TIME AND PLACE

For decades, executives, academics and CPA Canada have urged the federal government to overhaul Canada's outdated tax system. Now, with a former central banker in the prime minister's office and the U.S. provoking economic uncertainty, the opportunity for change could be right now.

BY JOHN LORINC

IN THE RUN-UP to the much-anticipated release of the federal budget, a group of manufacturing executives sat down with Ottawa journalists to talk taxes. According to a Bloomberg media account of the late October session, a lobbyist with a U.S.-based industry group said its members were encouraging Prime Minister Carney's Liberal government to enact changes to the Income Tax Act that would mirror those in President Trump's One Big Beautiful Bill. Recommendations included full expensing of equipment, matching renewed corporate tax reductions from Trump's first term, and tax rate cuts on domestic activity aimed at foreign sales.

"The only reason why the industry in the U.S. is not in worse shape is because of the big tax package that was passed," the lobbyist, Kip Eideberg, told Bloomberg. "Whether it's R & D [or] bonus depreciation, all of those provisions that were extended or made permanent have been a massive boon to the industry in the U.S. So we've been encouraging the Canadian government to do the same."

Steve Suarez, a tax lawyer and partner at Borden Ladner Gervais LLP (BLG), says these moves in some ways echo, or amplify, what's going on in other countries, where national governments are using their tax codes to boost productivity, export competitiveness and attract foreign investment. "The rest of the world is, to some degree or another, using its tax policy system and tax regime to try and attract domestic investment and stimulate its economy. The U.S. is doing that on steroids."

Suarez laid out a case for such reforms in a 47-page brief he published last summer, which advocates for reforms that would drive productivity and innovation for taxable Canadian corporations. He proposed measures such as targeted incentives for employee retraining, expanded credits for equipment capital investment and the removal of tax-based disincentives for scaling up innovation-oriented firms. "The government needs to stop being a spectator or a passive observer of the economy in terms of tax policy and start thinking about what would really help Canada's economy," he says. "We need to stop thinking that everyone views the world the way that we have historically."

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WHEN THE CARNEY GOVERNMENT tabled its first budget on November 4, the proposed measures included a cocktail of spending cuts, large-scale military investments and various infrastructure projects, as well as a suite of tax moves, several previously announced. According to Finance Minister François-Philippe Champagne, these are designed to spur private sector investment in productivity-enhancing equipment and R & D using provisions such as 100 per cent expensing of machinery and accelerated depreciation of manufacturing buildings for the first taxation year. There were also tax credits for productivity-enhancing assets, including patents, data network infrastructure and computers, and certain climate investments.

The budget allocates an additional $440 million "on an ongoing basis" to the existing $4.2 billion in annual support through the Scientific Research and Experimental Development (SR&ED) tax incentive program. Dubbed the "productivity super-deduction," these measures will cost an average of $2.7 billion annually, reports the *Financial Post*, reducing Canada's marginal effective tax rate (METR) to 13.2 per cent, which the budget states is the lowest among the G7 nations, including the United States in the post–One Big Beautiful Bill era. "With the productivity super-deduction," claimed the 493-page budget document, "Canada's METRs are competitive with those in the U.S. across most sectors, particularly in manufacturing and processing."

CPA Canada acknowledged the tight fiscal realities facing Carney's minority government, but wanted to see much more action on tax reform. "There's not a lot to unpack on the tax front in this long-awaited budget," said John Oakey, CPA Canada's vice-president of tax, in a press release issued by CPA Canada. "The government focused on economic productivity by expanding the SR&ED and critical minerals tax credits and committing to accelerated capital deductions, but left behind many promises outlined in their election platform."

Indeed, the budget stopped short of advancing comprehensive tax reform, says Suarez, pointing out that the new U.S. capital gain exemptions for small business remain far more lucrative than those available to Canadian entrepreneurs. He gave the Liberals' spending plan a C+. "They're certainly trying to present [the budget] as something that is responsive to what's happening in the U.S. I would respectfully suggest that's not really the case."

In theory, there should be broad political support for the goal of repairing Canada's creaky and cumbersome tax system. François Brouard, a professor of accounting and taxation at Carleton University's Sprott School of Business, says that when he canvassed the parties on tax reform prior to the spring election, they all agreed it was needed. "It seems we have a consensus among all the parties that we should have tax reform," he says.

The government's latest tax measures come on top of already announced tax policy changes, including the accelerated investment incentive (for writing down capital assets within the first year of ownership), the cancellation of the Trudeau government's contentious (and ultimately aborted) attempt to reduce the capital gains inclusion rate, and technical changes to rules governing the CRA's treatment of bare trusts and the underused housing tax (UHT). The budget also proposed to eliminate the UHT as of the 2025 calendar year, and broaden anti-avoidance rules for trust-to-trust transfers.

OUTDATED RULES AND COMPLEXITY LEAVE TAXPAYERS FACING CONFUSING, COSTLY COMPLIANCE

The question is whether these policies, in the aggregate, are sufficient, or if they'll satisfy the various constituencies in Parliament. CPA Canada expressed that there remains a lot of opportunity to tackle comprehensive tax reform—something that hasn't happened for decades. The last thorough reviews were the 1967 Royal Commission on Taxation and the 1986 white paper on tax reform, with the latter recommending the elimination of ineffective tax preferences as well as the introduction of a value-added tax to replace the hidden tax on business inputs.

Far-reaching reforms of tax systems have occurred more recently in other jurisdictions, such as Australia, New Zealand and the United Kingdom. It has been several decades since the last comprehensive review, and both domestic and global conditions have changed dramatically in that time, noted CPA Canada in its pre-budget submission to the government. It advocates that the tax system needs to be fit for purpose. CPA Canada's Oakey

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The page count of Canada's Income Tax Act. It's widely considered one of the longest and most complex pieces of tax legislation globally.

added in an op-ed published by *iPolitics* in the lead-up to the budget release that "outdated rules and needless complexity choke innovation, bog down businesses and leave taxpayers facing confusing, costly compliance."

Other experts point to the risk exposure created by Canada's status quo tax system in the context of the extreme volatility manufactured by Trump. Citing a policy uncertainty barometer, Trevor Tombe, economics professor at the University of Calgary, noted in the Canadian Tax Foundation's *Perspectives* newsletter that "by March 2025, economic policy uncertainty in Canada had risen to levels approximately 5.4 times higher than a year earlier. Among the nearly two dozen countries for which this measure is calculated, Canada has experienced, by far, the largest spike in uncertainty."

As an antidote, Tombe argues for rule changes such as full-cost expensing for capital investments in computer equipment, indexing asset cost bases to inflation for the purposes of capital gains taxes and tweaking the treatment of corporate tax loss carry-forwards. Some of these fixes showed up in the Liberal election platform in the spring. More recently, Champagne's officials took note and included immediate expensing for manufacturing or processing machinery and equipment, clean-energy generation, energy-conservation equipment and zero-emission vehicles in the November budget.

According to the U.S. Tax Foundation, Canada's international tax competitiveness, calculated before the new budget, is lagging badly compared to the 37 other Organisation for Economic Co-operation and Development (OECD) countries, even before Trump came into office. In 2024, we ranked 17th overall, one place above the United States but well behind northeastern and central European countries and nations such as Turkey and Israel. Canada's corporate and individual income tax rankings were even lower—26th and 31st, respectively.

The reason why we're so keen on a review is that taxes are not the holy grail of productivity and fairness, but they're a big part of it, says Ryan Minor, director of taxation for CPA Canada. "They create incentives or barriers to work, saving and investing. They add costs on society for compliance." He says that we need to look at not just the existing system, but ahead at the future development of taxes.

FOR MANY POLITICIANS across the ideological spectrum, the tax system too often serves as a kind of candy store, with a range of goodies on offer. For instance, during Stephen Harper's time in office, the Conservative government enacted a series of bespoke but small tax credits—for example, for art

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school or organized sports—intended more to harvest votes from target constituencies than to achieve wider policy goals. The Trudeau government also muddied the tax code waters with its own carve-outs as well as punitive surtaxes ostensibly designed to discourage certain behaviours, such as leaving dwellings unoccupied in a housing crisis.

Later in Harper's term, the Tories advanced a more serious effort at reform by cutting the federal corporate tax rate to 15 per cent. But that move—which sought to eliminate the marginal corporate tax rate as a decision point for companies choosing where in North America to locate—was largely undermined by some provinces raising their corporate tax rates, which erased the advantage created by the federal reduction, and also left Ottawa with a sizable gap in its operating revenues.

From an economic policy point of view—though not the public's—the Harper government's most controversial reform was shaving two points off the Goods and Services Tax. Canada's first value-added tax, the GST, dates to the early 1990s and Brian Mulroney's term. Despite the political firestorm that accompanied its introduction, subsequent governments, until Harper, maintained it, both because the GST brought in a lot of revenue but also for its cost effectiveness and transparency. "If you study the tax policy underlying it," says CPA Bertrand Lemieux, a doctoral candidate in management and a lecturer in taxation at Carleton University's Sprott School of Business, the GST "is a more equitable tax because people with more wealth tend to spend more … people that have less money consume less … All this creates a fair system."

This past summer, the C.D. Howe Institute put forward a case in the Canadian Tax Foundation's *Perspectives* newsletter for rejigging Canada's major tax streams to promote productivity in a revenue-neutral way. Its six key moves included: cuts to both the federal corporate tax rates and the top three income brackets; a restoration of two points to the GST; and other adjustments to the basic personal amount, medical expense exemptions and the federal age credit. As the authors—Alexandre Laurin, vice-president and director of research, and Nicholas Dahir, research officer at C.D. Howe—point out, such reforms aim to reduce the marginal cost of collecting taxes and mitigate the negative impact of corporate taxes on business investment.

Yet for a government run, at least for now, by a former central banker, it seems likely that tax measures aimed at boosting Canada's sluggish productivity, as well as its historically middling performance when it comes to business innovation, will gain the most traction.

The Liberals' election platform promised a number of reforms, including extending flow-through shares to the tech sector, incentives for small businesses to adopt AI and the establishment of a so-called "patent box," a measure designed to reduce the tax on income from intellectual property and encourage Canadian firms to retain patents instead of selling them to offshore investors. None of which were included in the budget.

The patent-box proposal is a direct response to the long-standing concerns that Canadian companies either tend not to invest in R & D or, when they do, lose control of their intellectual property

THERE'S NOW A PRESSING POLITICAL AND ECONOMIC CASE FOR FILLING THE GAPS BETWEEN CANADA'S TAX SYSTEM AND THE NEW U.S. RULES

by selling their patents to offshore firms. Although patent or innovation boxes are used in jurisdictions like the United Kingdom, some experts have questioned their effectiveness. "Other countries have these regimes and they don't work," says Minor. "Generally, the empirical [research] has said that they're not very effective."

In his own menu of possible fixes, BLG's Suarez also cites the potential for tax support aimed at encouraging companies to invest in artificial intelligence (AI), AI training and investor-focused incentives designed to de-risk investments in innovation-oriented firms. He says some U.S. states and Australia provide tax credits for angel investors and other qualified investors in firms that are deemed eligible based on various innovation tests. Lastly, Suarez and others argue that the tax system can be used to reward those who back successful innovation-oriented firms by enhancing capital gains exemptions for investors when they eventually dispose of their shares in such firms.

"The government has talked about flow-through share financing for certain kinds of businesses," he adds. "I used to do mining 15 years ago and did plenty of flow-through share deals. I'm not sure if it's adaptable for this sector, but [why not] give it a try."

1967

The last time a thorough review of the Canadian tax system was conducted—almost 60 years ago

DAVID PIERCE, vice-president of government relations for the Canadian Chamber of Commerce, offers a higher-level view of the narrative surrounding tax reform. Although political and media attention since January has been primarily focused on the consequences of Trump's tariffs, Pierce says the relatively less-discussed implications of the aggressive tax moves in the One Big Beautiful Bill are at least as, if not more, transformative. "Trump is essentially weaponizing his tax system to bring companies to the United States," he says. "We're saying this to anyone that will listen."

Pierce recounts a recent discussion with an unnamed Canadian firm that was assessing whether to stay or move to the United States. The firm concluded that "the reason to stay in Canada is because it's the right thing to do. The business case is eroding."

The Chamber had a generally positive response to the federal budget, lauding reforms to the SR&ED tax credit. But, the organization noted, "The test ahead is execution and follow-through—ensuring that policies translate into real-world competitiveness and growth."

However, the Liberals' budget plan, at least for this coming fiscal year, has failed to deliver a fully modernized tax system that will enable Canadian firms to survive against the enormous gravitational pressure being exerted by the United States. Pierce cites lingering uncertainty about the consequences of extant federal tax policies such as the recently adopted global minimum tax—a measure approved by several nations to discourage tax havens but rejected by the United States.

"Every example like that is one more reason to spend that investment dollar somewhere other than Canada," Pierce observes, adding that there's now a pressing political and economic case for "filling the gaps" between Canada's tax system and the new U.S. rules. "The risk of doing nothing," he says, "is far greater." ◆

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