>	<b>43.70 <sup>(9)</sup></b>	<b>43.70 <sup>(9)</sup></b>
Northwest Territories	43.05 <sup>(10)</sup>	42.55 <sup>(10)</sup>	42.05 <sup>(11)</sup>
Yukon	42.40 <sup>(11)</sup>	42.40 <sup>(11)</sup>	42.40 <sup>(10)</sup>
Nunavut	40.50 <sup>(12)</sup>	40.50 <sup>(12)</sup>	40.50 <sup>(12)</sup>
<b>Alberta</b>	<b>39.00 <sup>(13)</sup></b>	<b>39.00 <sup>(13)</sup></b>	<b>39.00 <sup>(13)</sup></b>

(1) denotes ranking from highest income tax cost to lowest.

**Table C**  
**Individual Single Taxpayer with Taxable Income in 2005**

	of \$40,000	of \$100,000
	Federal and Provincial Income Taxes \$	Federal and Provincial Income Taxes \$
Quebec	10,082 <sup>(1)</sup>	35,823 <sup>(1)</sup>
Newfoundland	9,387 <sup>(2)</sup>	34,865 <sup>(2)</sup>
<b>Manitoba</b>	<b>9,181 <sup>(3)</sup></b>	<b>33,124 <sup>(5)</sup></b>
Prince Edward Island	8,924 <sup>(4)</sup>	33,449 <sup>(3)</sup>
<b>Saskatchewan</b>	<b>8,901 <sup>(5)</sup></b>	<b>31,053 <sup>(7)</sup></b>
Nova Scotia	8,882 <sup>(6)</sup>	33,290 <sup>(4)</sup>
New Brunswick	8,843 <sup>(7)</sup>	32,674 <sup>(6)</sup>
<b>Ontario</b>	<b>7,920 <sup>(8)</sup></b>	<b>30,751 <sup>(8)</sup></b>
<b>Alberta</b>	<b>7,908 <sup>(9)</sup></b>	<b>28,261 <sup>(11)</sup></b>
Yukon	7,719 <sup>(10)</sup>	28,519 <sup>(10)</sup>
<b>British Columbia</b>	<b>7,471 <sup>(11)</sup></b>	<b>28,737 <sup>(9)</sup></b>
Northwest Territories	7,203 <sup>(12)</sup>	27,880 <sup>(12)</sup>
Nunavut	6,728 <sup>(13)</sup>	25,857 <sup>(13)</sup>

**Table D**  
**Federal and Provincial Income Tax**  
**2005 Top Marginal Rate on Dividend Income**

	2005 %	2004 %
Newfoundland	37.32 <sup>(1)</sup>	37.32 <sup>(1)</sup>
New Brunswick	37.26 <sup>(2)</sup>	37.26 <sup>(2)</sup>
<b>Manitoba</b>	<b>35.08 <sup>(3)</sup></b>	<b>35.08 <sup>(3)</sup></b>
Nova Scotia	33.06 <sup>(4)</sup>	33.06 <sup>(4)</sup>
Quebec	32.81 <sup>(5)</sup>	32.81 <sup>(5)</sup>
Prince Edward Island	31.96 <sup>(6)</sup>	31.96 <sup>(6)</sup>
<b>British Columbia</b>	<b>31.58 <sup>(7)</sup></b>	<b>31.58 <sup>(7)</sup></b>
<b>Ontario</b>	<b>31.34 <sup>(8)</sup></b>	<b>31.34 <sup>(8)</sup></b>
Northwest Territories	29.65 <sup>(9)</sup>	29.02 <sup>(9)</sup>
Nunavut	28.96 <sup>(10)</sup>	28.96 <sup>(10)</sup>
Yukon	28.64 <sup>(11)</sup>	28.63 <sup>(11)</sup>
<b>Saskatchewan</b>	<b>28.33 <sup>(12)</sup></b>	<b>28.33 <sup>(12)</sup></b>
<b>Alberta</b>	<b>24.08 <sup>(13)</sup></b>	<b>24.08 <sup>(13)</sup></b>

<sup>(1)</sup> denotes ranking from highest income tax cost to lowest.

**APPENDIX I  
COMPARISON OF CURRENT DIVIDEND TAX CREDIT SYSTEM TO IMPROVED SYSTEM**

**Example 1 – Current System**

Right now, an individual earning investment income directly in the form of interest or taxable capital gains pays tax at a rate of 46.4% at the top marginal rate. This tax is paid as follows:

<u>Tax per \$1,000 of Investment Income</u>		
<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
<u>\$ 174</u>	<u>\$ 290</u>	<u>\$ 464</u>

If that individual earned the income in a corporation, and the income were retained at the corporate level, the total refundable and non-refundable tax paid by the corporation would be at a total overall rate of 50.79% allocated as follows <sup>(1)</sup> :

<u>\$ 150</u>	<u>\$ 358</u>	<u>\$ 508</u>
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<sup>(1)</sup> The calculations are detailed below:

CORPORATE TAXES

	<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
Part I taxes	\$ 150	\$ 91	\$ 241
Refundable taxes		267	267
	<u>\$ 150</u>	<u>\$ 358</u>	<u>\$ 508</u>

In this situation, Manitoba earns \$150 of corporate tax on \$1,000 of income. The after-tax surplus is “trapped” in the corporation, because the directors determine not to distribute the surplus by way of taxable dividend to the shareholders.

If the corporation pays a dividend<sup>(4)</sup> to the individual so as to recover the refundable dividend tax, the total combined corporate<sup>(2)</sup> and personal<sup>(3)</sup> tax rate paid on that income would be at a top rate of 52.01%:

<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
<u>\$ 263</u>	<u>\$ 257</u>	<u>\$ 520</u>

<sup>(2)</sup> CORPORATE TAXES

	<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
Part I taxes	\$ 150	\$ 91	\$ 241
Refundable taxes		267	267
	150	358	508
Dividend refund on payment of \$738 dividend	-	(246)	(246)*
	<u>150^</u>	<u>112</u>	<u>262</u>

<sup>(3)</sup> PERSONAL TAX (on \$738 dividend at top marginal rate)

Basic	160	268	428
Dividend tax credit	(47)	(123)	(170)
	<u>113^</u>	<u>145</u>	<u>258**</u>
TOTAL TAXES	<u>\$ 263</u>	<u>\$ 257</u>	<u>\$ 520</u>

<sup>(4)</sup> Maximum dividend available to be paid is calculated as follows:

Gross corporate income	\$ 1,000
Corporate federal and Manitoba taxes	(508)
	492
Dividend refund available: (\$492 x 3/2 x 1/3)	246
TOTAL AVAILABLE SURPLUS	<u>\$ 738</u>

**APPENDIX I**  
**COMPARISON OF CURRENT DIVIDEND TAX CREDIT SYSTEM TO IMPROVED SYSTEM**  
(Continued)

The taxpayer is not motivated to distribute corporate surplus, because the personal tax payable of \$258\*\* exceeds the federal dividend tax refund of \$246\* received by the corporation. For this reason, dividends are seldom paid out to distribute corporate surplus. This surplus is “trapped” within the corporation, with most of the tax being “prepaid” at the federal level. Manitoba receives only \$150^ of corporate tax per \$1,000 of investment income. The other \$113^ of Manitoba personal tax is deferred while the surplus is retained in the corporation.

The above-noted comparison indicates that there is considerable “slippage” associated with earning investment income through a corporation as compared with earning that income directly at the personal level. There is not perfect integration in the tax system for corporations and their shareholders. Although perfect integration is not easy to achieve, a significant gap between tax payable on investment income earned directly as compared to tax payable on income earned through a corporation results in the retention of corporate surpluses.

This analysis and rate comparison indicates that there is a disincentive for Manitoba corporations to pay investment income through to shareholders in the form of dividends because additional net taxes will be paid as a result of doing so; i.e. the overall effective tax rate increases from 50.8% to 52.0%.

We believe that there are some distinct advantages to Manitoba that would be associated with a change that brings the combined tax rate on investment income flowed through a corporation to something less than 50.8%. Not only would such a change make the overall tax rate more competitive, it would also provide an incentive for Manitoba corporations to pay dividends to their shareholders, resulting in an increase in Manitoba tax revenues.

Such a situation could be created where the Manitoba provincial government enhances the provincial dividend tax credit to ensure that the tax payable at the top personal bracket is less than the federal 33<sup>1/3</sup> % refundable dividend tax credit. This can be achieved by increasing the provincial dividend tax credit from 5% to 10% of the grossed-up dividend received by the taxpayer.

The effect of this improvement to the provincial dividend tax credit rate is illustrated by the example on the next page.

**APPENDIX I**  
**COMPARISON OF CURRENT DIVIDEND TAX CREDIT SYSTEM TO IMPROVED SYSTEM**  
(Continued)

**Example 2 – Improved System**

This example demonstrates the tax result to an individual where a corporation earns \$1,000 of investment income and distributes its tax paid surplus by way of a taxable dividend to the individual. For purposes of the example, a Manitoba dividend tax credit of 10% of the grossed-up dividend or 12.5% of the actual dividend has been assumed.

	<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
Tax on \$1,000 of investment income earned personally:	<u>\$ 174</u>	<u>\$ 290</u>	<u>\$ 464</u>

Under the proposed improved system, if the corporation pays a dividend<sup>(4)</sup> to the individual so as to recover the refundable dividend tax, the total combined corporate<sup>(5)</sup> and personal<sup>(6)</sup> tax rate paid on that income would be:

	<u>\$ 218</u>	<u>\$ 257</u>	<u>\$ 475</u>
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<sup>(5)</sup> CORPORATE TAX

	<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
Part I taxes	\$ 150	\$ 91	\$ 241
Refundable taxes	<u>150</u>	<u>267</u>	<u>267</u>
		358	508
Dividend refund on	-	<u>(246)</u>	<u>(246)*</u>
Payment of \$731 dividend	<u>150</u>	<u>112</u>	<u>262</u>

<sup>(6)</sup> PERSONAL TAX (on \$738 dividend at top marginal rate)

Basic provincial tax	160	268	428
Dividend tax credit	<u>(92)</u>	<u>(123)</u>	<u>(215)</u>
	68 <sup>^</sup>	<u>145</u>	<u>213**</u>
TOTAL TAXES	<u>\$ 218</u>	<u>\$ 257</u>	<u>\$ 475</u>

In this situation, the taxpayer is now motivated to distribute corporate surplus, since the total personal taxes payable of \$213\*\* is less than the federal dividend tax refund of \$246\* received by the corporation.

Note that Manitoba would now receive \$68<sup>^</sup> of additional provincial taxes on a taxable dividend of \$738. The federal tax position is uncompromised, since it still collects the same \$257 of tax on \$1,000 of investment income earned by the corporation and flowed through to its shareholders.

**APPENDIX I**  
**COMPARISON OF CURRENT DIVIDEND TAX CREDIT SYSTEM TO IMPROVED SYSTEM**  
(Continued)

There are also further benefits in following this strategy, where a corporation receives dividend income. Currently, dividends received by a corporation are subject to a Federal Part IV tax of 33<sup>1/3</sup>%. Since Manitoba's tax regime on dividends discourages distribution, a change to a more integrated rate structure should actually increase tax revenues to Manitoba. This is outlined below:

Tax on \$1,000 of Dividend Income

	<u>Manitoba</u>	<u>Federal</u>	<u>Total</u>
Corporate taxes	<u>\$ -</u>	<u>\$ 333</u>	<u>\$ 333</u>

If the \$1,000 dividend is distributed, the actual tax allocation would be as follows:

Personal taxes on \$1,000 dividend	<u>\$ 92</u>	<u>\$ 196</u>	<u>\$ 288</u>
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Manitoba's tax revenues would increase by \$92 for every \$1,000 of dividend income generating a refund of Federal Dividend Tax on Hand.

The advantages of this initiative are as follows:

1. Overall integration is generally maintained in the Canadian tax system. A taxpayer resident in Manitoba earning investment income would pay \$508 per \$1,000 if maintained in the corporation as compared to \$475 if distributed and taxed at the personal level and \$464 if earned directly (and not through a corporation). This adjustment levels the playing field.
2. The federal tax position is uncompromised.
3. There is an opportunity for Manitoba to increase its tax revenues, since there would now be a preference to pay investment income to individual shareholders for a number of reasons, including estate planning and the reduction of corporate valuations which would otherwise create a potential for "double taxation" at death. Also there would be an incentive to extract surplus for personal consumption, investment, or wealth realization – and increasing cash flow into the economy benefits everyone.
4. Manitoba's top tax rate on dividends would now be more competitive with other provincial jurisdictions at 28.8%, instead of the current 35.08% rate. The 28.8% rate correlates closely with Saskatchewan's rate of 28.33%. This will also help to prevent an outflow or export of corporate structures to lower taxed provincial jurisdictions.
5. A more competitive tax rate on dividend income will also provide a more level playing field in terms of the comparative after tax yield on capital gains, which are currently taxed at 23.2%.

**APPENDIX II**  
**COMPARISON OF PROVINCIAL TUITION TAX CREDITS**  
(based on tax rates for 2004)

	<u>Federal</u>	<u>Manitoba</u>	<u>Alberta</u>
<b>A. Student with \$9,500 employment income</b>			
Taxable income	\$9,500.00	\$9,500.00	\$9,500.00
Modified taxable income	1,002.90	1,380.90	--
Required tuition deduction	1,002.90	1,380.90	--
Additional tuition carryforward	378.90	--	1,380.90

For Manitoba tax purposes, the student is required to claim \$378.90 more tuition than for Federal purposes in order to reduce Manitoba taxes to nil. By comparison, the Alberta student need not claim any tuition at all.

**B. Student with \$9,500 employment income, \$10,000 dividends (\$12,500 taxable) and \$7,178 tuition**

Taxable income	\$22,000.00	\$22,000.00	\$22,000.00
Modified taxable income	13,502.00	13,880.00	7,178.00
Required tuition deduction	7,178.00	7,178.00	7,178.00
Tax payable	--	100.62	--

The Manitoba student claims the entire amount of tuition to reduce Federal tax to nil, but must still pay Manitoba tax. In this case, the Alberta student pays neither Federal nor Alberta tax.

**C. Student with \$9,500 employment income, \$10,000 other income and \$7,178 tuition**

Taxable income	\$19,500.00	\$19,500.00	\$19,500.00
Required tuition deduction	7,178.00	7,178.00	4,678.00
Additional tuition carryforward	--	--	2,500.00
Tax payable	612.00	428.00	--

The Manitoba student must pay Federal and Manitoba tax, while the Alberta student pays no Alberta tax and still has tuition left to claim.