Québec
focus on jobs

Shaping an innovative economy

Corporate Taxation Reform

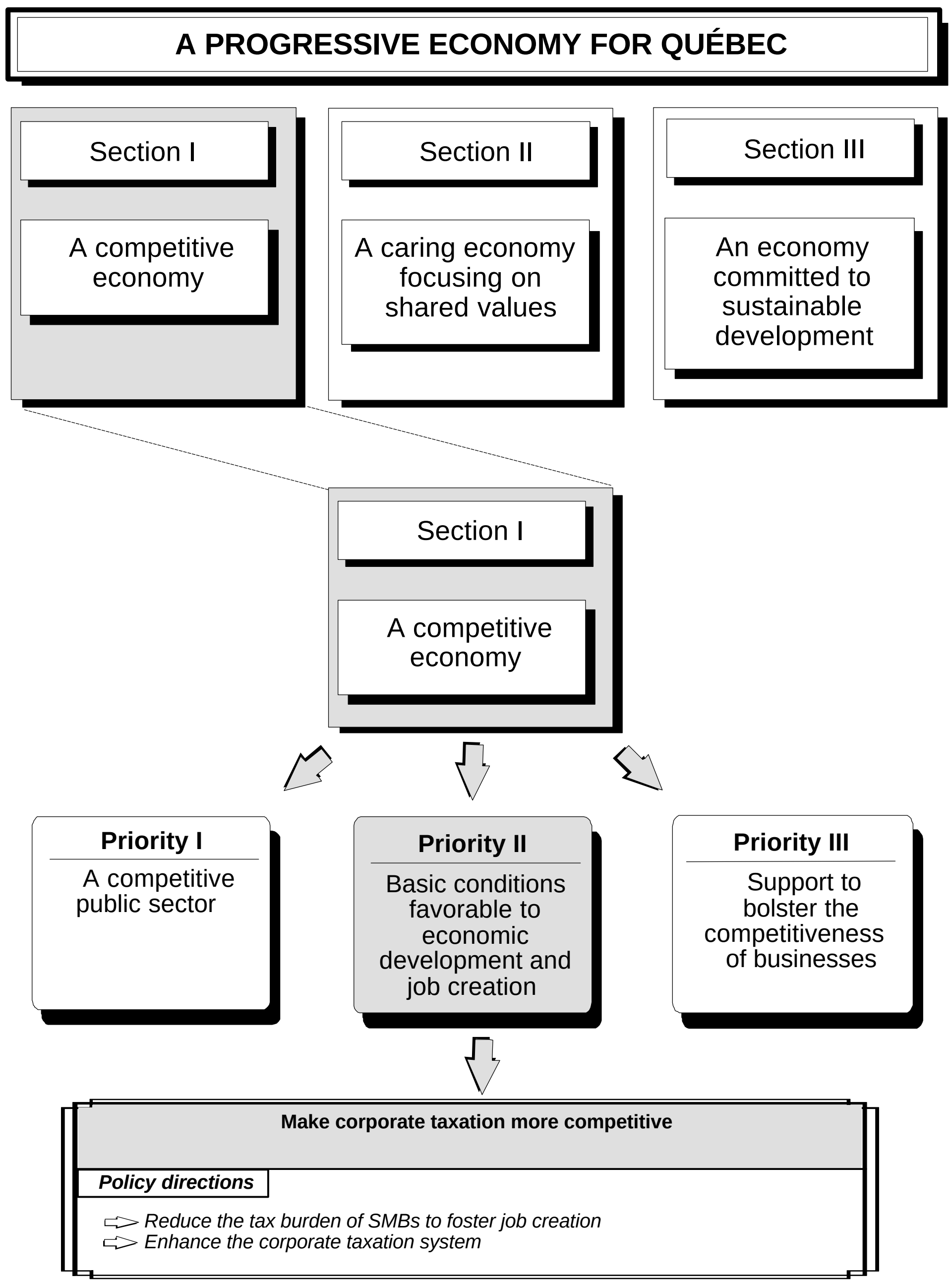
An economic development strategy for job creation

Gouvernement du Québec
Ministère des Finances

FOREWORD

The reform of corporate taxation is part of *An Economic Development Strategy for Job Creation* made public at the time of the 1998-1999 Budget Speech.

It focuses on Priority II of Section I of this strategy.



SUMMARY

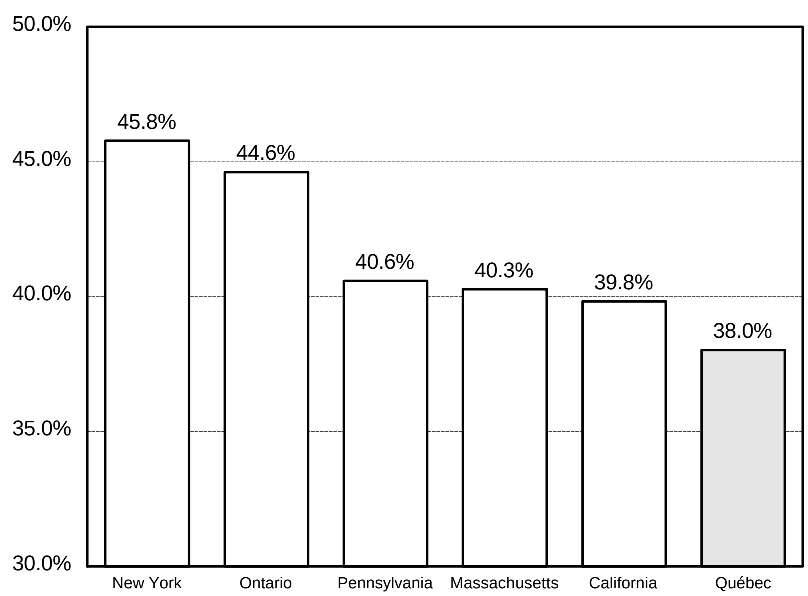
The reform of corporate taxation is part of a process aimed at reducing the tax burden in Québec, initiated in the wake of the deliberations of the Commission on Taxation and the Financing of Public Services. A first reduction in the tax burden was announced in the 1997-1998 Budget Speech:

– an overall reduction of $500 million in the tax burden of individuals;
– a complete tax exemption for an additional 200 000 taxpayers;
– a substantially simpler taxation system for four taxpayers out of five.

The second phase of this initiative to reduce the tax burden in Québec focuses on businesses. The reform maintains many of the Québec corporate taxation system's essential traits, which make it one of the most competitive in North America:

– low tax rates on corporate profits;
– significant tax assistance for investment, and research and development.

COMBINED TAX RATES[1] ON CORPORATE INCOME
Québec, Ontario and certain American states as at December 31, 1997



1 Maximum tax rates levied by different levels of government on the active income of corporations.
Sources: Price Waterhouse and ministère des Finances.

Reduction in the tax burden of small and medium-sized businesses (SMBs) to foster job creation

The reform proposes enhancements to the corporate taxation system in order to promote job creation in Québec by reducing the tax burden of SMBs through the following measures:

- a reduction of up to 37% in payroll taxes[1] for SMBs, equivalent to a $374-million reduction in the tax burden;
- a $23-million reduction in the sales tax on the purchases of SMBs.

These two measures will ultimately make it possible to reduce the tax burden of SMBs by $397 million. The reduction in the payroll tax rate will benefit 99.5% of Québec businesses.

ILLUSTRATION OF THE PAYROLL TAX RATE REDUCTION
(as a percentage of total payroll)

Total payroll of business	Current rate	Rate in effect as of July 1, 1999	Rate in effect as of July 1, 2000	Total reduction as a %
$1 million or less	4.26	3.75	2.70	-36.6
$2 million	4.26	3.88	3.09	-27.5
$3 million	4.26	4.01	3.48	-18.3
$4 million	4.26	4.13	3.87	-9.2
Over $5 million	4.26	4.26	4.26	—

Note: The rate of the payroll tax will be gradually reduced in the case of businesses whose total payroll is below $5 million, from 4.26% to 3.75% starting July 1, 1999 and from 4.26% to 2.7% starting July 1, 2000.

1 Employers' contribution to the Health Services Fund.

IMPACT ON THE TAX BURDEN OF SMBs OF THE MEASURE TO REDUCE THE PAYROLL TAX

	Average number of jobs per company[1]	Number of companies		Ultimate impact on the tax burden (in millions of dollars)
• Businesses with total payrolls of $1 million or less	35 and under	249 198	99.5% of businesses	-268[2]
• Businesses with total payrolls over $1 million and up to $5 million	36 to 170	7 007		-106
• Businesses with total payrolls over $5 million	over 170	1 399		—
• All businesses	—	257 604		-374

1 According to Statistics Canada, the average annual wage in February 1998 stood at $22 038 for businesses with fewer than 20 employees and $28 334 for businesses with 20 to 100 employees. The figure was $28 890 for all wage earners in Québec.
2 Including $26 million attributable to the reduction in the payroll tax rate for unincorporated businesses.

The Québec economy overall will benefit from these reductions in the tax burden. For example, big companies, which now benefit from a clearly competitive taxation system, will enjoy reductions in production costs through their purchases of inputs from SMBs.

Partial financing measures

The measures designed to reduce by $397 million the tax burden of SMBs must be carried out in keeping with the objective of eliminating the deficit in 1999-2000. From the standpoint of partial financing measures, the reform of corporate taxation proposes the elimination of:

– the income tax deduction for small businesses, which would raise the tax rate applicable to the first $200 000 of income from 5.75% to 8.9%;
– the refundable tax credit for losses.

The tax rate on the profits of small businesses in Québec will remain lower, at 8.9%, than the rates levied by Québec’s main economic competitors. For example, Ontario levies a tax rate of 9.5% on small businesses.

Other measures to enhance the corporate taxation system

The corporate taxation reform also proposes additional measures to improve the corporate taxation system:

– enhancement of the tax holiday for new companies, which will increase the assistance for businesses in the start-up phase, since such firms have accounted for over half of net job creation in the past 15 years;

– the implementation of a guaranteed tax rate for firms that undertake major investment projects in Québec;

– enhancement of the dividend tax credit in order to take into account the elimination of the income tax deduction for small businesses.

From a financial standpoint, the entire array of measures proposed herein are neutral until a balanced budget is achieved in 1999-2000. Once the zero deficit objective has been attained, government revenues from businesses will be reduced annually by $293 million.

IMPACT ON THE GOVERNMENT'S FINANCIAL FRAMEWORK OF MEASURES TO REDUCE THE TAX BURDEN OF BUSINESSES
(in millions of dollars)

	1999-2000	2000-2001	2001-2002
Measures to reduce the fixed tax expenses of SMBs			
• Reduced payroll tax rate[1]	-106	-358	-430
• Reduction in the sales tax on the purchases of SMBs[2]	-20	-27	-27
Sub-total	**-126**	**-385**	**-457**
Partial financing measures[2]			
• Elimination of the small business deduction	112	148	148
• Elimination of the refundable tax credit for losses	18	54	70
Sub-total	**130**	**202**	**218**
Additional measures to enhance the corporate taxation system[2]			
• Enhancement of the five-year tax holiday for new businesses	-4	-16	-10
• Implementation of a guaranteed tax rate for firms undertaking major investment projects	—	—	—
• Enhancement of the dividend tax credit	—	-26	-44
Sub-total	**-4**	**-42**	**-54**
Overall impact on the government's financial framework	**0**	**-225**	**-293**

1 Reduction of up to 12% starting July 1, 1999 and 37% starting July 1, 2000 in the payroll tax paid by SMBs.
2 Measures applicable starting July 1, 1999.

Forthcoming stages leading to a reduction in the tax burden in Québec

Once the second phase of the process aimed at reducing the tax burden has been completed, the government will have a taxation system even better suited to job creation. In order to subsequently bolster the competitiveness of the economy and foster job creation, the government deems it a priority to begin to reduce the tax burden of individual Quebecers.

The government is committed to gradually reducing the discrepancy in the tax burden between Québec and its main trading partners. Once it has achieved a zero deficit, the government intends to use for this purpose most of the initial leeway it has achieved.

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INTRODUCTION

The Commission on Taxation and the Financing of Public Services was asked to collect opinions and suggestions from all segments of Québec society. It has pinpointed a number of general guidelines to help the Québec government elaborate measures aimed at enhancing the efficiency, fairness and competitiveness of the taxation system.

In the wake of the Commission's deliberations, the 1997-1998 Budget Speech announced, in conjunction with a reform of personal income tax, a $500-million reduction in the tax burden of individuals. This reform has simplified the personal taxation system while bolstering the competitiveness and fairness of the taxation system overall. Moreover, an additional 200 000 taxpayers will no longer pay income tax in Québec.

The reform of personal income tax was the first step in the process of reducing Quebecers' tax burden. This initiative will soon include the corporate taxation system.

In publishing *Corporate Taxation Reform*, the Québec government wishes to unveil the measures that it is planning to implement starting July 1, 1999 to reduce the tax burden of small and medium-sized businesses (SMBs) with a view to further encouraging job creation and economic growth.

The corporate taxation reform maintains many of the essential traits of the Québec corporate taxation system that make it one of the most competitive systems in North America.

The system's advantages will be enhanced by a $397-million payroll and sales tax reduction for SMBs:

– a reduction of up to 37% in the payroll tax for SMBs, equivalent to a $374-million reduction;
– $23-million reduction in the sales tax on the purchases of SMBs.

These measures to reduce the tax burden of SMBs will be implemented in keeping with the objective of eliminating the deficit in 1999-2000. Partial financing measures comprise the elimination of the small business deduction and the refundable tax credit for losses as of July 1, 1999.

The reform is proposing other measures to ameliorate the corporate taxation system:

- improvement of the tax holiday for new companies;

- implementation of a guaranteed tax rate formula in respect of businesses that effect major investments in Québec;

- enhancement of the dividend tax credit.

The foregoing measures will be neutral from a financial standpoint for the government, until the deficit is eliminated in 1999-2000. Subsequently, government revenue from businesses will be reduced by $293 million a year.

1 *Québec's corporate taxation system is generally competitive*

1.1 BREAKDOWN OF BUSINESSES AND JOBS

1.1.1 Breakdown of businesses by size and sector

While there is no universally accepted definition of the notion of small and medium-sized businesses, such businesses usually employ fewer than 100 people, except in the manufacturing sector, where the figure can be higher than in the service sector.[2]

In 1994, 242 652 companies[3] filed a tax return in Québec. Of this number, nearly 99% were small and medium-sized businesses.

SMBs operate primarily in the tertiary sector of the economy, while one third of big companies are concentrated in manufacturing. Generally speaking, half of Québec companies in 1994 were operating in the services, finance, insurance and real estate sectors.

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2 According to certain definitions that are widely used to analyse SMBs, a manufacturing SMB could have more than 100 but 500 employees or fewer.

3 In this paper, “company” means a “corporate entity” or “corporation”. It does not include unincorporated businesses such as general partnerships and sole proprietorships, or self-employed workers. The term “business” includes companies and unincorporated businesses and essentially designates all activities intended to generate a profit.

TABLE 1
NUMBER OF COMPANIES[1] BY SIZE[2] AND SECTOR
(1994)

Sector	Small	Medium	Large	Total
Primary sector				
• Agriculture, mines and forests	9 587	405	85	10 077
Secondary sector				
• Manufacturing	15 522	1 251	1 021	17 794
• Construction	25 634	1 348	86	27 068
Tertiary sector				
• Transportation, communications and public services	11 412	792	173	12 377
• Wholesale and retail trade	43 557	6 523	1 080	51 160
• Finance, insurance and real estate services	55 140	1 783	491	57 414
• Business and other services[3]	64 268	2 140	354	66 762
Total	**225 120**	**14 242**	**3 290**	**242 652**
As a percentage of total	**92.8**	**5.9**	**1.3**	**100.0**

1 Excluding government corporations.
2 The size of the company is determined by the following criteria:

Size of company	Manufacturing sector Assets	Other sectors Revenues
Small	Under $3 000 000	Under $2 000 000
Medium	Between $3 000 000 and $12 000 000	Between $2 000 000 and $20 000 000
Large	Over $12 000 000	Over $20 000 000

3 Includes non-profit organizations.

1.1.2 Breakdown of jobs by size of business

Most jobs in the private sector, i.e. 54.1%, were concentrated in 1994 in businesses with fewer than 100 employees. The total payroll in respect of these jobs accounted for 45.2% of all wages paid by the private sector, totalling $54.9 billion.

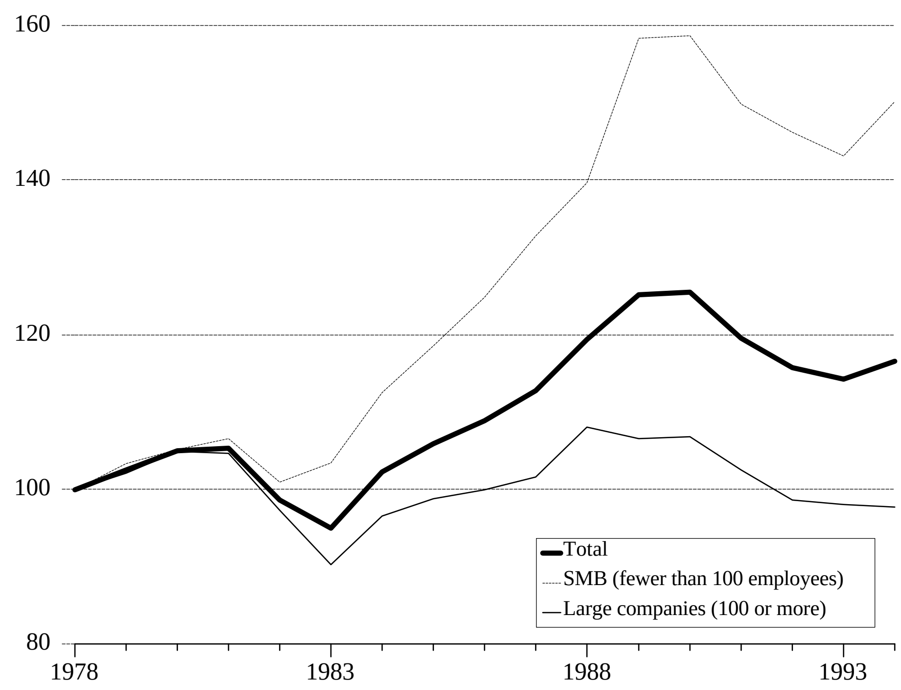
TABLE 2
BREAKDOWN OF JOBS[1] AND TOTAL PAYROLL IN THE PRIVATE SECTOR BY SIZE OF BUSINESS
(1994)

	Fewer than 100 employees	100 or more employees	Total
Jobs			
• Number of employees	1 072 400	908 400	1 980 800
• As a percentage of total	54.1	45.9	100.0
Total payroll			
• In millions of dollars	24 834	30 086	54 920
• As a percentage of total	45.2	54.8	100.0

1 Full-time equivalent jobs measured according to the average labour unit concept.
Note: Excluding educational and health services.
Source: Ministère de l’Industrie, du Commerce, de la Science et de la Technologie, *Les PME au Québec, état de la situation*, 1997.

Between 1978 and 1994, at a time when employment in large companies was more or less stable, the number of jobs in SMBs with fewer than 100 employees increased by more than 50%, as the following graph shows. Over half of these jobs were generated by the creation of new businesses.

GRAPH 1
CHANGE IN THE INDEX OF THE TOTAL NUMBER OF JOBS BY SIZE OF BUSINESS, FROM 1978 TO 1994
(1978 = 100)



Source: Ministère de l’Industrie, du Commerce, de la Science et de la Technologie.

Unincorporated businesses are contributing significantly to job creation. More and more Quebecers are creating their own jobs and becoming self-employed. In 1994, nearly 250 000 individuals derived their main income from self-employment. Most of the businesses concerned were in the tertiary sector of the economy and employed over 300 000 wage earners.

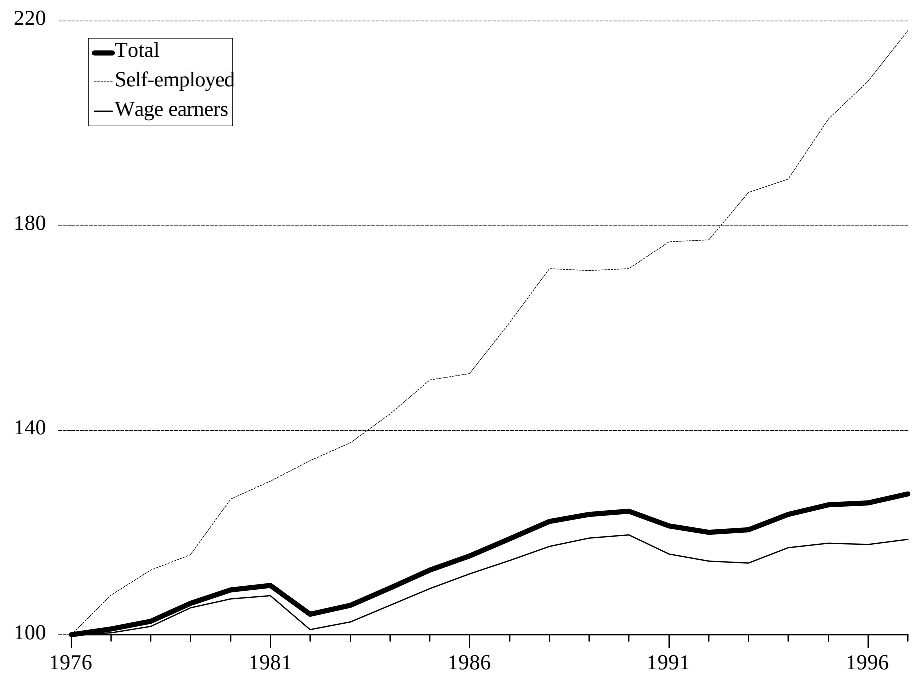
TABLE 3
NUMBER OF SELF-EMPLOYED WORKERS BY TYPE OF BUSINESS INCOME
(1994)

Business income	147 956
Farm or fishing income	31 349
Professional income	48 590
Commission income	15 653
Total	**243 548**

Source: Ministère de l'Industrie, du Commerce, de la Science et de la Technologie, *Les PME au Québec, état de la situation*, 1997.

From 1976 to 1997, the number of self-employed workers more than doubled. In 1997, the self-employed accounted for 15.3% of total employment, compared with 9% in 1976.

GRAPH 2
CHANGE IN THE SELF-EMPLOYED WORKERS INDEX, FROM 1976 TO 1997
(1976 = 100)

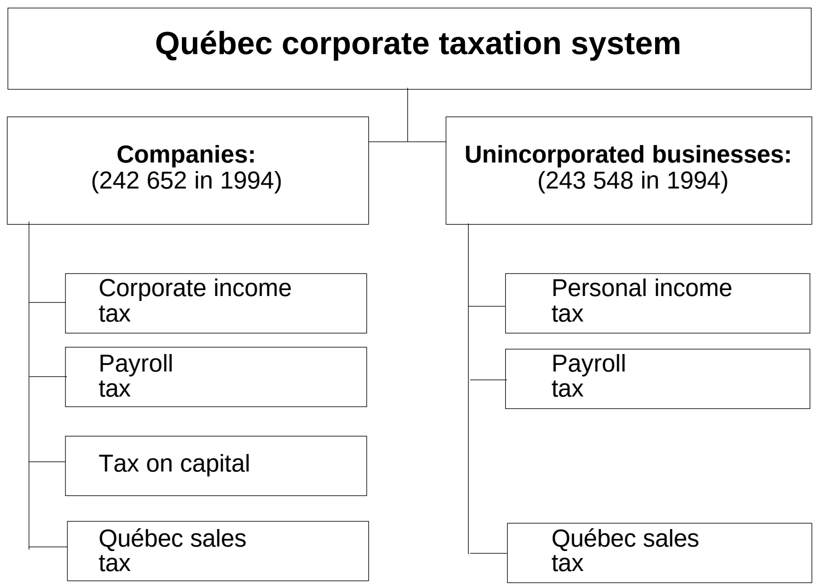


Sources: Statistics Canada and ministère des Finances.

1.2 BASIC STRUCTURE OF THE TAXATION SYSTEM

The basic structure of the Québec corporate taxation system comprises income tax, the tax on capital and the payroll tax, i.e. employer contributions to the Health Services Fund. Québec businesses are also subject to the Québec sales tax (QST).

GRAPH 3
BASIC STRUCTURE OF THE TAXATION SYSTEM



1.2.1 Income tax

The amount of income tax levied depends directly on a company's profitability. In the case of the active operating income of a company and bearing in mind federal income tax, three rates may apply: the general rate, the rate for manufacturing concerns, and a reduced rate for small businesses. In the latter instance, a small business deduction (SBD) is granted in the form of a reduced tax rate on the first $200 000 of income. A company's passive or investment income, such as rent, interest and capital gains, is taxed at a higher rate.

The low tax rates on income are one of the basic features of Québec's corporate taxation policy. Companies actively operating a business benefit in Québec from one of the lowest rates of taxation on income in North America. In particular, the general tax rate of 8.9% on active income is much lower in Québec than elsewhere in Canada. For example, the general rate is 15.5% in Ontario.

TABLE 4
TAX RATES ON CORPORATE INCOME*
(as a percentage)

	Active income			
		Ineligible for SBD		
	Eligible for SBD[1]	Manufacturing, processing	General	Passive income
Québec[2]	**5.75**	**8.9**	**8.9**	**16.25**
Ontario[3]	9.5	13.5	15.5	15.5
British Columbia	9.0	16.5	16.5	16.5
Alberta	6.0	14.5	15.5	15.5
Saskatchewan	8.0	10.0	17.0	17.0
Manitoba	9.0	17.0	17.0	17.0
New Brunswick	7.0	17.0	17.0	17.0
Prince Edward Island	7.5	7.5	16.0	16.0
Nova Scotia	5.0	16.0	16.0	16.0
Newfoundland	5.0	5.0	14.0	14.0
Canada (federal)[4]	13.12	22.12	29.12	29.12

* Rate in effect as at March 1, 1998.
1 The small business deduction (SBD) is a reduction in the tax rate on the first $200 000 of a company's taxable active income. The deduction is granted solely to Canadian-controlled private corporations (CCPCs) with paid-up capital of less than $15 million.
2 Québec has levied a contribution of 2.8% of tax payable since November 27, 1996, for a three-year period, to finance the fund to combat poverty through reintegration into the labour market.
3 Ontario levies a 4% surtax on the portion of the taxable income of CCPCs in excess of $200 000. The amount of the surtax may not exceed the tax reduction obtained through the SBD.
4 Including the 4% surtax. The passive income of a CCPC is taxed at the rate of 35.79%.

The Québec income tax system also makes provision for several tax assistance measures, generally in the form of refundable tax credits, thereby enabling companies to reduce their tax burden. The most important measure covers the R&D of businesses.

MAIN DEVELOPMENTAL TAX MEASURES

Québec independently administers its taxation system, which allows it to implement tax incentives that help, notably, to stimulate research and development, develop and support certain economic sectors, foster employment and investment, promote culture and encourage training.

TABLE 5
COST OF THE QUÉBEC GOVERNMENT'S MAIN DEVELOPMENTAL TAX MEASURES[1]
(1997^E, in millions of dollars)

Stimulate research and development	**319**
Tax credits for research and development	319
Develop new economic sectors	**23**
Information Technology Development Centres	1
Tax credit for the production of multimedia titles	6
Tax credit for design	16
Foster employment and investment	**77**
Five-year tax holiday for new companies	15
Two-year tax holiday in respect of the tax on capital for new investments	16
Accelerated capital cost allowance	43
Tax credit for shipbuilding	3
Promote culture	**76**
Tax credit for film and television production	76
Encourage training	**37**
Tax credit for on-the-job training	37
Total	**532**

E: Estimate

1 The appendix briefly describes the developmental tax measures.

1.2.2 Fixed tax expenses: the tax on capital, the payroll tax and the Québec sales tax

The tax on capital is levied on private-sector companies and those government corporations engaged in operations of a commercial nature. The payroll tax is paid by all employers in the private and public sectors in Québec. As for the Québec sales tax (QST), it is paid by all consumers, businesses and individuals.

The fixed tax expenses levied by the Québec government and those levied by other jurisdictions or the federal government are deductible in the calculation of corporate income for the purpose of federal and Québec income tax.

Four jurisdictions in Canada levy a general payroll tax. Seven jurisdictions and the federal government levy a general tax on capital.

All of the provinces except Alberta levy a sales tax. Only Québec and those Atlantic Provinces that have harmonized their sales tax with the goods and services tax refund to businesses the tax paid on their purchases. Certain restrictions on these refunds continue to apply in Québec in respect of businesses whose annual taxable sales exceed $6 million.

Prior to July 1, 1992, the Québec sales tax represented a tax expense estimated at roughly $1.9 billion for all Québec businesses. However, the reform of the QST in 1992 considerably reduced the relative importance of this tax in the overall tax burden of businesses.

TABLE 6
TAX RATES FOR THE TAX ON CAPITAL, THE PAYROLL TAX AND SALES TAXES*
(as a percentage)

	Tax on capital		General payroll tax[3]	Sales tax	
	General rate[1]	**Rate applicable to financial institutions[2]**		**Rate**	**Refund of the tax on purchases**
Québec	**0.64**	**1.28[4]**	**4.26**	**7.5[5]**	**yes[6]**
Ontario	0.30	0.6/0.9	1.95	8.0	no
British Columbia	0.30	1.0/3.0	—	7.0	no
Alberta	—	2.0	—	—	no
Saskatchewan	0.60	3.25	—	9.0	no
Manitoba	0.30	3.0	2.25	7.0	no
New Brunswick	0.30	3.0	—	8.0	yes
Prince Edward Island	—	3.0	—	10.0[5]	no
Nova Scotia	0.25	3.0	—	8.0	yes
Newfoundland	—	4.0	2.0	8.0	yes
Canada (federal)	0.225	1.25	—	7.0	yes

* Rate in effect as at March 1, 1998.
1 A lower rate than the one indicated, or a nil rate, applies to companies with taxable capital of less than $2.3 million in Ontario, $3 million in Manitoba, $1.5 million in British Columbia, $5 million in New Brunswick, and $10 million at the federal level, in Saskatchewan and Nova Scotia. Moreover, the federal tax on capital is reducible from amounts paid in respect of the surtax on corporate income tax.
2 All of the provinces, with the exception of Québec and Alberta, offer basic exemptions. Furthermore, the rate in British Columbia is 1% when paid-up capital is less than $750 million, while in Ontario, the rate is 0.6% when paid-up capital is less than $400 million.
3 A nil rate applies to companies with total payrolls under $300 000 in 1998 and $400 000 in 1999 in Ontario, $1 million in Manitoba, and $100 000 in Newfoundland.
4 Since November 27, 1996, Québec has levied a contribution of 3% for a three-year period to finance the fund to combat poverty through reintegration into the labour market.
5 The tax base of these taxes includes the GST.
6 Certain restrictions apply to input tax refunds in the case of businesses whose taxable sales in Canada exceed $6 million a year, on the following goods and services: electricity, gas, fuel and steam used otherwise than in the production of movable property intended for sale; telephone and other telecommunications services except 1-800 and 1-888 services; meals and entertainment expenses; motor vehicles except vehicles and trailers of 3 000 kg or more; fuel used to operate motor vehicles, except fuel oil.

ECONOMIC IMPACT OF FIXED TAX EXPENSES

The relationship between fixed tax expenses and the level of employment is complex.

For example, with no adjustment in wages, an increase in the payroll tax leads to a net short-term increase in the cost of labour and consequently results in a reduction in employment. In the long term, however, most economists are of the opinion that businesses will transfer the tax increase by reducing growth in wages or by raising the price of the goods and services they offer, thus leaving the level of employment unchanged.[1]

The length of this transition period will depend notably on rigidity factors in the economy, such as labour contracts or the minimum wage. Moreover, the adjustment process will lag during periods of low inflation, when businesses will find it harder to raise the prices of their goods and services. A company's ability to absorb the payroll tax, and generally speaking, fixed tax expenses not related to its profitability, will depend on its size and the level of wages it pays. Fixed tax expenses will be heavier for SMBs and in the case of the lowest-paid jobs.

1 See *Taxation in Québec: Incidence on Growth and Employment*, Volume 19, Commission on Taxation and the Financing of Public Services.

1.2.3 Breakdown of the tax burden of businesses

Fixed tax expenses under the basic Québec taxation system accounted for 79.1% of the taxes levied directly on public and private-sector businesses in 1997. The payroll tax alone accounted for nearly 45% of the taxes the Québec government levied on private-sector businesses and public-sector employers.

TABLE 7
BREAKDOWN OF QUÉBEC GOVERNMENT TAXES (ALL BUSINESSES)
(1997, in millions of dollars)

	Fixed tax expenses					
	Tax on capital	**Payroll tax**	**Québec sales tax[1]**	**Total fixed tax expenses**	**Income tax**	**Total**
Private sector	1 560	2 522	639	4 721	1 722	6 443
Public sector	326	1 155	318	1 799	—	1 799
Total	**1 886**	**3 677**	**957**	**6 520**	**1 722**	**8 242**
Breakdown as a percentage	**22.9**	**44.6**	**11.6**	**79.1**	**20.9**	**100.0**

1 Excluding the specific sales tax on insurance premiums and including $272 million in respect of the sales tax paid by municipal administrations, school boards and hospitals, $422 million in respect of restrictions on ITRs, $131 million in respect of the sales tax paid by businesses effecting exempted sales, and $132 million in respect of the compensatory tax paid by financial institutions. Since July 1, 1992, Québec financial institutions have been subject to a compensatory tax with a view to maintaining their tax burden at a constant level following the zero-rating of financial services with the reform of the QST.

The following table indicates the tax burden of the private sector only. The proportion of fixed tax expenses in the basic tax burden of businesses is, in this instance, 73.3%.

TABLE 8
BREAKDOWN OF QUÉBEC GOVERNMENT TAXES (PRIVATE-SECTOR BUSINESSES)
(1997, in millions of dollars)

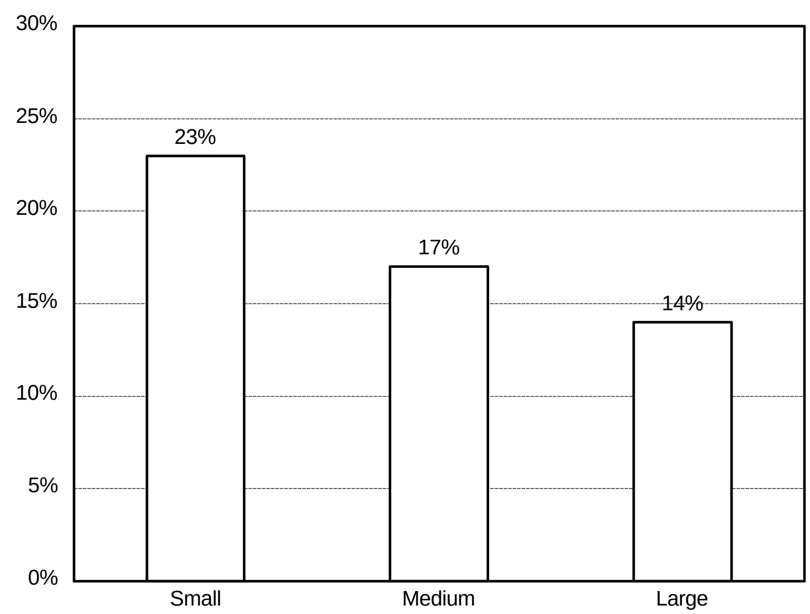
	Fixed tax expenses					
	Tax on capital	**Payroll tax**	**Québec sales tax[1]**	**Total fixed tax expenses**	**Income tax**	**Total**
Small and medium-sized businesses[2]	593	1 329	150	2 072	851	2 923
Large companies[2]	967	1 193	489	2 649	871	3 520
Total	**1 560**	**2 522**	**639**	**4 721**	**1 722**	**6 443**
Breakdown as a percentage	**24.2**	**39.1**	**9.9**	**73.3**	**26.7**	**100.0**

1 Excluding the specific sales tax on insurance premiums and the sales tax paid by government corporations.
2 See footnote 2, Table 1, page 6, for a definition.

The payroll tax is more important to small and medium-sized businesses than to large companies.

Given the relative importance of total payroll in relation to total sales in Québec, depending on the size of the company, it is apparent that SMBs use manpower more intensively than large companies in the production of goods and services. The wages paid represent on average 23% of the overall sales of SMBs in Québec, compared with 14% in the case of large companies.

GRAPH 4
TOTAL PAYROLL AS A PERCENTAGE OF TOTAL SALES IN QUÉBEC, BY SIZE[1] OF BUSINESS
(1997)



1 See footnote 2 of Table 1, page 6, for a definition.

1.3 OVERALL COMPETITIVENESS OF THE CORPORATE TAXATION SYSTEM

The Québec taxation system is generally competitive and especially advantageous for manufacturing concerns. The key factors that determine the competitiveness of the system are:

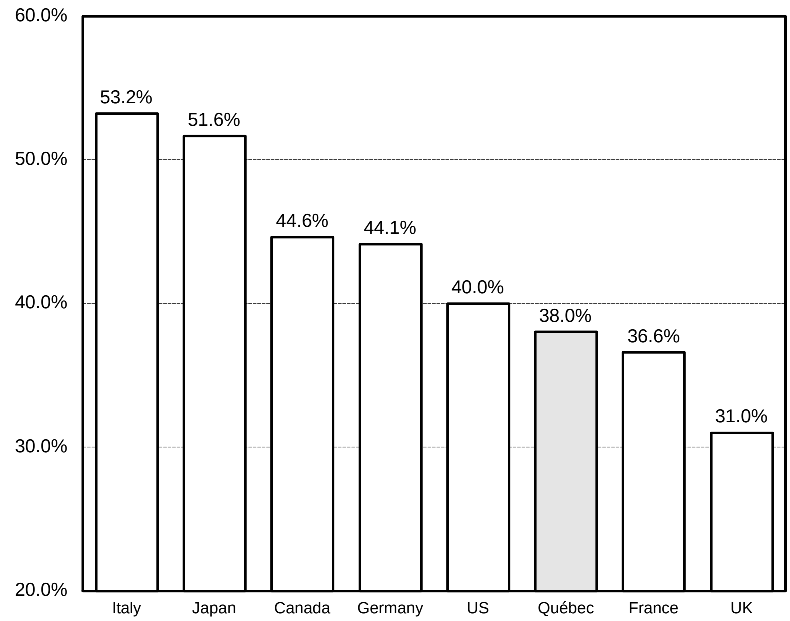
– tax rates on corporate income that are markedly lower than those in Ontario and generally lower than in most American states and the G-7 countries;

– developmental tax measures that foster R&D and investment;

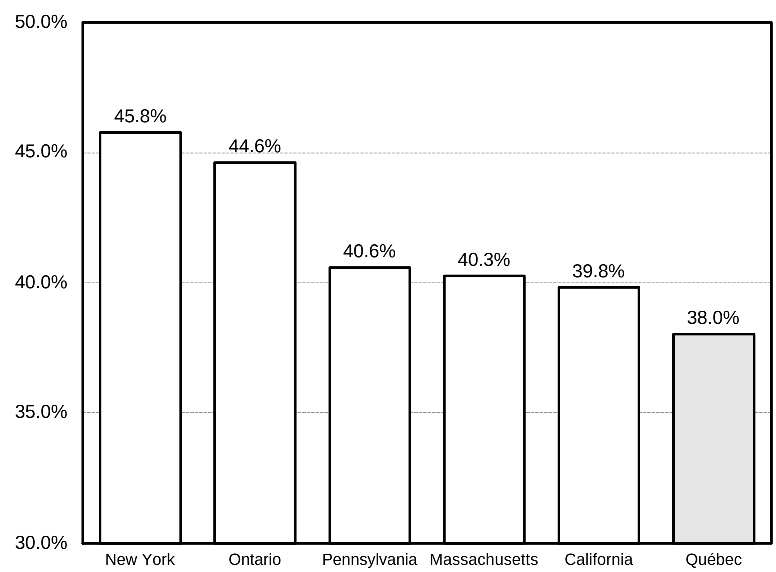
– the QST input tax refund.

GRAPH 5
COMBINED CORPORATE INCOME TAX RATES[1]

Québec and G-7 countries as at July 1, 1997



Québec, Ontario and certain American states as at December 31, 1997



1 Maximum tax rates levied on active business income by different levels of government.
Sources: KPMG, *Corporate Tax Rate Survey*, March 1998, Price Waterhouse and ministère des Finances.

1.3.1 Discrepancy in the tax burden between Québec and Ontario

Since the early 1980s, the ministère des Finances du Québec has regularly published a comparison of the private-sector tax burden in Québec and Ontario.

In order to compare the tax burdens in Québec and Ontario, the Ontario tax structure is applied to Québec tax bases. For this purpose, the tax burden of businesses comprises all the taxes they pay, except local taxes, incidental taxation, and certain specific consumption taxes.

The findings for 1998 reveal that Québec companies will pay $216 million more in taxes than their Ontario counterparts, i.e. 3.6%.

TABLE 9
DISCREPANCY IN THE TAX BURDEN BETWEEN QUÉBEC AND ONTARIO BUSINESSES
(1998)

	In millions of dollars	As a percentage
Corporate income tax	-1 559	-68.3
Payroll tax[1]	1 643	155.3
Tax on capital	873	114.4
Sales tax[2]	-740	-39.4
Total	**216**	**3.6**

1 Including the Québec payroll tax and the Ontario health tax.
2 Including the specific sales tax on insurance premiums.
Note: The total may not correspond to the sum of the elements because of rounding.

1.3.2 Comparison with certain jurisdictions in North America

The discrepancy between the tax burden in Québec and Ontario makes it possible to broadly ascertain the relative importance of the taxes paid considering all private-sector businesses. This method does not take into account, in particular, incidental or local taxes.

In collaboration with Price Waterhouse, the ministère des Finances du Québec has developed another approach to measure the competitiveness of Québec's taxation system that examines all taxes. It makes it possible to successively evaluate the overall tax burden that a typical business would bear if it were subject to the tax structure in effect in other North American jurisdictions.

This analysis focuses on three situations, i.e. a business's current operations, investment projects and R&D expenditures. In all instances where the index exceeds 100, the tax structure of the jurisdiction concerned is less competitive than Québec's system. The findings show that the Québec tax system as it applies to companies is generally very competitive. Its competitiveness increases notably when companies invest or engage in R&D. For example, this index is 110 for a large company incurring R&D expenses in Ontario, which means that such a business bears a tax burden 10% higher than in Québec.

TABLE 10
COMPARISON WITH CERTAIN NORTH AMERICAN JURISDICTIONS
COMPETITIVENESS INDEX[1] OF VARIOUS TAX STRUCTURES
ACCORDING TO DIFFERENT ANALYSES
(Québec = 100)

	Québec	Ontario	New Brunswick	Massachusetts	Michigan	New York	Pennsylvania
Small business							
• Without investment project	100	101	85	126	122	133	120
• With investment project	100	105	118	138	131	145	147
• For R&D expenditure[2]	100	112	120	192	198	196	200
Large business							
• Without investment project	100	99	89	130	127	133	124
• With investment project	100	107	145	129	121	135	134
• For R&D expenditure[2]	100	110	106	138	143	143	144

1 An index over 100 indicates that the tax structure in the jurisdiction concerned is less competitive than the tax structure in Québec.
2 Results obtained when the research is conducted in-house.
Sources: Price Waterhouse and ministère des Finances, *Corporate Taxation in Québec: A Competitive System That Favours Investment*, 1997.

2 *The corporate tax reform: taxation geared to job creation*

While the Québec corporate taxation system is generally competitive when compared with the taxation systems of Québec's key economic competitors, it is nonetheless noteworthy in that it relies more extensively on fixed tax expenses, notably payroll taxes, than other Canadian jurisdictions.

In light of this observation, several stakeholders and the Commission on Taxation and the Financing of Public Services expressed the opinion that the reorganization of the basic structure of the taxation system would make it possible to generally enhance the corporate taxation system.[4]

Among the recommendations proposed to the government, one option often emphasized focused on a reduction of the payroll tax.

2.1 MEASURES TO REDUCE THE TAX BURDEN OF BUSINESSES

2.1.1 Reduction in the payroll tax rate

In order to further enhance the competitiveness of the corporate taxation system, the payroll tax rate will be reduced for all businesses with total payrolls of $5 million or less.

This reduction will be introduced in two stages. The maximum rate reduction will be granted to businesses with total payrolls of $1 million or less, i.e. from 4.26% to 3.75% starting July 1, 1999. For businesses with total payrolls between $1 million and $5 million, the rate will be between 3.75% and 4.26%.

[44] Gouvernement du Québec, *Report of the Commission on Taxation and the Financing of Public Services*, 1996, Chapter 5.

A second payroll tax rate reduction will be introduced on July 1, 2000, when the rate will fall to 2.7% for businesses with total payrolls of $1 million or less, a 37% reduction over the current rate of 4.26%.

TABLE 11
ILLUSTRATION OF THE PAYROLL TAX RATE REDUCTION
(as a percentage of total payroll)

Total payroll of business	Current rate	Rate in effect as of July 1, 1999	Rate in effect as of July 1, 2000	Total reduction as a%
$1M or less	4.26	3.75	2.70	-36.6
$2M	4.26	3.88	3.09	-27.5
$3M	4.26	4.01	3.48	-18.3
$4M	4.26	4.13	3.87	-9.2
Over $5M	4.26	4.26	4.26	—

Note: The rate of the payroll tax will be gradually reduced in the case of businesses whose total payroll is below $5 million, from 4.26% to 3.75% starting July 1, 1999 and from 4.26% to 2.7% starting July 1, 2000.

This reduction in the payroll tax rate will represent when fully implemented a $374-million drop per year in the tax burden of SMBs. Some 99.5% of Québec businesses will benefit from this measure.

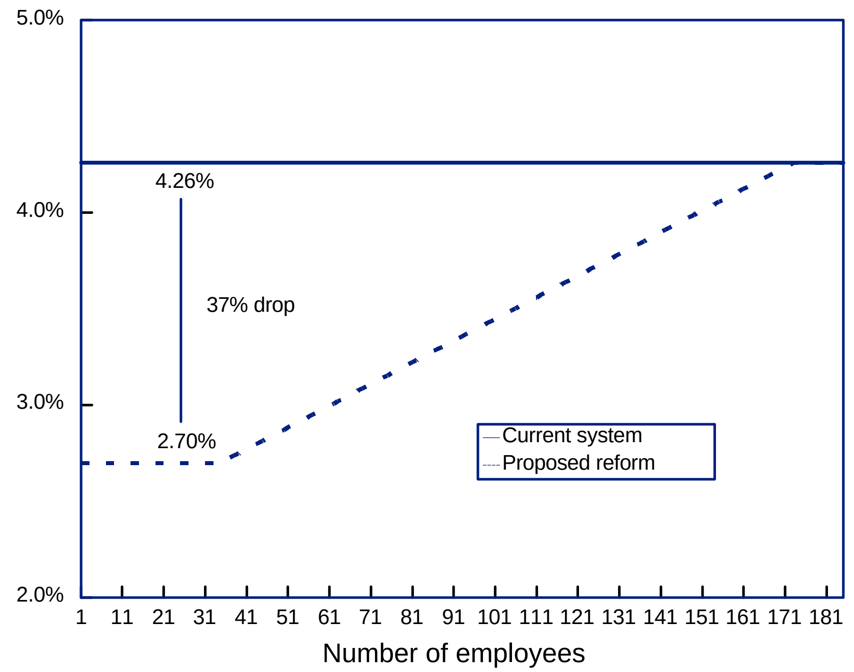
TABLE 12
IMPACT ON THE TAX BURDEN OF SMBs OF THE MEASURE TO REDUCE THE PAYROLL TAX

	Average number of jobs per company[1]	Number of companies		Ultimate impact on the tax burden (in millions of dollars)
• Businesses with total payrolls of $1 million or less	35 and under	249 198	99.5% of businesses	-268[2]
• Businesses with total payrolls over $1 million and up to $5 million	36 to 170	7 007		-106
• Businesses with total payrolls over $5 million	over 170	1 399		—
• All businesses	—	257 604		-374

1 According to Statistics Canada, the average annual wage in February 1998 stood at $22 038 for businesses with fewer than 20 employees and $28 334 for businesses with 20 to 100 employees. The figure was $28 890 for all wage earners in Québec.
2 Including $26 million attributable to the reduction in the payroll tax rate for unincorporated businesses.

Generally speaking, considering an average annual wage of $28 890 in Québec in 1998, the reduction in the payroll tax rate will for the most part apply to all businesses with 170 or fewer employees. Small businesses having, by and large, 35 or fewer employees will benefit from a 37% reduction in the payroll tax.

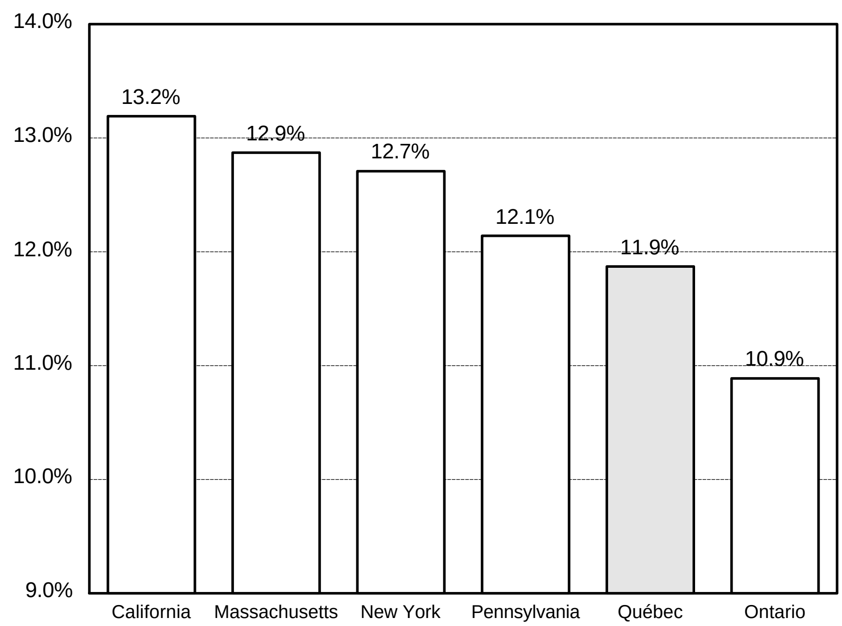
GRAPH 6
PAYROLL TAX RATE



Note: Drop in the payroll tax rate for an average annual wage of $28 890.

Once the reduction in the payroll tax has been fully implemented, the effective overall payroll tax rate in Québec for businesses with payrolls of $1 million or less will be generally lower than that applicable to small American businesses and will be more in line with that applicable to small Ontario businesses.

GRAPH 7
COMBINED EFFECTIVE PAYROLL TAX RATES[1, 2]
Québec after measure, Ontario and certain American states as at December 31, 1997 (as a percentage of payroll)



1 Includes all tax assessments and incidental taxation. For Québec, includes the contribution to the Health Services Fund, the Québec Pension Plan, the Commission des normes du travail, the Commission de la santé et de la sécurité du travail, and employment insurance.
2 Business with 35 employees and a total payroll of $1 million.

2.1.2 Reduction in the Québec sales tax for SMBs

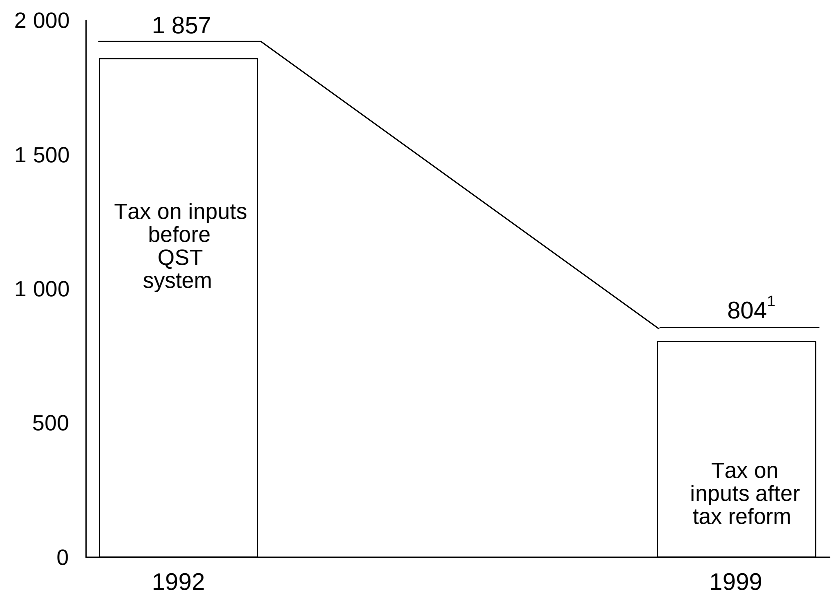
Restrictions on the Québec sales tax (QST) refund in respect of certain inputs is also a fixed tax expense for medium-sized Québec businesses with taxable annual sales in Canada in excess of $6 million. Businesses that exceed this threshold as a result of increased sales assume higher overall tax expenses proportionate to their production costs since they are no longer entitled to the full input tax refund (ITR).

To foster the growth of medium-sized businesses and enhance their tax competitiveness, the application threshold for restrictions on obtaining the full ITR will be raised to $10 million starting July 1, 1999.

This measure represents a gain of $23 million for nearly 2 300 businesses whose taxable sales exceed $6 million but not $10 million.

Roughly 98% of companies will from now on benefit from QST refunds on all their purchases and investments. Since the reform of consumption taxes in 1992, such refunds overall represent, with the modifications proposed, a striking drop in the tax burden of businesses from the standpoint of the sales tax, which will have fallen from nearly $1.9 billion in 1992 to $804 million in 1999.

GRAPH 8
REDUCTION IN THE TAX BURDEN OF BUSINESSES RESULTING FROM THE INPUT TAX REFUND
(in millions of dollars)



1 Excluding the specific sales tax on insurance premiums and including $150 million in respect of the compensatory tax paid by financial institutions, $494 million in respect of ITR restrictions, and $160 million in respect of the QST paid by businesses making exempted sales.

2.1.3 Impact of the measures to reduce the tax burden of businesses

Overall, the tax burden of SMBs will be reduced by $397 million because of the reduction in fixed tax expenses.

TABLE 13
IMPACT OF MEASURES TO REDUCE THE TAX BURDEN OF BUSINESSES
(Fully implemented measures, in millions of dollars)

Reduced payroll tax rate	-374
Reduction in the QST for SMBs	-23
Total	**-397**

2.2 PARTIAL FINANCING MEASURES

The measures to reduce the tax burden of SMBs must be in line with the objective of eliminating the deficit in 1999-2000. Partial financing measures include the elimination as of July 1, 1999 of the small business deduction and the refundable tax credit for losses.

2.2.1 Elimination of the small business deduction

Québec now applies two tax rates on the active income of companies, i.e. a general rate of 8.9% and a reduced rate of 5.75% applicable to the first $200 000 of the income of small companies. This reduced rate represents a tax benefit of up to $6 300. Starting July 1, 1999, this deduction will be eliminated and a single rate of 8.9% will apply to all companies. The elimination of the small business deduction will generate $148 million in additional revenue a year for the government.

TABLE 14
CORPORATE INCOME TAX RATES
(As a percentage of taxable income)

	Current rate	Rate as of July 1, 1999
Active income		
• eligible for the SBD	5.75	8.9
• general	8.9	8.9
Passive income	16.5	16.5

The tax rate on Québec small businesses will, at 8.9%, still be lower than the rate levied by Québec's main economic competitors. For example, Ontario applies a 9.5% tax rate on small businesses.

Moreover, the drop in the payroll tax will offset the increase in the tax rate applicable to small companies. For example, the net gain for a business with 35 employees and taxable income of $200 000, i.e. the maximum income eligible for the SBD, could reach $4 461 a year.

TABLE 15
ILLUSTRATION OF THE IMPACT ON AN SMB[1] WITH 35 EMPLOYEES OF A REDUCTION IN THE PAYROLL TAX RATE AND THE ELIMINATION OF THE SMALL BUSINESS DEDUCTION
(in dollars)

	Taxable income of $200 000	Total payroll of $1 million	Total
Current tax burden in Québec	11 500	42 600	54 100
Québec tax burden after changes	22 639	27 000	49 639
Gain for business	-11 139	15 600	4 461

1 Manufacturing concern carrying out 100% of its business in Québec.
Note: Including the effect of the deductibility of the payroll tax on federal and Québec income tax.

2.2.2 Elimination of the refundable tax credit for losses

The refundable tax credit for losses is aimed at reducing the fixed tax expenses of money-losing businesses. Only SMBs are eligible for this measure.

Since the proposed modifications directly reduce the amount of the payroll tax payable by SMBs, the refundable tax credit for losses no longer seems necessary. Consequently, it will be eliminated as of July 1, 1999. This measure will bring the government additional revenue of $70 million a year.

Businesses that avail themselves of the credit to offset their financial losses in the year will be able, however, pursuant to existing tax rules, to carry over such losses against their taxable income for the three years preceding or the seven years subsequent to the year of the loss. Over an entire economic cycle, this measure will not affect the tax burden of these businesses.

2.2.3 Impact of partial financing measures

The elimination of the small business deduction and the tax credit for losses will, ultimately, reduce by $218 million the cost to the government of the measures designed to reduce the tax burden of businesses.

TABLE 16
IMPACT ON THE TAX BURDEN OF BUSINESSES OF PARTIAL FINANCING MEASURES
(Fully implemented measures, in millions of dollars)

Elimination of the small business deduction	148
Elimination of the refundable tax credit for losses	70
Total	**218**

2.3 ADDITIONAL MEASURES TO ENHANCE THE CORPORATE TAXATION SYSTEM

2.3.1 Enhancement of the tax holiday for new companies

The five-year tax holiday for new companies offers a complete income tax exemption on the first $200 000 of profit. Given that the current tax rate on the profits of SMBs is 5.75%, this exemption offers a maximum tax benefit of $11 500. A similar benefit is also offered in respect of the payroll tax and the tax on capital, which brings to $37 080 the maximum annual tax benefit available to new companies as a result of the tax holiday.

In order to maintain this tax benefit, the value of the income tax exemption will be increased automatically from $11 500 to $17 800. With a view to fostering the development of new businesses and entrepreneurship, the benefit procured by the tax holiday as regards the total payroll will be raised from $12 780 to $18 900. The benefit generated by the tax holiday in respect of the tax on capital will also be raised by the same proportion, from $12 800 to $19 200. The following table indicates these modifications, which will apply starting July 1, 1999 and will reduce by $10 million a year the tax burden of new companies.

TABLE 17
EXEMPTIONS AND TAX BENEFITS APPLICABLE TO THE FIVE-YEAR TAX HOLIDAY FOR NEW COMPANIES
(in dollars)

	Income tax	**Payroll tax**	**Tax on capital**	**Maximum annual value of tax holiday**
Existing tax holiday				
• exemption	200 000	300 000	2 000 000	
• maximum value	11 500	12 780	12 800	37 080
Proposed tax holiday starting July 1, 1999				
• exemption	200 000	500 000/ 700 000[1]	3 000 000	
• maximum value	17 800	18 750/ 18 900	19 200	55 900
Gain for business				
• exemption	—	400 000	1 000 000	
• maximum value	—	6 120	6 400	12 520

1 The total payroll exempted from the tax will be $500 000 starting July 1, 1999 and $700 000 starting July 1, 2000.

2.3.2 Guaranteed tax rates for major investment projects

In light of the extensive time frame often required to make a major investment project profitable, the stability of taxes is a key element when businesses decide where to invest. In order to promote investment and the realization of major projects in Québec, the government will agree, starting July 1, 1999, to guarantee by private contract the stability of tax rates applicable to income, total payroll and the capital of businesses that undertake such projects.

The maximum guarantee will be for 10 years. In the event that tax rates increase during this period, the government will financially compensate the business for the additional tax burden arising from the increase. This guarantee will be offered for major investment projects that result in significant net job creation.

This guarantee will provide support for the government's new approach to seeking out investment. Investissement-Québec, a new government corporation that will be responsible for promoting Québec's advantages, will be able to rely on a new means of ensuring the stability of the decision-making framework of businesses from the standpoint of taxation.

2.3.3 Enhancement of the dividend tax credit

The Québec income tax system is structured so that business income, regardless of whether it is earned directly by an individual or a company, is taxed overall at the same level and is not subject to double taxation. To this end, a procedure to integrate personal and corporate taxation applies to dividend income paid to an individual by a taxable Canadian corporation. This procedure, which uses a dividend tax credit, makes it possible to refund to the taxpayer the taxes paid by companies on the dividends he receives and to thus avoid doubly taxing this income.

The dividend tax credit is now based on a combined corporate tax rate of 20%, i.e. 8% in respect of Québec and 12% at the federal level. The elimination of the small business deduction makes it necessary to raise the rate of the dividend tax credit in order to avoid the double taxation of corporate profits. The rate of the dividend tax credit will be raised from 8.87% to 10.83% starting January 1, 2000. For 1999, the rate of the dividend tax credit will be 9.85%, so as to take into consideration that the elimination of the small business deduction applies to only half the year. The following table illustrates the change made to the dividend tax credit.

TABLE 18
ENHANCEMENT OF THE DIVIDEND TAX CREDIT
(in dollars)

	Current system	**Proposed system**	**Impact of the change**
Corporate income	100.0	100.0	—
Corporate taxes			
• federal	-13.12	-13.12	—
• Québec	-5.75	-8.90	-3.15
Dividend received	81.13	77.98	-3.15
Personal income tax[1]			
• federal	-26.91	-25.87	+1.04
• Québec	-26.37	-25.34	+1.03
Dividend tax credit			
• federal[2]	12.37	11.89	-0.48
• Québec	9.00	10.56	1.56
Net taxes after dividend tax credit			
• federal	-14.54	-13.98	0.56
• Québec	-17.37	-14.78	2.59
Total taxes on dividends (companies and individuals)			
• federal	-27.66	-27.10	0.56
• Québec	-23.12	-23.68	-0.56
Total tax burden	**50.78**	**50.78**	—
Dividend gross-up rate	25%	25%	—
Dividend tax credit (as a % of grossed-up dividend)	8.87%	10.83%	1.96%

1 Personal income tax according to the maximum marginal rates applicable to the dividend paid grossed up by 25%.
2 Rate of 13.33% applicable to the grossed-up dividend for the purpose of the federal income tax.

This enhancement of the dividend tax credit will ensure that taxpayers who earn income from a company are not subject to an increase in income tax.

Over a full taxation year, this measure will reduce the government's revenue by $35 million.

2.4 IMPACT OF THE REFORM OF CORPORATE TAXATION

Impact on the government's financial framework

The entire array of measures proposed under the corporate taxation reform will have no impact on government revenue in 1999-2000 and will reduce such revenue by $225 million in 2000-2001, and $293 million in 2001-2002.

TABLE 19
IMPACT ON THE GOVERNMENT'S FINANCIAL FRAMEWORK OF MEASURES TO REDUCE THE TAX BURDEN OF BUSINESSES
(in millions of dollars)

	1999-2000	2000-2001	2001-2002
Measures to reduce the fixed tax expenses of SMBs			
• Reduced payroll tax rate	-106	-358	-430
• Reduction in the sales tax on the purchases of SMBs	-20	-27	-27
Sub-total	**-126**	**-385**	**-457**
Partial financing measures			
• Elimination of the small business deduction	112	148	148
• Elimination of the refundable tax credit for losses	18	54	70
Sub-total	**130**	**202**	**218**
Additional measures to enhance the corporate taxation system			
• Enhancement of the five-year tax holiday for new businesses	-4	-16	-10
• Implementation of a guaranteed tax rate for firms undertaking major investment projects	—	—	—
• Enhancement of the dividend tax credit	—	-26	-44
Sub-total	**-4**	**-42**	**-54**
Overall impact on the government's financial framework	**0**	**-225**	**-293**

Impact on the tax burden of the private sector

Once it is fully implemented, the proposed corporate tax reform will reduce by $224 million the tax burden of Québec businesses. This figure is lower than the $293-million financial impact on the government notably because of the effect of the deductibility of taxes on total payroll and the sales tax on income tax.

TABLE 20
IMPACT ON THE PRIVATE SECTOR TAX BURDEN OF CHANGES IN THE CORPORATE TAXATION SYSTEM
(in millions of dollars)

	Ultimate impact
Measures to streamline fixed tax expenses	
• Reduced payroll tax rate	-374
• Reduction in the Québec sales tax paid by SMBs	-23
Sub-total	**-397**
Partial financing measures	
• Elimination of the small business deduction	+148
• Elimination of the refundable tax credit for losses	+70
Sub-total	**+218**
Additional measures to enhance corporate taxation	
• Enhancement of the five-year tax holiday for new companies	-10
• Enhancement of the dividend tax credit	-35
Sub-total	**-45**
Total impact on the tax burden of the private sector	**-224**

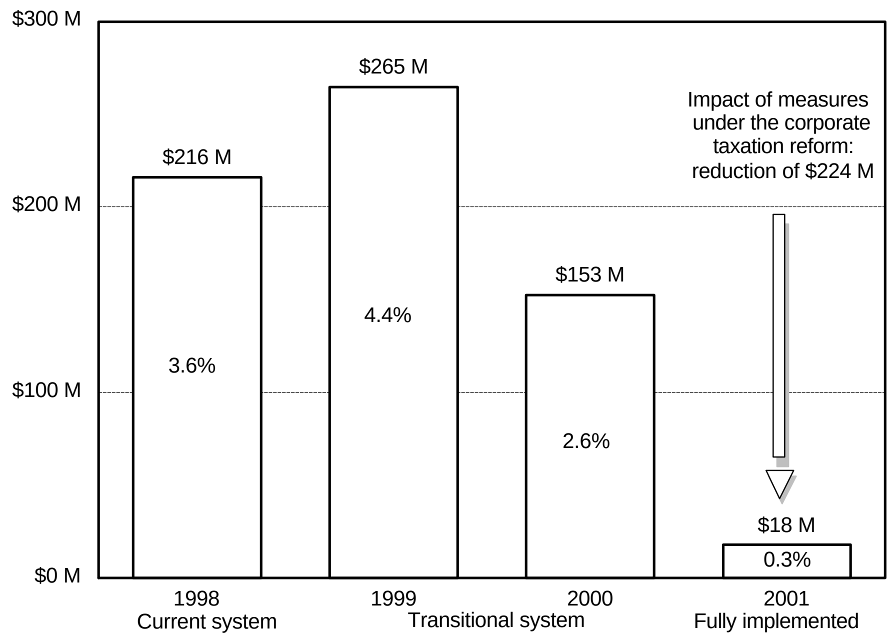
TABLE 21
IMPACT ON THE TAX BURDEN OF BUSINESSES OF THE CHANGES MADE TO THE CORPORATE TAXATION SYSTEM
(Fully implemented measures, in millions of dollars)

Sector	Québec taxes[1]	Measures to lighten fixed tax expenses	Partial financing measures	Impact of new measures	% change in the tax burden
1. Measures to lighten the fixed tax expenses of SMBs					
Primary sector					
• Agriculture, mines and forests	225	16	16	—	—
Secondary sector					
• Manufacturing	1 715	66	32	-34	-2,0
• Construction	300	40	23	-17	-5,8
Tertiary sector					
• Transportation, communications and public services	515	24	12	-12	-2,3
• Wholesale and retail trade	1 072	100	56	-44	-4,1
• Finance, insurance and realty services	1 622	37	32	-5	-0,3
• Business and other services[2]	922	93	47	-46	-5,0
• Unincorporated businesses[3]	72	22	—	-22	-30,3
Total, measures to lighten fixed tax expenses	**6 443**	**397**	**218**	**-179**	**-2,8**
2. Additional measures to enhance the corporate taxation system					
• Enhancement of the tax holiday for new companies	—	—	—	-10	-0,2
• Guaranteed tax rates for major investment projects	—	—	—	—	—
• Enhancement of the dividend tax credit	—	—	—	-35	-0,5
Total, additional measures	**—**	**—**	**—**	**-45**	**-0,7**
All measures	**6 443**	**397**	**218**	**-224**	**-3,5**

1 Includes corporate income tax, the tax on capital, the payroll tax and the Québec sales tax.
2 Including non-profit organizations and cooperatives.
3 Excluding farm businesses. Unincorporated businesses are subject to personal income tax, which is not considered in this table.
Note: A (-) sign indicates a reduction in the tax burden. The total may not correspond to the sum of the elements because of rounding.

The discrepancy in the tax burden between Québec and Ontario, which stands at $216 million in 1998 to the advantage of Ontario and which will increase to $265 million in 1999, notably because of the reduction in Ontario of the payroll tax applicable to SMBs, will be gradually reduced starting in 2000. It should stand at $18 million in 2001.

GRAPH 9
DISCREPANCY IN THE TAX BURDEN BETWEEN QUÉBEC AND ONTARIO
Corporate taxes



Note: Including the impact of the increase in the dividend tax credit starting July 1, 1999 in the wake of the elimination of the small business deduction.

Appendix

Description of the main developmental tax measures

The Québec taxation system includes a series of developmental tax measures that make it possible to support certain economic sectors, encourage what the government deems to be desirable activities, foster job creation and promote investment. Most of these measures are specific to Québec and relate to activities that take place in Québec.

This appendix briefly examines the functioning and objectives of the main developmental measures in the Québec taxation system.

❑ Corporate income tax

¾ *Accelerated capital cost allowance*

The accelerated capital cost allowance is intended to promote investment in Québec. Generally speaking, taxpayers who operate a business in Québec may benefit from a 100% capital cost allowance in respect of certain eligible assets used in Québec, without taking into account the half-year capital cost allowance rule and the put-in-use rules that are usually applicable under tax legislation. An increase equivalent to 25% is granted in respect of assets eligible for the 100% allowance provided they are acquired prior to January 1, 1999, temporarily bringing the accelerated capital cost allowance to 125%. The tax legislation also makes provision for an additional deduction that is intended to accord the same financial value to the accelerated capital cost allowance, regardless of whether the concerns do business solely in Québec or also in other jurisdictions where the tax treatment of these investments is less advantageous.

TABLE A.1
ACCELERATED CAPITAL COST ALLOWANCE MEASURE APPLICABLE RATES

Eligible expenditure	Basic deduction	Additional deduction[1]	Maximum additional deduction[2]
Capital cost of certain assets used in Québec - New assets used in the manufacturing and processing of goods - New computer equipment - Certain intangible assets	100%	25%	20%

1 Assets acquired prior to January 1, 1999. The amount of the deduction must be divided by the proportion of business done in Québec.
2 This deduction is for taxpayers doing part of their business outside Québec. The amount of this deduction must be multiplied by the ratio of business conducted outside Québec and business conducted in Québec.

¾ *Tax holiday for the tax on capital respecting new investments*

Under the taxation system, companies established in Québec must pay a tax on capital, at the general rate of 0.64%, calculated on the paid-up capital recorded in the financial statements. With a view to stimulating new investment in Québec, a deduction is granted in the calculation of a company’s paid-up capital for the taxation year in which it makes eligible investments and for the subsequent year. This deduction, which is temporary in nature, is established according to the acquisition costs incurred prior to January 1, 1999 in respect of eligible assets.

The assets in respect of which a company may benefit from this deduction are, generally speaking, manufacturing or processing equipment, computer equipment, buildings used in conjunction with manufacturing or processing operations, and equipment and buildings used in conjunction with operations in the tourism sector.

❑ Research and development, and design

¾ Tax assistance for scientific research and experimental development (R&D)

The numerous measures introduced in the field are intended to foster R&D in Québec. Their objective is to encourage in-house research by businesses and university research, create synergy between businesses and the universities, and promote the use by businesses of human capital.

Various refundable tax credits are offered with respect to R&D, depending on the type of research conducted and the size of the company. Tax credits are generally calculated according to the wages paid for in-house R&D or eligible expenses incurred by a university entity, a research centre or a consortium, or in conjunction with a pre-competitive research project.

TABLE A.2
TAX ASSISTANCE FOR R&D

	SMB[1]	**Large company**
Deduction	All R&D expenses are deductible in calculating corporate income. They are reduced by the relevant federal tax credit paid for expenses incurred.	
Refundable tax credit by type of research		
- In-house research	40% tax credit applicable to the first $2 million of eligible wages	20% tax credit on eligible wages
- Research conducted by a university entity or a public research centre - Research conducted by a research consortium	Tax credit of 40% of an amount equal to 80% of the eligible R&D expense	
- Pre-competitive research	Tax credit of 40% of the eligible R&D expense	

1 A small or medium-sized business is a company with assets under $25 million.
Note: Special rules apply to the eligible expense when the R&D is conducted by a third party and to general expenses in the case of university research contracts or contracts concluded with a public research centre.

For companies that engage in in-house R&D and with assets totalling between $25 million and $50 million, the 40% rate falls in a linear fashion to 20%.

¾ *Refundable tax credit for design*

The tax credit for design seeks to support and accelerate innovation in businesses that engage in design in order to face competition.

This refundable tax credit has two components intended to encourage design. The first component concerns design activities carried out under outside consulting contracts concluded prior to January 1, 2000, in respect of design activities carried out prior to January 1, 2001. Companies operating in the industrial and fashion design sectors may take advantage of this tax credit, which is calculated according to the cost of a consulting contract. The second component focuses on in-house design activities. Companies operating in the fashion and furniture sectors may take advantage of this tax credit, which is calculated according to the wages paid prior to January 1, 2000, in respect of eligible designers, by a company with gross income of $150 000 or more. The tax credit includes essentially the same provisions for each component.

TABLE A.3
REFUNDABLE TAX CREDIT FOR DESIGN

Type of company	Rate of the refundable tax credit
SMB[1]	40%
Large company	20%

1 An SMB is a company with less than $25 million in assets.

The 40% rate diminishes in a linear fashion to 20% in the case of companies with assets totalling between $25 million and $50 million.

❑ Training and employment

¾ *Refundable tax credit for on-the-job training*

The refundable tax credit for on-the-job training seeks to better match student training programs and the needs of the labour market. A business that accepts a student or an apprentice for an eligible internship is entitled to a refundable tax credit provided that the internship begins before January 1, 2002. The eligible expense consists primarily of the intern's wages and the wages of the employee supervising the intern.

This measure is aimed essentially at apprentices, secondary and Cegep vocational training students, certain university undergraduates and secondary school students enrolled in special training streams aimed at social and vocational insertion.

TABLE A.4
REFUNDABLE TAX CREDIT FOR ON-THE-JOB TRAINING

			Refundable tax credit rate	
Clientele enrolled in the following programs:	**Maximum weekly credit**	**Maximum eligible weekly expense**	**Company**	**Individual**
- Secondary school vocational training - Cegep technical training - Undergraduate university - Qualification scheme[1]	$200	$500	40%	20%
- New vocational training stream[2] (secondary level) - Socio-professional insertion services (secondary level) - Specific training aimed at the social and occupational insertion of young people (secondary level) - Apprenticeship program[1]	$250	$625	40%	20%

1 Administered by Emploi-Québec.
2 For so-called non-specialized trades.

❑ Assistance for culture and communications

¾ *Refundable tax credit for Québec film and television production*

The refundable tax credit for Québec film and television production was introduced to support the production of independent films and television programs produced by Québec businesses.

A company that produces a Québec film or television program is entitled to a refundable tax credit calculated according to eligible labour costs, equivalent to a maximum of 45% of total production costs. Feature films, television films, mini-series, television series, documentaries, variety shows, television magazines and children's programs are covered by the tax credit. The amount of the tax credit is limited to $2.5 million per production.

Additional tax assistance is granted with respect to expenditures pertaining to the production of computer animation or special generated effects for use in certain Québec films and television programs. The wages paid to the employees assigned directly to such activities may make a business eligible for this additional tax assistance.

This enhancement is intended to foster the development of Québec firms operating in the information technologies sector.

TABLE A.5
REFUNDABLE TAX CREDIT FOR QUÉBEC FILM AND TELEVISION PRODUCTION

Production	Nominal rate applicable to remuneration	Effective rate based on production costs[1]	Cap on credit per production or series
French-language feature film[2]	45%	20¼%	$2.5 million
Specific documentary	45%	20¼%	$2.5 million
Other production			
-Without animation	33 1/3%	15%	$2.5 million
-With animation[3]	45%	20¼%	$2.5 million

1 When the 45% limit is applied to total production costs.

2 To be eligible, the film must satisfy more stringent Québec content criteria than those normally required by SODEC. This category also includes feature film coproductions that meet certain criteria.

3 The additional tax assistance, at the rate of 11 2/3%, applies solely to labour expenses incurred in respect of computer animation and special effects.

¾ *Refundable tax credit for dubbing*

In order to support dubbing operations carried out in Québec and enable businesses in this sector to broaden their market share, a refundable tax credit is being granted in respect of labour expenses incurred to dub an eligible production.

The tax credit is equivalent to 33 1/3% of the labour expenses incurred for this purpose. However, eligible expenses may not exceed 45% of production costs pertaining to dubbing, with the result that the tax assistance may not exceed 15% of such costs.

¾ *Refundable tax credit for film and television production services*

This refundable tax credit is designed to support the development of the Québec film and television industry, notably by encouraging foreign businesses to engage in filming in Québec. Productions that are not eligible for the film and television production tax credit because their Québec content is insufficient may also be entitled to the tax credit.

The amount of the tax credit obtained by a company is equivalent to 11% of the labour costs it incurs, provided that it maintains an establishment in Québec and that the expenses relate directly to services provided in conjunction with the filming of an eligible production.

As is the case with the tax credit for Québec film and television production, additional financial assistance is granted to companies that incur eligible expenses in respect of computer animation or special effects for use in an eligible production.

TABLE A.6
REFUNDABLE TAX CREDIT FOR FILM AND TELEVISION PRODUCTION SERVICES

Production	**Nominal rate applicable to remuneration**	**Effective rate based on production costs**
Production service		
-Without animation	11%	5 1/2% [1]
-With animation	31%	15 1/2% [2]

1 Assuming that the eligible labour expense is equivalent to 50% of the production service cost.
2 Assuming the eligible labour expense related to production services corresponds entirely to wages paid for computer animation and special effects and that such wages represent 50% of the cost of the production service.

¾ *Refundable tax credit for the production of multimedia titles*

This tax credit was introduced to foster the production of multimedia titles in Québec, notably in French, and to enable Québec companies to face international competition.

The tax credit is refundable and is based on the wage expenses incurred directly in the production of an eligible title or the cost of subcontracting contracts carried out by a business located in Québec. The tax credit has two components. The first is intended for companies that entirely or almost entirely devote themselves to the production of multimedia titles. The second is intended for other companies.

While the level of tax assistance is identical in the two components, the conditions of application of the tax credit vary depending on the component and in order to reflect the production structure of different businesses. To this end, a simplified attestation procedure has been adopted to facilitate the administration of the tax credit in the case of the businesses covered by the first component.

Provision is also made for additional financial assistance to encourage the use of the French language under the two components of the tax credit.

TABLE A.7
REFUNDABLE TAX CREDIT FOR THE PRODUCTION OF MULTIMEDIA TITLES

Category	Basic credit	Bonus for use of French
Multimedia titles intended for mass marketing	40%	10%
Other titles	35%	NA

¾ *Information Technologies Development Centre (ITDC)*

The purpose of this measure is to advantageously position Québec in the information technologies and communications sector, while fostering investment and job creation in this promising sector.

A company that carries out almost all of its operations in a building designated as an ITDC will benefit for five years from an exemption on income tax, the tax on capital and the payroll tax. Moreover, the company will benefit from a refundable tax credit in respect of the wages paid to eligible employees and a refundable tax credit for the acquisition of eligible specialized equipment. These tax credits are available during the first three years of eligibility for the tax holiday.

For a period of two years, foreign trainers employed by an eligible company in an ITDC will benefit from an exemption on income tax on the wages paid to them.

TABLE A.8
TAX BENEFITS (ITDC)

	Form	**Duration**
COMPANY		
— Income tax	Exemption	5 years
— Tax on capital	Exemption	5 years
— Payroll tax	Exemption	5 years
— Wages paid to an eligible employee	Tax credit equivalent to 40% of wages (maximum: $15 000)	3 years
— Eligible specialized equipment	Tax credit equivalent to 40% of the cost of the equipment	3 years
FOREIGN TRAINER		
— Tax holiday	Tax exemption	2 years

❑ Assistance for the shipbuilding industry

¾ *Refundable tax credit for the construction of or major repairs to a ship*

In order to revitalize the Québec shipbuilding industry, a refundable tax credit has been implemented in respect of certain construction or major repair costs incurred by a company maintaining an establishment in Québec.

Aside from the cost of plans and specifications, eligible expenses generally include wages paid to the company’s employees who are directly involved in building or transforming an eligible ship. The tax credit also applies to a portion of the cost of subcontracting contracts. The amount of the tax credit may not, however, exceed a certain percentage of the cost of construction or of major repairs.

TABLE A.9
REFUNDABLE TAX CREDIT FOR SHIPBUILDING

Ship	Rate	Limit based on construction costs
Prototype	50%	20%
1st model	37,5%	15%
2nd model	25%	10%
3rd model	12,5%	5%
Other[1]	NA	NA

1 The tax credit applies to certain expenditures inherent in the construction of or major repairs to four ships only, that is the prototype and the first three models in a series.