

# BUDGET

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May 2, 2006

## FEDERAL BUDGET SPEECH OF MAY 2, 2006

- Tax measures
- Economic Viewpoint



**Desjardins**

Office of the vice-president, Tax Service  
Office of the Vice-president, Economic Studies



May 2, 2006

This afternoon, Minister of Finance James Flaherty tabled the first Conservative budget, that of fiscal 2006-2007. As promised, the budget introduces a cut in the GST rate that will go from 7% to 6% effective July 1, 2006, as well as a \$100 monthly taxable benefit for the care of a child under age 6 effective July 2006.

In addition, this budget proposes a cut in the corporate tax rate and confirms the measures proposed by the previous government with respect to dividends. Lastly, some adjustments are brought to personal income tax, including a slight tax increase, an employment credit and another credit for public transit passes.

### Highlights

#### General Measure

- . GST cut from 7% to 6% effective July 1, 2006

#### Mesure affecting Desjardins – Corporate

- . Lower corporate income tax rate
- . Higher business limits
- . Elimination of the corporate surtax
- . Decrease of the reduced corporate tax rate
- . Elimination of the federal capital tax

#### Mesures affecting individuals

- . Increase of the basic tax rate and the conversion rate of personal tax credits
- . Decrease of the basic personal amount
- . Canada employment credit
- . Universal child care benefit
- . Tax credit for public transit passes
- . Large corporation dividends
- . Pension income credit
- . Children's fitness tax credit
- . Bursaries and scholarships
- . Tax credit for textbooks
- . Capital gains for fishers
- . Deduction for tools
- . Flow-through shares
- . Publicly-listed securities and ecologically sensitive land
- . Child disability benefit
- . Administrative provisions

#### Mesures affecting businesses

- . Measures described in the Desjardins–Corporate section
- . Apprenticeship job creation tax credit
- . Capital cost allowance for tools
- . Carry-forward period for non-capital losses and investment tax credits
- . Dividends from agricultural cooperatives



May 2, 2006

### GENERAL MEASURE

The federal government announces a cut in the GST rate to 6% effective July 1, 2006. Transitional measures are planned for the application of this measure. In short, if the GST is not payable or paid before July 1, the applicable rate will be 6%, while it will be 7% if the tax is paid or payable before this date. In general, the tax becomes payable upon production of the invoice.

Desjardins entities that are financial institutions do not generally recover the GST that they pay on their purchases. So, given this cut, it would be worth while to

delay some purchases of goods and services after the month of June.

For businesses that are not financial institutions and that generally claim GST on their purchases, the main effect of this measure will be to change their billing system for July 1, 2006.

For individuals, this cut will have a net effect of 1.075% given that the Québec sales tax (TVQ) is applied on the GST.

### MESURES AFFECTING DESJARDINS - CORPORATE

#### Lower Corporate income Tax Rate

The general corporate tax rate that currently stands at 21% will be brought back to 20.5% effective January 1, 2008, to 20% effective January 1, 2009 and to 19% effective January 1, 2010.

This cut will be calculated with proration for taxation years that include those dates.

However, the lower general corporate income tax rate does not apply to the following types of income: income already benefiting from the small business deduction or the additional deduction for credit unions and the investment income of Canadian-controlled private corporations, which is eligible for a special refundable tax.

#### Higher Business Limit

The business limit that is eligible for the reduced corporate tax rate will be increased from \$300,000 to \$400,000 effective January 1, 2007.

The increase in the business limit will be calculated with proration for the taxation years that include January 1, 2007.

#### Elimination of the Corporate Surtax

The corporate surtax will be eliminated for all corporations effective January 1, 2008. The legislation already adopted allowed for this surtax to be eliminated in 2008, but only for small and medium businesses.

The elimination of the corporate surtax will be calculated with proration for the taxation year that include January 1, 2008.

#### Decrease of the Reduced Corporate Rate

The reduced corporate tax rate, which currently stands at 12%, will be brought back to 11.5% effective 2008 and to 11% effective 2009. The reduced rate applies to income that is eligible for the small business deduction or the additional deduction for credit unions.

The decrease of the reduced or rate will be calculated with proration for the taxation years that include those dates.

	Current rates	Proposed rates		
		2008	2009	2010
Reduced rate	13.12 <sup>1</sup>	11.5	11	11
Basic rate	22.12 <sup>1</sup>	20.5	20	19

1 : including the surtax

### **Elimination of the Federal Capital Tax**

It is proposed to eliminate the federal capital tax retroactively to January 1, 2006, i.e. 2 years earlier than planned.

The elimination of the federal capital tax will be calculated with proration for the taxation years that include January 1, 2006.

## **MESURES AFFECTING INDIVIDUALS**

### **Increase of the Basic Tax Rate and Conversion Rate for Personal Tax Credits**

In November 2005, the Liberal government rushed an economic update in which it announced a decrease of the conversion rate of tax credits and the minimum tax rate, decreasing it from 16% to 15% retroactively to January 1, 2005.

This budget increases the rates from 15% to 15.5% effective July 1, 2006, bringing the actual rates to 15.25% for 2006. Taking into account the decrease of the basic tax credit, this is equivalent to an additional tax of \$83 per year for each Québec taxpayer who earned income equal to or above \$36,378. The additional cost is \$99 for the residents of other provinces.

For 2007 and the following years, the basic tax rate will remain at 15.5%.

### **Decrease of the Basic Personal Amount**

At the same time, the former Liberal government had announced an increase in the basic personal amount of \$500 for 2005, raising it from \$8,148 to \$8,648. After indexation, it gave Canadians a basic exemption of \$9,039 effective January 1, 2006.

We learned that the \$9,039 will be brought back to \$8,639 on July 1, 2006, which means \$8,839 for the year. To determine the basic amount for 2007, the \$8,639 amount will first be indexed to take inflation into account and then an amount of \$100 will be added. The same method will be applied in 2008, but the amount added will be \$200. For 2009, sources confirm that the basic personal amount will not be lower than \$10,000.

Similar adjustments are brought to the credit for a spouse. Accordingly, effective July 1, 2006, this credit will be brought back from \$7,675 to \$7,335, which means an amount of \$7,505 for the year.

### **Canada Employment Credit**

Effective July 1, 2006, the government announces the introduction of the Canada employment credit. This credit will allow employees to benefit for 2006 from a tax credit on a maximum amount of \$250, i.e. a tax cut that can reach \$32 per year for Québec residents (\$38 in other provinces). For 2007, the tax credit will be calculated on an employment income that can reach \$1,000. This amount will be indexed effective 2008.

### **Universal Child Care Benefit**

A awaited measure of this budget is the introduction of the universal child care benefit. Effective July 2006, each family with a child under age 6 will receive \$100 per month per child.

Please note that this amount will be taxable in the hands of the lower-income spouse.

This assistance will reduce the child tax benefit for children under age 6. This non-taxable amount can reach \$1,945 for low-income Canadians.

### **Tax Credit for Public Transit Passes**

The budget proposes the introduction of a non refundable tax credit for the cost for monthly public transit passes or passes of a longer duration. The credit rate will be 15.25% for 2006 and 15.5% effective 2007. The credit can be claimed by the individual in respect of eligible transit costs of the individual, the individual's spouse or dependent children under 19 years of age

This measure will apply in respect of the cost of public transit passes for periods after June 2006.

## Large Corporation Dividends

The budget confirms the government's intention to proceed with measures consistent with those announced on November 23, 2005, which would enhance the gross-up and the dividend tax credit for eligible dividends. Eligible dividends will generally include dividends paid after 2005 by public corporations (and other corporations that are not Canadian-controlled private corporations (CCPCs)) that are resident in Canada and subject to the general corporate income tax rate. In addition, CCPCs will be able to pay eligible dividends to the extent that their income (other than investment income) is subject to tax at the general corporate income tax rate.

Specifically, in respect of eligible dividends, shareholders will include 145% of the eligible dividend amount in income (that is, a 45 percent gross-up), and the federal dividend tax credit with respect to eligible dividends will be approximately 19 per cent of the grossed-up amount (reflecting the general corporate income tax rate that will apply beginning in 2010).

## Pension Income Credit

Effective 2006, the eligible amount for the tax credit for pension income will increase from \$1,000 to \$2,000.

## Children's Fitness Tax Credit

Effective 2007, the budget proposes the introduction of a non refundable credit for eligible expenses for a child under the age of 16 enrolled in a physical activity program, up to \$500. The credit will be calculated at a 15.5% rate and can be claimed by either parent. However, this credit cannot be claimed for amounts for which the deduction for child care was claimed.

## Bursaries and Scholarships

Currently, the first \$3,000 of bursary, a scholarship or a fellowship income are not taxable.

The budget proposes to fully exempt all bursary, scholarship or fellowship income effective 2006.

## Textbook Tax Credit

Effective 2006, post-secondary students will now be able to count on a new non refundable tax credit for textbooks. This credit will be equal to \$65 for each month for which the student qualifies for the full-time education tax credit amount and of \$20 for each month the student qualifies for the part-time education tax credit.

## Capital Gains for Fishers

Currently, the tax relief available for the transfer of agricultural property does not apply to fishing firms.

Under certain conditions, this budget proposes to first grant a tax deferral when a "fishing property" of an individual is transferred to a child or grandchild of an individual. "Fishing property" will be land, depreciable property and eligible capital property that is used principally in a fishing business carried on in Canada in which the individual, or the individual's spouse or common-law partner, parent, child or grandchild, was actively engaged on a regular and continuous basis. It will also include shares of the capital stock of family fishing corporations and interests in family fishing partnerships.

This budget measure proposes that an individual be allowed access to the \$500,000 lifetime capital gains exemption in respect of capital gains arising on a disposition of "qualified fishing property." "Qualified fishing property" will include real property, fishing vessels and eligible capital property, such as an interest in a fishing licence, used principally in a fishing business carried on in Canada in which the individual, or the individual's spouse or common-law partner, parent, child or grandchild, was actively engaged on a regular and continuous basis.

Lastly, similar to the rule governing agricultural property, a maximum 10-year period will be granted to fishers in respect of the part of the proceeds of disposition that the individual has not yet received as a result of the disposition of a "fishing property."

## Tool Deduction

The government recognizes that many employed tradespeople must provide their own tools as part of their job. For this reason, the budget proposes that the cost of eligible new tools purchased on or after May 2, 2006 by an employed tradesperson in excess of \$1,000 be deductible up to a maximum of \$500.

The employer will be have to certify that the employee is required to purchase such tools as a condition of the employment.

### **Flow-through Shares**

The government proposes to reintroduce the tax credit for mineral exploration with respect to flow-through share agreements reached for the period between May 2, 2006, and April 1, 2007. The rate will be equal to 15% of the specific mineral exploration expenses carried out in Canada, which the corporation will have given up in favour of the investors.

### **Publicly Listed Securities and Ecologically Sensitive Lands**

Currently, the capital gains inclusion rate for charitable donations of listed publicly-traded securities and ecologically sensitive land is cut in half to 25 per cent.

To encourage additional such donations, Budget 2006 proposes to reduce the capital gains inclusion rate for such donations made effective May 2, 2006, to zero.

In addition, an individual who makes a qualifying charitable donation of listed publicly-traded securities that were acquired with employee stock options has also been eligible for a special deduction that has the effect of taxing the associated employment benefit at a 25% rate. Budget 2006 also proposes to reduce the effective inclusion rate for such donations made effective May 2, 2006, to zero per cent.

### **Child Disability Benefit**

The Child Disability Benefit (CDB) is part of the Canada Child Tax Benefit (CCTB) and is payable in respect of low- and modest-income families eligible for the disability tax credit.

Currently, the maximum amount of the CDB is \$2,044 annually per eligible child. This amount is gradually cut declining to zero as the family income reaches a threshold, depending on the number of children.

Effective July 2006, to improve the CDB, the budget proposes the following changes:

- the annual limit will increase from \$2,044 to \$2,300;
- the income thresholds will be increased; and
- the reduction rates will be decreased.

### **Administrative Provisions**

In addition, Budget 2006 confirms the adoption of measures that had been proposed in the previous budgets but had not been adopted. The main measures involved are the following:

- a new adoption tax credit
- adoption of the recommendation of the Technical Advisory Committee on Tax Measures for Persons with Disabilities concerning the eligibility criteria for the disability tax credit and the expenses eligible for the disability supports deduction
- expansion of the list of expenses eligible for the medical expenses tax credit and clarification of the eligibility of home renovation and construction expenses
- doubling of the amount of disability-related and medical expenses that can be claimed by a caregiver.

## MEASURES AFFECTING BUSINESSES

### Measures Described in the Desjardins-Corporate Section

The following measures apply to all businesses:

- reduction of corporate income tax rate
- higher business limit
- elimination of the corporate surtax
- reduced corporate tax rate
- elimination of the federal capital tax

### Apprenticeship Job Creation Tax Credit

A new tax credit for the creation of jobs for apprentices is introduced. Eligible employers are entitled to a non refundable tax credit equal to 10% of the salary and wages paid to qualified apprentices effective May 2, 2006. The maximum annual amount of the credit is \$2,000 per apprentice.

### Capital Cost Allowance for Tools

Currently, tools that cost less than \$200 are eligible for a capital cost allowance of 100% (category 12). Tools that cost more than \$200 are eligible for a capital cost allowance of 20% (category 8).

The budget proposes that the amount eligible for the 100% capital cost allowance be increased from \$200 to \$500 for tools purchased after May 2, 2006.

The same goes for the cost of kitchen utensils and medical or dental instruments.

### Carry-Forward Period for Non-capital Losses and Investment Tax Credits

The carry-forward period for non-capital losses will be extended from 10 to 20 years for all taxpayers.

In addition, the carry-forward period for investment tax credits will be extended from 10 to 20 years.

### Dividends from Agricultural Cooperatives

This budget reintroduces the measures announced previously with respect to the deferral of tax on some dividends paid after 2005 by agricultural cooperatives.

## Federal Budget

### Comments on the 2006 Federal Budget

**A budget patterned  
on the Conservative campaign promises**



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## A budget patterned on the Conservative campaign promises

### Highlights

The first budget of the Conservative government of Stephen Harper and Finance minister James Flaherty introduces a new type of involvement for the federal government in comparison with previous governments. While trying to please a wide range of Canadians, this budget is also in line with the promises made by the Conservative Party during the last election campaign. Many measures to cut the tax burden of businesses and individuals have been introduced. It is also an ambitious budget with over \$35B in new initiatives over 2 years. Like the budgets tabled by the Liberals, it aims to be balanced and to reduce the government's debt. Moreover, it sets the stage for a dialogue along with immediate measures aimed at rectifying the fiscal imbalance.

- Over 2 years, the budget proposes close to \$20B in tax relief for individuals, including a cut of one percentage point on the goods and services tax. However, in comparison with the current 15% rate, the first tax bracket will increase to 15.5% next July.
- To stimulate employment, growth and competitiveness, the Conservative government is proposing several initiatives to cut corporate taxation.
- The federal government is determining a specific approach to rectify the fiscal imbalance in Canada.
- The budget earmarks \$8B for debt reduction in 2005-2006 and \$3B during the next fiscal years. The debt-to-GDP ratio should decrease from 38.7% in 2004-2005 to 31.7% in 2007-2008.
- The budget plan is based on realistic and conservative economic assumptions. However, Minister Flaherty is dropping the contingency reserve and the reserve for economic prudence.

SUMMARY OF BUDGETARY TRANSACTIONS					
In billions of \$	2003-2004	2004-2005	2005-2006f	2006-2007f	2007-2008f
Budgetary transactions:					
<b>Budgetary revenues</b>	198.9	211.9	220.9	227.1	235.8
- Variance (%)	4.4	6.6	4.2	2.8	3.8
<b>Program spending</b>	-154.2	-176.3	-179.2	-188.8	-196.5
- Variance (%)	5.5	14.4	1.6	5.4	4.1
<b>Operating balance</b>	44.7	35.6	41.7	38.3	39.3
<b>Public debt charges</b>	-35.8	-34.1	-33.7	-34.8	-34.8
- Variance (%)	-4.0	-4.6	-1.2	3.3	0.0
<b>Projected reduction of the debt</b>	---	-1.5	-8.0	-3.0	-3.0
<b>Budgetary balance</b>	8.9	0.0	0.0	0.6	1.4
Non-budgetary transactions					
Financial source and requirements	-2.6	3.3	-2.7	-6.0	1.7
Ratio of program spending to GDP (%)	12.7	13.7	13.1	13.0	13.0
Ratio of budgetary balance to GDP (%)	0.7	0.1	0.0	0.0	0.1
Ratio of debt charges to budgetary revenues (%)	18.0	16.1	15.3	15.3	14.8
Debt representing accumulated deficits	495.9	494.4	486.4	483.4	480.4
Debt-to-GDP ratio (%)	40.8	38.3	35.5	33.3	31.7
f: forecasts					
Source: Departement of Finance of Canada					

## Budget analysis

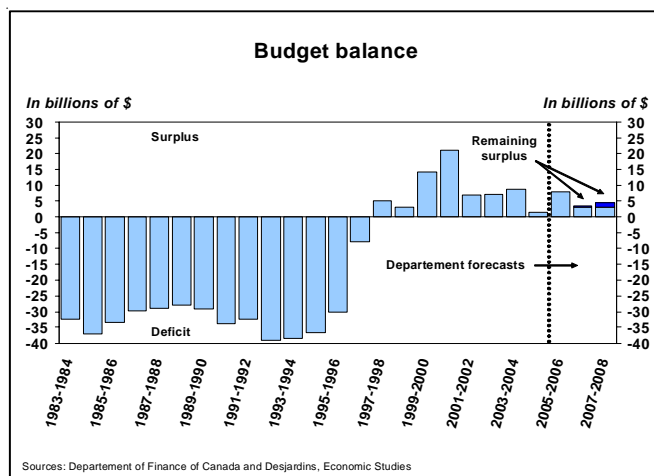
### The tradition of prudence is maintained

Once again, today's budget shows to the degree of financial leeway that the federal government has. Economic growth that is more solid than anticipated, strong corporate profits and soaring revenues from fuel taxes generated higher than anticipated budget revenues. So, even when taking into account the new initiatives announced today, the minister of Finance is anticipating a surplus of approximately \$8B for the fiscal year ended last March 31. If the final results that will be published next fall are similar to these forecasts, the federal government's debt should go down by \$8B in 2005-2006.

In general, the first Conservative government budget maintains the tradition of prudence adopted by the Liberals over the last few years. The economic assumptions used in drawing up the budget are realistic, although the forecasts on the growth of nominal GDP are slightly lower than our own and anticipated interest rates in 2006 and 2007 are slightly higher. Accordingly, the minister of Finance's scenario probably underestimates budgetary revenues and overestimates the costs related to the debt, which shows some prudence on the part of Minister Flaherty.

Even if the outlook for the Canadian economy is relatively good, one must keep in mind that some risks are still present and as a result, we are not completely sheltered from economic setbacks. The existence of global imbalances, the uncertainty in the American real estate market, a strong appreciation of the loonie, the increase in energy costs and the prices of other raw materials are so many factors that could lead to a slowdown in the global and Canadian economy in 2006 and 2007.

Following a 14.4% increase in 2004-2005 due mostly to higher transfers to provinces, and growth of only 1.6% in 2005-2006, the progress of program spending should now match that of the economy, i.e. 5.4% in 2006-2007 and 4.1% in 2007-2008. With respect to budgetary revenues, the many initiatives included in this budget (like the GST cut for instance) should curb their increase in such a way that the Department anticipates that it will show significantly lower growth than that of the economy.



Sources: Department of Finance of Canada and Desjardins, Economic Studies

As for debt service charges, the anticipated increase in interest rates, according to the budget plan, should lead to a slight increase in 2006-2007 and in 2007-2008. Bear in mind that public debt charges have decreased markedly over the past few years due to the combined effect of the lower interest rates and the gradual repayment of the federal debt. Even so, the ratio of debt charges to budgetary revenues should keep going down and reach 14.8% in 2007-2008 compared with 1995-1996 when it peaked at 35.2%.

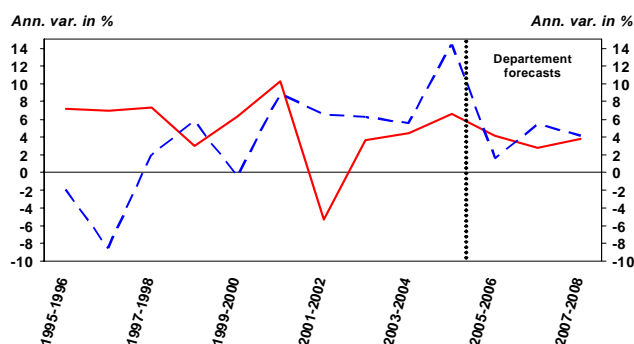
### Economic and financial forecasts

	2005	2006 Forecasts		2007 Forecasts	
		Budget	Mouvement Desjardins	Budget	Mouvement Desjardins
Nominal GDP Canada (%)	6.1	6.0	6.3	4.6	5.1
Real GDP Canada (%)	2.9	3.0	3.0	2.7	2.8
GDP deflator Canada (%)	3.2	3.0	3.2	1.9	2.2
Treasury bills 3-month (%)	2.70	4.00	3.90	4.10	3.60
Canadian bonds 10-year (%)	4.10	4.40	4.20	4.50	4.10
Unemployment rate (%)	6.8	6.6	6.6	6.6	6.6

Note: For all indicators, the data represents annual averages.

Sources: Department of Finance of Canada and Desjardins, Economic Studies

### Growth of program spending and budgetary revenues



Sources: Department of Finance of Canada and Desjardins, Economic Studies

It should also be noted that minister Flaherty is replacing the contingency reserve established by the Liberals with an announced reduction of the federal debt. However, the size of the anticipated repayment is identical to the former Liberal contingency reserve, i.e. \$3B per year, so that in the end, these 2 ways of doing things are similar and meet, as it were, the same objective. Unlike the Liberals, the Conservative government is dropping the reserve for economic prudence. This measure is not as necessary since minister Flaherty's projections only apply for two budget years, in comparison with five during the Liberal years.

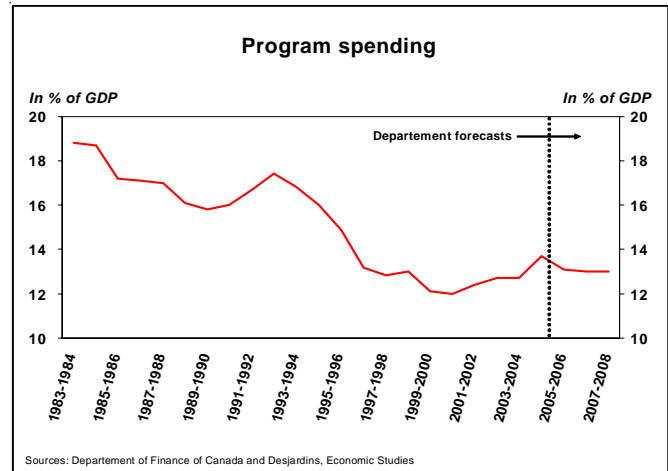
### A range of new measures targeting both businesses and individuals

Most new measures presented by the minister of Finance are in line with the campaign promises of Stephen Harper and the Conservative Party. There are in fact very few real surprises and most measures are aimed at easing the tax burden of individuals and businesses.

For individuals, the goods and services tax (GST) will, as promised, be cut from 7% to 6% effective July 1, 2006. By 2007-2008, this measure will have cost \$8.7B to the federal government. Minister Flaherty is also committed to creating a new \$500 employment credit effective July 1, that will increase to \$1,000 on January 1, 2007. However, he finances part of these measures by raising the lowest tax rate to 15.5% in July. Bear in mind that it had been cut to 15% by the Liberals for 2005 and 2006 in the fall 2005 Budget update. The new government is also cutting back part of the increase in the basic personal amount announced by minister Goodale: after increasing considerably in January, this amount will be cut by \$400 on July 1. Other more minor and targeted measures are also included in this budget, namely for pensioners, students and public transit users.

The budget introduces a Universal Child Care Benefit that will provide \$100 per month to all families for each child under age 6 effective July 1. Over 2 years, this measure will cost \$3.7B. The government is also setting aside \$250M to create daycare spaces.

For businesses, the budget tabled by Minister Flaherty is definitely looking to increase their competitiveness by significantly easing their tax burden. Accordingly, the general tax rate on corporate income will go down from 21% to 19% by 2010. While the corporate surtax was slated to be eliminated in 2008 for SMEs, it will in fact be eliminated for all corporations. Federal capital tax will also be eliminated, but two years earlier than what had been announced by the former government, i.e. retroactively to January 1, 2006.



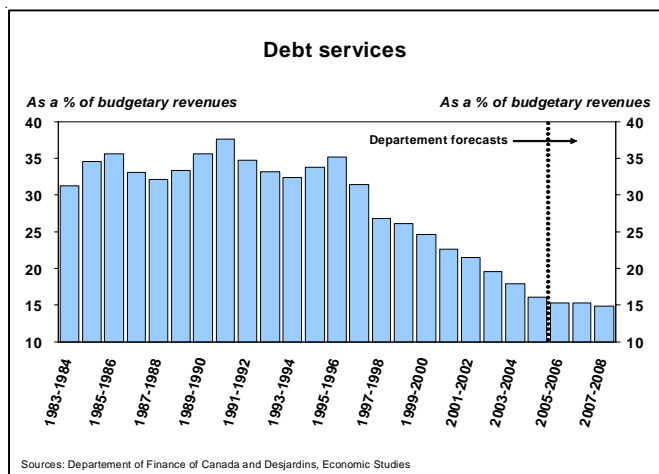
More specific measures are aimed at small businesses, such as the \$100,000 increase in the amount of business income eligible for the reduced tax rate and the lower tax rate. In addition, the Conservatives renewed the Liberal measure aimed at eliminating double taxation of large corporation dividends. Assistance programs and tax credits for specific economic sectors were also introduced.

National security and strengthening Canada's role in the world are major concerns of the new government. It is allocating an additional \$2.6B over 2 years for these concerns, in particular to hire RCMP officers, secure borders and increase pandemic preparedness. Over \$5B will be allocated to the Canadian Forces in the next 5 years.

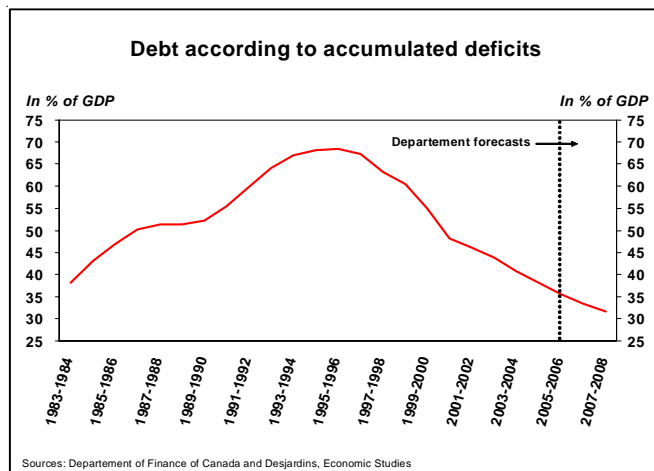
While the Chrétien and Martin governments did not recognize it, the fiscal imbalance is a real challenge for the current administration. It is pointing out in its budget documents that it is determined to find an overall solution to this issue. The Harper government is also committed to taking immediate measures to this effect. In the short term, the minister of Finance will pay \$3.3B to the provinces and territories through 5 trusts associated with specific urgent needs: post-secondary education (\$1,000M), public transit (\$900M), affordable housing (\$800M), affordable housing in the North (\$300M) and off-reserve Aboriginal housing (\$300M). Québec should get approximately \$671M of the total amount. The federal government is also committed to paying an additional \$255.4M to some provinces for equalization in 2006-2007 (including \$185M for Québec). In the coming year, the Harper government is aiming to take other measures with the provinces to develop new approaches in the allocation of federal budgetary surpluses to the renewal of equalization, long-term support for post-secondary education and training and the funding of infrastructure programs.

## Impacts on capital markets

Given that the new government is maintaining a balanced budget and that the Minister of Finance will tackle the debt through \$3B payments every year, the capital markets should be satisfied with this first Conservative budget. With respect to its overall financial situation, Canada should keep performing well in comparison with other leading economies.



Investors will also appreciate that a number of new measures are tackling the corporate tax burden while limiting growth in program spending. Given that one of the main risks weighing on the Canadian economy is the strong appreciation of the Canadian dollar, the measures dealing with increased competitiveness for local businesses are well received. Applying the measure already announced by the previous government on eliminating the double taxation of large corporation dividends should also please shareholders of Canadian corporations.



## Conclusion: A budget that will please Canadian voters

In short, the Harper government's first budget respects the main Conservative direction with a host of new measures and initiatives affecting both individuals and businesses. With this budget, the Conservatives are obviously looking to increase their support among Canadian voters, especially in Québec.

Yet, the economic efficiency of the GST cut can be questioned. It should be noted that most economists believe that consumption taxes are more effective than income taxes. Not only is Canadian income tax relatively high, but it is often considered as a work disincentive. High income taxes are also less effective from the standpoint of productivity as it curbs savings, investment and job creation up to a point.

### Impact of the GST cut

- The 7% to 6% cut in the GST will come into effect on July 1, 2006. Under the transitional rules, if a purchase is made by June 30, the 7% rate will apply if the tax is paid or becomes payable before July 1.
- The Department of Finance believes that this measure will cost \$3.5B in year 2006-2007, as the GST cut will only come into effect in the fourth month of this fiscal year and to \$5.2B in fiscal 2007-2008.
- Since the amounts subject to the Québec sales tax include GST payments, its cut to 6% should bring a shortfall of approximately \$100M per year for the government of Québec. However, the Charest government could decide to recover part of the tax room made available by the federal government by adjusting its own sales tax. Accordingly, a 1% increase in the QST would add approximately \$1.5B per year to Québec's budgetary revenues. An alternate solution with a 0.5% increase in the QST would increase Québec's tax revenues by a little over \$600M per year.
- According to Statistics Canada estimates, the 1% cut in the GST should bring down the consumer price index by 0.6% next July. So, the overall annual inflation rate could temporarily fall under the 2% level, i.e. the median target of the Bank of Canada. However, the decrease in the overall annual inflation rate should be limited by the increase in energy prices observed in the last few months.

In this context, we can only disapprove the decision to cut the GST rather than to bring down personal income tax. The GST cut could also be ineffective when compared to other consumption taxes in effect around the world. According to OECD data, the Canadian consumption tax level is similar to that of most industrialized countries even when considering the taxes in effect in some provinces. However, the income tax is much higher here than in most other countries.

Sales rate in effect in some countries		
	National administrations	Provinces/localities
Germany	16%	---
Australia	10%	---
Canada	6% (starting July 2006)	0 to 10%
Spain	16%	---
United States	---	0 to 7.25%
France	19.6%	---
Italy	20%	4.50%
Japan	5%	---
United Kingdom	17.5%	---

Source: OECD, United States Congress and Desjardins, Economic Studies

In the end, most Canadians should even so come out winners from this first Conservative budget. Indeed, the increase of the first tax rate is largely offset by the benefits from the GST cut, the \$1,200 family allowance payment for children under 6 and the employment credit.

In closing, the decision of the Harper government to begin discussions with the provinces on the fiscal imbalance should be applauded. Not only is the Harper government announcing a \$3.3B financial assistance for provinces from the 2005-2006 surplus, but it is considering a new approach to allocate part of the unplanned federal surpluses, an improvement to equalization, a new framework for the long-term funding of infrastructures and a new approach for the funding of training and post-secondary education.