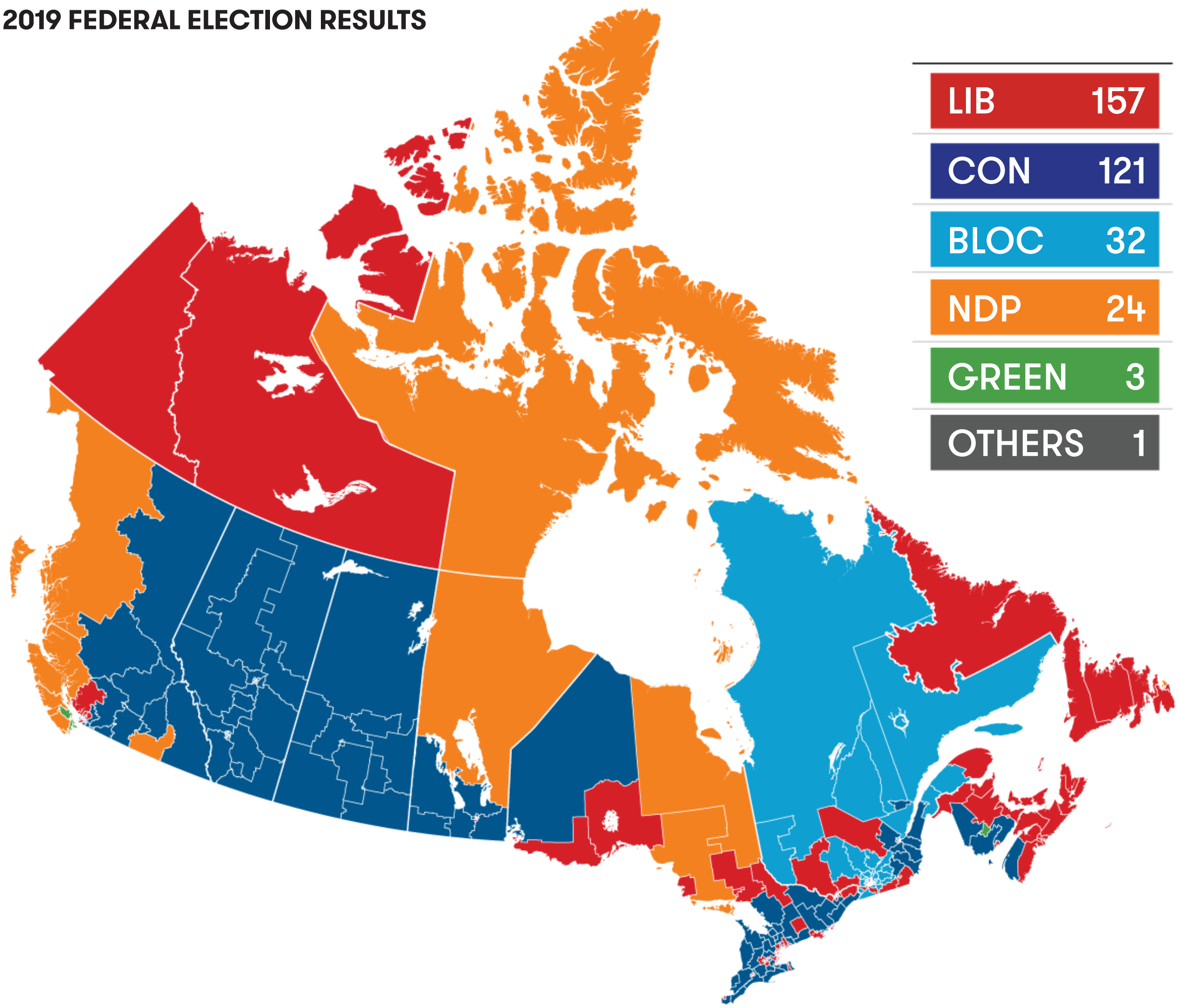
Canada renews Liberal mandate, with new cautions and conditions

Canadians have returned the Liberal government to Ottawa, though with new limits on that government's authority. Businesses, consumers and families may find new opportunities—as well as a few new risks—as the government seeks to enact budgetary, tax and environmental policies that can bridge regional and political divisions.

2019 FEDERAL ELECTION RESULTS



SOURCE: The Globe and Mail. https://www.theglobeandmail.com/politics/article-federal-election-2019-results-trudeau-liberal-minority-explainer/

Canada's 2019 federal election has concluded, ballots have been counted and the Liberal party will be returning to Ottawa to form government, although this time without a majority in Parliament.

After a 40-day campaign, the election results answer some key questions, but also raise new questions and uncertainties stemming from regional and political divisions:

- The Bloc Quebecois has surged since the last election, dominating Quebec at the expense of the other parties.
- The two top political parties received almost the same share of the popular vote, although the party with the higher popular vote, the Conservatives, will not be forming government.
- Sentiment in the West, particularly in Alberta and Saskatchewan, has leaned even further towards the Conservative party, with both the Liberals losing the few seats they held in those provinces and the NDP losing all but one.

170

What's in a number?

With 170 (or more) seats in the House of Commons, a government has a free hand to shape the laws and policies that impact Canadian businesses and individuals. Falling short of 170 seats means the government must have the support – or at least acquiescence – of other parties to pass its budgets and other parts of its legislative agenda.

The first and most significant outcome of this election is the new limit it places on the Liberals' authority – the government will now need some form of cooperation from outside its caucus to pass budgets and other essential legislation. Given the political and regional differences between the major parties, that cooperation could come from different quarters, so it's possible that the Conservatives, the Bloc and the NDP could wield additional influence at various points in the legislative process. This fundamental shift adds a new variable to the political calculations surrounding any significant legislative measure – a variable that may generate uncertainty, but that could also open new opportunities for Canadian businesses and individuals.

Prior to the election, Grant Thornton released a **summary of the major party platforms** with a particular focus on tax and business-related items. Today we are revisiting our comparison to consider what policy changes we might expect now that the election results are in, and what those policy changes might mean for Canadians.

The focus of this analysis will be on key policy proposals through the following lenses:

1. Impact on Canadian businesses and business owners;
2. Impact on Canadian families and homeowners; and
3. Impact on Canadian consumers.

Impact on Canadian businesses and business owners

Prior to the 2019 election, the Liberal government stated that small business owners have not been paying their "fair share," taking advantage of "loopholes" in the tax system.

Over the past few years, the government has implemented a number of changes to tax law to address this perceived unfairness. The most significant of these changes include:

- Limits on income-splitting with family members (i.e. TOSI rules);
- Limits in passive investments held within a corporation; and
- Additional restrictions on the ability to share the small business tax rate amongst associated corporations.

In contrast to this, however, the federal small business tax rate was decreased, from 11% in 2015, when the Liberal government first came to power, to 9%, as it currently stands in 2019. Nonetheless, this 2% decrease in the tax rate has provided minimal relief to small business owners who are now facing a significant additional tax burden due to the changes made by the Liberal government during their first mandate. It remains to be seen how the Liberals will approach business tax changes now that they will be operating as a minority government, and what changes, if any, will be forthcoming.

Tax rates on Cleantech business

In an effort to promote clean technology businesses, the Liberal platform included proposals to halve the corporate tax rates for businesses using renewable and sustainable sources of energy. As proposed, the benefit would halve the tax rates for both smaller and larger cleantech businesses.

Proposed Corporate "Cleantech" tax rates

	Regular rate	Cleantech rate
Small business	9%	4.5%
Large business	15%	7.5%

Whereas the NDP and Green parties both proposed an increase to the general corporate tax rate, the Conservatives proposed a policy line similar to the Liberals, cutting the corporate tax rate down to 5% for green technology businesses. Canadian businesses – and the Canadian economy as a whole – could benefit from the resulting growth in clean energy businesses able to reinvest their tax savings. Although the Conservatives have been vocal opponents of the Liberals' recent tax changes impacting Canadian businesses, this is one area of potential collaboration between the two in a future federal budget.

Changes impacting employees

The Liberal party included several proposals impacting employees and, consequently, employers as well. Leading the list is the proposal to raise the **minimum wage** federally to $15 per hour. Currently, only Alberta has a minimum wage equal to this proposed amount, with BC set to reach $15.20 by 2021.

$15/hr

Raise the federal minimum wage

The Liberal platform also includes a proposal for an additional **Family Day holiday**, as well as additional health and safety requirements, greater labour protections for freelancers and a worker's right to refuse overtime. Businesses have expressed concerns that these new measures, if passed, could result in increased costs for employers as well as additional administrative burdens. A higher minimum wage could potentially result in layoffs, while the right to refuse overtime may result in employers having difficulty in finding workers to complete projects on time, or alternatively, increased costs due to a higher overtime wage being demanded by workers.

Pipelines and Energy

The issue of pipelines was surrounded by uncertainty even before the election – as the government had difficulty articulating a consistent position – and that uncertainty is likely to persist in the new political landscape.

It has been argued that the passage of **Bill C-69** this past summer made it more difficult to get new pipelines built due to that bill's inclusion of measures that would require an environmental assessment of all new energy projects. However, the Liberal government also purchased the **Trans Mountain pipeline** in 2018, and all signs seem to indicate that they are intent on getting it operational. Although the question of Trans Mountain is currently with the courts, there is also a question of whether or not a minority Liberal government intends on building new pipelines in the West, and what their intentions are with respect to the Energy sector across the country. Furthermore, if the Liberals do intend on pushing through Trans Mountain (or any other pipeline), they will need to consider which political party they will turn to for support.

In their platform, the Conservatives supported building more pipelines, flagshipped by their National Energy Corridor project, to expand oil, gas, hydroelectricity and telecommunications infrastructure. For its part, the NDP platform stated that it would eliminate fossil fuel subsidies to oil and gas companies, however the party's position on pipelines is unclear, (and the source of intra-party disputes between provincial party leaders in BC and Alberta). With the provinces of British Columbia, Alberta and Saskatchewan sure to contribute each of their opinions on the matter – particularly Alberta, whose governing United Conservative Party is set to release their first provincial budget on October 24 – there is still much to be seen with respect to this issue.

Limitations on deductibility of interest

In a position that could require certain businesses to review and restructure their corporate debt arrangements, the Liberal platform proposes to limit the deductibility of interest expense greater than $250,000 to 30% of earnings before interest, tax, depreciation and amortization (EBITDA). Details of this rule were not available in the Liberal party's platform and had to be examined through the Parliamentary Budget Officer's costing document. This document makes the assumption that the rule would not apply to Canadian-controlled private corporations (CCPC) with active business income less than $500,000 or taxable capital less than $10 million, but this is not yet clear as no specifics have been provided to date by the Liberal government.

Although the assumed exceptions mean the rule would not apply to some "smaller" Canadian small businesses, there is still the potential for this rule to impact those Canadian businesses that are part of a larger corporate group. There is no indication of whether or not the $500,000 active business income and $10 million taxable capital exceptions would apply to an associated group of companies; however, this seems likely based on other tax rules that rely on these thresholds.

It is also possible that such a measure will restrict the ability of companies to raise new capital to finance operations. These companies may have to rely more on raising capital through equity, which is not always a viable option, particularly in closely-held family businesses. An increased reliance on financing growth and expansion via equity (instead of debt) could potentially limit Canadian businesses ability to grow and even to operate effectively, as the reduced tax savings from the limitations on interest deductibility could potentially have a negative effect on cash flow.

Capital-intensive businesses may also struggle as they often rely upon debt financing to raise sufficient capital to continue operations. The tax savings obtained from interest payments on large amounts of debt could be severely limited for businesses operating in lower margin industries, such as with some types of manufacturing and utilities. Businesses looking to expand outside of Canada or through M&A transactions could also be affected, with the ability for expansion through either method being limited.

Should these proposals be passed, careful planning will have to be undertaken in advance by businesses that may be looking to raise capital in order to ensure the impact on the interest deductibility and their business operations is limited.

Taxation of the digital economy

Nearly all the major parties included a proposal for a tax on digital corporations similar to the one levied by France earlier this year. Furthermore, the details of each party's proposal were almost identical. The Liberal proposal would impose a 3% tax on revenues earned by international digital corporations and would only be applicable to those with worldwide income of at least $1 billion and Canadian revenues of over $40 million. Given the widespread support for this tax amongst the parties, as well as amongst the general public, there is a significant chance that this tax will be introduced in an upcoming federal budget.

Although it has the potential to bring in a substantial amount of tax revenues, it is unclear what the impact of this tax would be to the rest of the Canadian economy. There may be a trickle-down effect, as there is some likelihood that such a tax will be passed on to the Canadian consumer, both businesses and individuals alike.

Changes to the taxation of stock options

Budget 2019 included proposals to change the taxation of stock options in a future budget (potentially Budget 2020). Although these measures were not fully flushed out nor enacted prior to the election, preliminary details were provided. These details included limiting the stock option deduction (equal to one half of the income inclusion under certain circumstances) to an annual maximum of $200,000; although such a limit would not apply to start-ups or rapidly growing Canadian businesses.

It is likely that changes to increase the taxation of stock options will be forthcoming. Both the NDP and Green parties included limitations to the stock option deduction in their platforms, with the former proposing to eliminate the stock option deduction entirely, which could result in a significant increase in the tax bill of many Canadian employees.

The impact of this change to Canadian businesses could potentially be significant too. Many Canadian businesses use stock options to attract skilled employees. Limitations on the stock option deduction, or the complete removal of it, could lead to a decrease in Canadian businesses' ability to attract skilled employees as these limitations would increase the amount of tax the employee would have to pay on the benefit received. Although the effect is somewhat mitigated by the fact that these rules would not apply to start-ups and growing businesses, the rules are not yet finalized and the proposed changes could have unintended consequences on the ability of Canadian businesses and business owners to attract top talent.

Capital gains

Although there was some discussion from other parties about increasing the capital gains inclusion rate, which currently stands at 50%, the Liberals did not include this in their 2019 platform. However, as part of the previous package of tax changes mentioned above, the Liberals had also proposed changes to limit the ability to claim capital gains treatment (instead of dividend treatment) on certain tax planning arrangements, which effectively lowers the tax rate of these transactions. Although these proposals were ultimately withdrawn, there is speculation that this is still on the government's radar, particularly because the courts have generally ruled in favour of the taxpayer in such tax planning arrangements.

Despite - or perhaps because of - this fact, it is possible that the Liberals will again pursue such changes. Or, perhaps the easier solution would be to increase the capital gains inclusion rate, thus reducing the effectiveness of these tax planning arrangements. Although not included as part of the Liberal 2019 platform, an upcoming budget may include a measure to increase the capital gains inclusion rate, which would likely be supported by the NDP, which included an increase in the inclusion rate to 75% as part of their platform.

Effect of increase in inclusion rate example

	50% inclusion rate	75% inclusion rate
Capital gain	$100,000	$100,000
Amount included in income	$50,000	$75,000
Federal tax @ 33%	$16,667	$25,000
Additional tax on higher inclusion rate	–	$8,333

Impact on Canadian families and homeowners

Although some of the parties had similar proposals when it came to measures impacting businesses and business owners, the parties varied a fair bit in their approach to personal taxation.

The Liberals proposed lowering taxes for the "middle class", which would be phased out when income hit a certain level; the Conservatives proposed a menu of boutique tax credits that reflected priorities they have promoted since the Harper-era; and the NDP proposed higher tax rates at the top bracket as well as a 1% super-wealth tax on those who's net wealth is over $20 million. Most parties proposed enhancements to childcare benefits or funding and each party had its own plan to help Canadian homeowners and would-be homeowners.

Taxes

There is a high likelihood that Budget 2020 will include measures to lower personal taxes through an increase in the basic personal amount ("BPA"), which is a tax credit that is indexed to inflation. In 2019, every Canadian resident is exempt from federal income tax on the first $12,069 (i.e. the BPA) of taxable income. The Liberal platform proposed to increase this exemption (beyond the regular increases indexed to inflation) starting in 2020 such that in four years the BPA would reach $15,000. This measure is unlikely to face opposition from any of the political parties in the legislature, given its nature as a tax cut to individuals, particularly lower and middle income individuals, since the increased BPA begins to be phased out once taxable income hits $150,605.

Family benefits

The Canada Child Benefit ("CCB"), which was introduced by the previous Liberal government in 2016, provides families with a tax-free monthly payment of up to $6,639 for children under 6 and $5,602 for children from 6 to 17, as of July 2019. The benefit is reduced as income increases beyond a certain threshold; thus, it is targeted towards low and middle-income families. The Liberal platform proposed to increase the CCB by 15% for children under the age of one.

The Liberal platform also proposes increased childcare spaces, increased extended-hour childcare spaces and lower childcare fees for before and after school programs. In addition to these changes to childcare, the Liberals are also proposing to make maternity and paternity benefits tax-free, as well as expanding paid leave in other ways.

Like the proposed cuts to personal taxation noted above, it is unlikely that any of these measures will be strongly-opposed by any of the political parties due to the targeted nature of the measures.

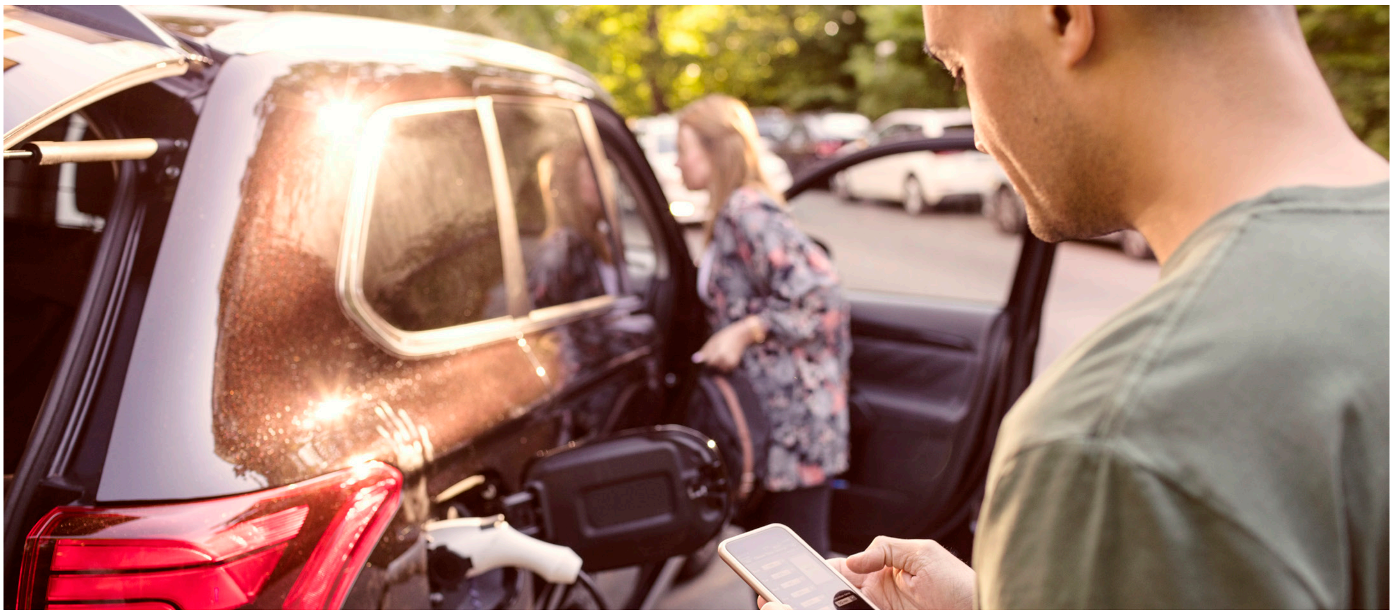
Home-related incentives

The Liberals put forward two major pillars related to making home ownership more affordable for Canadians: enhancements to the First-Time Home Buyer Incentive and a federal vacancy and speculation tax on non-residents.

The First-Time Home Buyer Incentive, which is available to taxpayers with at least a 5% down payment and under $120,000 of household income, provides homebuyers with up to 10% toward a down payment on a new home (5% on resale homes). The criteria for a home to qualify for this incentive was somewhat restrictive and made it difficult for potential homeowners in expensive markets to benefit. To address these concerns, the Liberals have proposed to increase the value of a qualifying home from approximately $500k to $800k in specific markets.

The federal vacancy and speculation tax would apply a 1% tax on the property value of any residential real estate owned by non-resident non-Canadians (whether they be individuals, corporations, partnerships or trusts). The tax would not apply to any home occupied by a tenant or family member for at least six months of the year.

Impact on Canadian consumers



The Liberal platform included several environment-related proposals. One of these is actually an expansion of an existing incentive, extending the rebate that is currently available on the purchase of new zero-emission vehicles (ZEVs) to include used ZEVs too. The rebate would be equal to 10% of the used vehicle's price, up to $2,000. This measure is likely to gain support from the NDP, which also proposed tax relief on ZEVs by waiving the sales tax on these vehicles. With a greater push towards green technology, particularly in automobiles, new tax incentives could mean savings for Canadians in the market for a ZEV and this could also result in an increase in Canadian production and sales for auto manufacturers of ZEVs and related industries.

On the other end of the spectrum, the Liberal platform also proposed an additional 10% excise tax on luxury cars, boats and personal aircraft over $100,000. The additional tax would not apply to commercial use of these vehicles. It is uncertain whether such a tax would have a significant impact on the buying behavior of Canadians in the market for such goods, or if it would generate significant new revenue for the government. Previous attempts to impose luxury taxes in other jurisdictions have resulted in disruptions to businesses that manufacture those goods.

In your corner

Taken as a whole, the proposals on the table for the 2020 federal budget (and beyond) could offer new opportunities for Canadians – though there are some potential risks for businesses, consumers and individuals as well.

Uncertainty is always a part of the process following a federal election. Even for majority governments, measures included in party platforms are rarely translated 100% into law, and the incoming government's minority status means that there are now more variables in the equation. The tax, advisory and accounting experts at Grant Thornton are following these dynamics in Ottawa in order to help you maximize your financial growth potential. If you have questions about how these potential changes might impact you, please contact us.

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