TAX POLICY

58. Reforming Canada's Tax System

DESCRIPTION

In a time when our largest trading partner has implemented sweeping tax reform that substantially simplified the U.S. federal tax code, Canadians face a dauntingly complex federal tax system that is filled with 'boutique tax credits' and is complicated by a collection of piecemeal changes implemented by successive governments based on tax changes driven by short term political issues rather than good tax policy. The resulting federal income tax system threatens Canada's economic competitiveness and is a barrier to success for Canadian businesses in the global race for talent where the best and brightest are highly mobile.

BACKGROUND

The United States tax reforms are expected to have an overall negative economic impact on Canada with the most significant impact on Canada's tax competitiveness. Other countries like France and the United Kingdom are creating attractive environments for businesses looking to expand or invest by dramatically reducing business taxes and taking measures to reduce red tape.

A December 20, 2017 opinion column in The Vancouver Sun by Fraser Institute staff Charles Lamman and High MacIntyre noted that "neither the federal government, nor any of the provinces, has presented a plan to maintain Canada's competitive position on business taxes. To the contrary, some provinces in the past two years have actually raised their corporate tax rates, making us less competitive compared with the U.S."

Furthermore, current federal and provincial finances particularly in Alberta and Ontario make short-term tax relief highly challenging without running larger deficits.

Jack Mintz of the University of Calgary argues that Canada's competitive edge in attracting business investment has rested on two pillars – a lower corporate tax rate and free trade. One pillar is gone with the second highly unstable for Canadian businesses exporting into the United States. In a December 19, 2017 Financial Post article Mintz further observed that Canada's competitive position is about to get rocked, making it harder for Canadian governments to push costs onto businesses through higher taxes and regulations. Federal and provincial authorities will need to change course and if politicians sit on their hands, Canadians will see investment, jobs and profits flowing to the United States.

It has been over 50 years since the release of the report of the Carter Commission, formally known as the Royal Commission on Taxation, which in 1966 released its report which was the country's last major undertaking to review and reform the country's tax policies and ensure a fair and equitable tax system for all Canadians. In that time, the country's tax system has become extremely complex due to the piecemeal reforms implemented by successive governments driven by the then-current political agenda rather than considering goals of fairness, efficiency and economic competitiveness. As National Post columnist Andrew Coyne notes "Put simply, the Canadian tax system is a creaking, productivity-killing wreck: hugely over-complicated, and riddled with unjustified deductions and exemptions that distort economic decisions and bleed the government of revenues, recouped by much higher tax rates than would otherwise be the case." (National Post, Dec. 15, 2017)

For example, the political backlash faced by the federal government for their series of July 2017 proposals to implement tax changes that disproportionately impacted Canadian small and medium-sized businesses under the guise of promoting 'fairness' in the tax system highlighted a problem created by decades of 'in the moment' political tax policy decisions. In justifying its proposals, the government pointed out the sharp trend upward in private corporations apparently motivated by the benefits of tax deferral and income sprinkling to name a few. Yet, that same government had just finished quickly and quietly implementing a 4% increase in the top marginal personal income tax bracket to well above 50% while lauding its efforts to make the wealthiest Canadians pay more. By doing so, the government effectively increased the impetus for Canadians to incorporate in a perfectly logical, legal and purely economic-driven attempt to reduce the substantial tax burden faced by them by taking advantage of the substantially lower small business tax rates afforded to private corporations for which successive federal governments have taken credit. The political uproar that resulted from businesses and professionals across the country succinctly demonstrated the effects of attempts to implement piecemeal tax changes rather than undertaking an overall review and reform of the country's tax system.

Manufacturing is vital to the Canadian economy. In 2016, it accounted for 10.4 per cent of the country's entire Gross Domestic Product (GDP). However, when the demand for goods and services generated by manufacturers are included, or the consumer spending from all the jobs created or maintained by manufacturers, nearly three of every ten dollars in wealth created in Canada can be traced back to the manufacturing sector.

Manufacturing businesses also invested an estimated $15.9 billion in new capital in 2016, including $12.1 billion in machinery and equipment. No other sector of the Canadian economy invests more in machinery and equipment. In addition, manufacturers account for one third of all research and development activities in Canada. Nearly 60 per cent expect to increase their investment in research and development over the next three years.

The personal and business tax changes in the U.S combined with the change that allows companies in all sectors to immediately write off the full cost of new machinery and equipment could affect the outcome of many companies' tax planning and investment location decisions, shifting growth and some companies to the U.S. This accompanied with the additional red tape and regulations borne by employers is reducing business investment. In fact, Canada is now the second lowest among 17 advanced countries.

Beginning in 2019, the expansion of the Canada Pension Plan (CPP) will further reduce funds available for domestic investment. This leaves less money available in Canada to finance innovative start-up businesses, the maintenance and expansion of existing operations and investments in new machines and technology which is critical for the economy.

Allowing Canadian companies to deduct cost of certain capital assets, such as machinery and equipment, over an accelerated period of time (such as one year) would increase capital spending and economic activity.

Canada can and should create an internationally competitive system of small business taxation as well as personal income tax rates that encourages business to invest in the technologies, skills, and capacity they need to grow while attracting highly qualified people from around the world.

The calls for a comprehensive review and reform of the Canadian tax system have substantially increased recently including a call from the federal Minister of Finance's Advisory Council on Economic Growth which in its third and final report to the Minister recommended that "we need to conduct a targeted review of our tax system to ensure that the tax regime fosters the development and adoption of innovation, and secures Canada's position as a global magnet for investment and talent. It is worth noting that it has been decades since the last significant review of Canada's tax systemâ€"years before the emergence of mobile phones and the internet, and the rise of the digital economy." (The Path to Prosperity: Resetting Canada's Growth Trajectory, Report of the Advisory Council on Economic Growth, December 1, 2017) Recently, the Royal Bank of Canada's CEO, Dave McKay, raised concerns of a 'significant investment exodus already underway' and suggested that Canada must take immediate steps to address the issue of competitiveness with the United States in its tax policies (Financial Post, "Investment dollars are already flowing out of Canada in 'real time', RBC CEO warns", Andy Blatchford, April 1, 2018). The Organization for Economic Co-operation and Development ('OECD') recognized the need to improve the global system for taxation in light of the digital economy and released a report in 2015 addressing Base Erosion and Profit Shifting ('BEPS'). This report included 15 action items to reform the global mechanisms through which tax is assessed and countries interact. These global changes need to be understood and woven into the Canadian domestic tax legislation.

As a result of the foregoing, it is time for the Canadian tax system to once again be reviewed from the ground up.

RECOMMENDATIONS

That the federal government:

1. Immediately appoint an independent, non-partisan commission or committee of tax policy experts to conduct an accelerated, comprehensive review of Canada's tax system to produce recommendations for reforms with the following aims:
    a. Promoting fairness and reasonable integration between the personal and corporate tax systems.
    b. Simplify and streamline the tax system to promote efficiency and ease of compliance for all individual and business taxpayers.
    c. Promote Canada's competitiveness in the global market and reward risk-takers, growth and innovation.
2. Adjust the tax mix (across the entire tax spectrum of business taxation, personal taxation, VAT, digital taxation, and property taxes) to encourage the attraction and retention of the investments, businesses, people, and skills needed to compete in today's global economy;
3. Allow businesses to fully expense the cost of new machinery and equipment in one year to support productivity, investment, and innovation;
4. Reduce the administrative burden of the Canadian tax system.

SUBMITTED BY LONDON CHAMBER OF COMMERCE
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THE TAXATION COMMITTEE SUPPORTS THIS RESOLUTION