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Post-alert

Budget 2019

Making sense of what's next.

New promises, but are they enough?

Budget 2019 provided the federal government with an opportunity to address some of the issues that have been affecting our economy, by introducing policy and spending plans that might help improve the competitiveness of Canadian businesses. Although there were some policies introduced that could have a potential positive effect on Canada's business environment and the economy as a whole, Budget 2019 fails to deliver the real change that is needed.

Innovation and growth

As noted in Grant Thornton's pre-budget alert, accessing capital and attracting talent are two of the biggest challenges faced by start-ups. Budget 2019 introduces several measures that aim to promote innovation and support entrepreneurs.

Elimination of taxable income requirement for refundable SR&ED credit

Under the existing Scientific Research and Experimental Development (SR&ED) tax incentive program, certain Canadian controlled private corporations (CCPCs) are eligible for an enhanced fully refundable investment tax credit (ITC) at a rate of 35% available on up to $3 million of qualifying SR&ED expenditures annually. Prior to the changes proposed in Budget 2019, this expenditure limit was gradually reduced when

- the prior year's taxable income for the associated group exceeded $500,000 (completely eliminated at $800,000) or
- taxable capital employed in Canada by the associated group exceeded $10 million (completely eliminated at $50 million).

Budget 2019 proposes to repeal the taxable income component of the qualifying expenditure reduction formula so that CCPCs will only be subject to reductions in their enhanced SR&ED credits on their taxable capital employed in Canada. The new rules are intended to better support growing innovative businesses as they are scaling up, and the taxable capital thresholds will help to ensure that the enhanced rate remains targeted toward small and medium-sized enterprises (SMEs).

Although this change can potentially result in more Canadian SMEs qualifying for the 35% refundable ITC (as opposed to the 15% non-refundable ITC), some of these businesses may still be subject to the limit due to the taxable capital threshold, which remains in place. As such, the changes to the rules may not promote innovation as much as the government may have intended. Expanding the refundable ITC to entities that do not currently qualify, such as foreign-owned entities or public corporations, could help to achieve this goal.

Canada Training Credit and Employment Insurance training support benefit

Budget 2019 introduces the Canada Training Credit (CTC), a refundable tax credit for Canadian residents enrolled at eligible educational institutions for up to 50% of eligible tuition and fees associated with training.

Furthermore, a new Employment Insurance (EI) benefit (55% of a person's average weekly earnings) provides workers with up to four weeks of paid leave every four years to help them cover living expenses when they take a leave from work for additional training. Budget 2019 also introduces an EI Small Business Premium Rebate for small businesses, to alleviate the impact of the EI training support benefit.

The skills gap remains one of the biggest challenges faced by STEM (science, technology, engineering and mathematics) industries today. According to a Business Development Bank of Canada research study, 53% of SMEs say the labour shortage will limit their business investment this year. The CTC and EI training support benefit may motivate workers to update their knowledge and skill in this rapidly changing technological world and reduce the skill gaps in the Canadian labour market.

However, the Canadian Federation of Independent Businesses is worried that these expensive programs cannot guarantee that what workers study will match the needs of employers.

Am I eligible for the Canada Training Credit?

Eligible individuals can accumulate $250 each year (to a lifetime maximum of $5,000) in a notional account starting in 2019. The credit will be available to be claimed for expenses in respect of the 2020 tax year.

An eligible individual must meet the following conditions for the year:

- File a tax return for the year;
- Be between 25 and 65 years old at the end of the year;
- Be resident in Canada throughout the year;
- Earn at least $10,000 in the year (this includes employment income, self-employment income, maternity and parental employment insurance benefits, the taxable portion of scholarship income and the tax-exempt part of earnings of status Indians and emergency service volunteers); and
- Have individual net income for the year that does not exceed the top of the third personal tax bracket for the year ($147,667 in 2019).

Stock option deduction

Budget 2019 attempts to align the tax treatment of stock options with similar US rules for employees of "large, long-established and mature" companies by proposing to limit the availability of the stock option deduction to an annual maximum of $200,000 of stock option grants (based on the fair market value of the underlying shares on the date of grant). However, employee stock option benefits for start-ups and rapidly growing Canadian businesses would not be subject to the proposed limit.

Although the budget expressly excluded employees of "start-ups and rapidly growing Canadian businesses" from the $200,000 annual cap, many uncertainties still exist. For example, how will the government define "large, long-established and mature firms"? Also, what would happen if a business that is considered a start-up were to become a "large, long-established and mature firm" with stock options that were issued during its start-up phase still outstanding?

The government will need to provide greater clarity surrounding these rules to allow businesses to properly and effectively plan their strategies for talent attraction and remuneration. Further details about this proposed measure are expected to be released by the government before the summer of 2019.

Funding for global talent attraction stream

In June 2017, the government introduced a 24-month Global Talent Stream pilot program to provide a faster and more predictable route to bring top talent from around the world to Canada.

Budget 2019 proposes to invest $35.3 million over five years to make the Global Talent Stream a permanent program. This change may help to close the skills gap for STEM businesses across the country.

Eligible foreign workers with employer-approved applications can receive their work permits in two weeks. As of November 2018, 3,265 applications were approved for over 900 unique employers from various industries, such as:

- information and communications technology
- advanced manufacturing
- visual effects and animation
- financial services
- video gaming and entertainment
- clean technology

Funding provided by Futurpreneur

As discussed in Grant Thornton's Entrepreneurship article, the overall entrepreneurship rate (number of entrants as a fraction of total number of firms) in Canada declined from 24.5% in 1984 to 12.7% in 2013. As the article explains, the 24 to 35 year old age group saw the largest drop in entrepreneurship rates—and increasing levels of student debt might be at least part of the reason for this decline.

Budget 2019 proposes to provide $38 million over five years to Futurpreneur Canada, a national not-for-profit organization, to support the next generation of entrepreneurs. Futurpreneur Canada will match these investments to help support the work of approximately 1,000 entrepreneurs per year aged 18 to 39. Additional funding invested in Futurpreneur Canada may help mitigate some of the financial pressure faced by young entrepreneurs.

Trade and Canadian business competitiveness

A muted response to external pressures

In recent years, Canada has continued to face increasing economic pressures from outside its borders. Some of the more significant events include:

- Large reductions to corporate and personal tax rates in the US
- Difficulties in renegotiating the North American Free Trade Agreement (NAFTA)
- Tariffs on Canadian aluminum and steel imported into the United States
- Continuing trade tensions with China

No tax rate changes

With the 2018 US Tax Cuts and Jobs Act (TCJA), US corporate tax rates were reduced from 35% to 21%. After factoring in state taxes, according to the OECD, the US statutory rate dropped from approximately 39% to 25.8%, a full percentage point lower than Canada's combined rate of 26.8%. The TCJA also included an accelerated write-off for capital purchases, further improving the tax position of US businesses vis-à-vis Canadian businesses.

Many in the business community called on the Canadian government to respond to these tax cuts with similar measures to ensure Canadian businesses, and the economy as a whole, would remain competitive with the United States, its largest trading partner. In its 2018 Fall Economic Statement, the Canadian government did respond to the US tax cuts by implementing an accelerated write-off of capital purchases. However, no further reduction to tax rates was introduced in that release, nor in Budget 2019.

The spread between the highest US and Canadian corporate tax rates provides companies with a greater incentive to earn profits in the United States, rather than in Canada, since those profits will be taxed at a lower rate. Furthermore, personal income tax rates have also been reduced in the United States, with a 2.6% decrease in the top rate. Prior to this rate change, the OECD indicated that in 2017 there was already a seven percent difference between the top US rate (46.3%) and the top Canadian rate (53.5%).

Given that the top rate in Canada applies to a much lower income than in the United States, these changes have the potential to induce a migration of skilled talent to the United States.

Overall, the tax changes in the United States, and Canada's lack of response thereto, can potentially have a significant impact on Canada's ability to remain competitive. Budget 2019 resulted in a missed opportunity to address these issues.

Canada-US tax comparison (based on OECD statistics)

	Canada (2018)	United States (2018)
Top corporate tax rate	26.8%	25.8%
Top personal tax rate (single individual)	53.5%	*(est.) 43.7%
Top personal bracket (federal; single individual)	C$205,843	US$500,000

*Estimate based on 2017 figures provided by the OECD and 2.6% decrease in top personal tax rate for 2018.

Little to address Canada's continuing trade woes

Although Canada, the United States and Mexico have been able to come to an agreement on the United States-Mexico-Canada Agreement (USMCA) to replace NAFTA, the deal has yet to be ratified in any of the three countries. Furthermore, there has been speculation in all three countries that the USMCA may not be ratified, for various reasons.

In addition to the uncertainty surrounding the ratification of the USMCA, the United States continues to impose tariffs on Canadian steel and aluminum. Canada has also recently been involved in a trade dispute with China, most recently resulting in the cancellation of export permits for at least two large canola seed exporters in Canada. The imposition of such measures from two of Canada's largest trading partners can have a significant effect on Canada's economy, which is highly dependent on export.

As mentioned in our pre-budget release, Canada has recently entered into free trade agreements with countries in Europe, Asia and other parts of the world with the CPTPP and CETA. Given all of these recent difficulties, it became clear that Canadian businesses would have to explore other export markets to continue to grow and succeed.

Budget 2019 presented an opportunity to provide assistance to Canadian business owners and help them bring their goods to additional markets. However, apart from the assistance offered to Canadian farmers (see below), Budget 2019 did little to help the vast majority of Canadian business owners that continue to operate in today's uncertain economic climate.

Assistance for Canadian farmers

Due to terms negotiated in some of Canada's free trade agreements, Canadian farmers have been negatively affected. Budget 2019 proposes up to $3.9 billion for farmers, as follows:

- Up to $2.4 billion for eligible dairy, poultry and egg farmers to assist them with any losses incurred stemming from the free trade agreements, and
- Up to $1.5 billion to help farmers deal with a reduction in quota value when a quota is sold.

The Canadian Federation of Agriculture and the Dairy Farmers of Canada have both reacted positively to the news of this funding. These measures, along with proposed relief from certain carbon fuel charges, provide some support to farmers that have been, and continue to be, negatively affected by Canada's continuing trade issues.

Additional tax incentives and other measures

Although the government's response to the major issues of trade and competitiveness was largely ineffective, some measures were introduced that could have a potentially positive overall effect for Canadians.

Support for millennial homebuyers

Since January 1, 2018, prospective homebuyers have had to undergo new mortgage stress tests, which generally reduce the amount of mortgage that the homebuyer can qualify for. This, coupled with rising interest rates since July 2017, has made home-buying increasingly difficult for many Canadians. Millennials, in particular, have been negatively affected, since they often struggle with high student debt and lower-wage jobs.

Budget 2019 introduced two changes meant to specifically target this demographic and improve their ability to purchase a home:

1 First-time homebuyer incentive

2 Updates to the homebuyer's plan

The first change is a new measure that provides funding to the Canada Mortgage and Housing Corporation (CMHC), which would contribute up to 10% of the value of the home as a down payment for first-time homebuyers who qualify. This could help prospective homebuyers purchase a new home if they do not have enough savings for a down payment.

The second change increases the amount that can be borrowed from an RRSP to purchase a home from $25,000 to $35,000, for withdrawals made after March 19, 2019.

Although there are some positive aspects to each of these rules, some uncertainties as to their effectiveness remain. Given the maximum incentive available per household (i.e. $480,000, equal to four times the maximum household income threshold of $120,000), the first-time homebuyer incentive will likely have limited benefit given the average price of a home in Canada. This is particularly true in larger cities with active markets, such as Vancouver and Toronto (see chart below).

The increase in the RRSP limit to $35,000 may also not be as effective as intended. Millennials struggling to save for retirement will likely have difficulty raising these funds. And prospective homebuyers who have accumulated the additional $10,000 in their RRSP would be less likely to need help purchasing a new home in the first place.

Average home prices, Feb. 2019 (Canadian Real Estate Association)

Canada	Greater Toronto	Greater Vancouver
$468,350	$767,800	$1,016,600

2016 (last) Canadian census stats (Stats Canada)

43.6%	70.1%	76.3%
Home owners aged 20 - 34	Home owners aged 35 - 54	Home owners aged 55 - 64

Furthermore, these changes do not attack the root of the problem, which is the high price of homes in many cities across Canada. An increase in the supply of housing is more likely to bring the price of homes down to more affordable levels. Budget 2019 is providing additional funding of $10 billion over nine years to the Rental Construction Financing Initiative, which provides low-cost loans for the construction of new rental housing. It remains to be seen whether this additional funding will have a significant enough effect on the supply of homes to actually lower overall prices.

Accelerated write-off of zero-emission vehicles and other related measures

Budget 2019 introduced new tax incentives and spending measures to promote the purchase and use of zero-emission vehicles.

As previously mentioned, in the 2018 Fall Economic Statement the federal government introduced an accelerated write-off—commonly referred to as capital cost allowance (CCA)—of various types of assets. Continuing along these lines, Budget 2019 introduced measures to allow for a 100% CCA deduction for zero-emission vehicles.

What is considered a "zero-emission vehicle" eligible for 100% CCA?

Zero-emission vehicles include both passenger vehicles and other motor vehicles, including taxis and freight trucks, powered by

- electric battery,
- plug-in hybrid (at least 15 kWh capacity), or
- hydrogen fuel cells.

In addition to these measures, several other related measures were introduced to promote the adoption of these types of vehicles:

- Additional spending to expand the network of charging and refueling stations across the country
- Additional funding to Transport Canada to allow them to work with auto manufacturers to ensure they meet zero-emission vehicle sales targets
- A purchase incentive of $5,000 for those who purchase electric battery or hydrogen fuel cell vehicles under $45,000

These incentives have the potential to grow the market for zero-emission vehicles. It remains to be seen whether or not these measures will have a significant impact on improving the competitiveness of the Canadian economy, as a whole, since their scope may have limited impact.

For businesses that operate in the trucking or transport industries, there is potential for tax savings on the purchase of new vehicles for their fleet. Businesses, in general, may also benefit from the accelerated tax deduction, which provides cash that can be used for additional investment much sooner.

Canada-wide broadband network

The federal government's commitment to expand Canada's broadband network is likely to result in an overall benefit for all Canadians, including Canadian businesses. Access to a reliable, high-speed network allows businesses to boost productivity, access more resources and become more competitive.

What is considered "high-speed" internet?

In determining what it considers to be "high-speed" internet, the government has identified 50/10 Mbps:

50 megabits per second for downloading, and

10 megabits per second for uploading

The government has set lofty goals in its quest to provide high-speed internet to every Canadian home and business:

- 95% of Canadian homes by 2026
- 100% of Canadian homes by 2030

Although the CRTC has currently identified 50/10 Mbps as the speed necessary to achieve cloud computing, among other network-related computing, it is unclear whether such speeds will continue to represent "high-speed" internet by 2030. With ongoing rapid advancements in technology, the demand for bandwidth and speed continues to grow. The government may have to continually reevaluate and adjust its benchmark 50/10 goal if it is to truly provide a high-speed network to all Canadians across the country.

Access to small business deduction for farming and fishing
In 2016, rules were introduced that limited the ability for a farm or fishing business to obtain the lower small business tax rate on certain sales.

Cooperative corporation requirement eliminated

The original 2016 rule stated that if the sales from either a farm or fishing business were made to a purchaser in which the farm or fishing business held an interest, those sales would not be entitled to the small business tax rate. There was an exception for sales made to arm's length purchasers, provided that the purchaser was considered a "cooperative corporation."

Budget 2019 removes the requirement that the purchaser must be a "cooperative corporation."

Budget 2019 modifies the 2016 rule by reducing its restrictive nature, allowing more farming or fishing businesses to obtain the reduced small business rate.

This is a welcome change to the rules, particularly because it is retroactive back to years ending on or after March 21, 2016. Not only may an incorporated family farm or fishing business save on its most recent tax bill, but it can also potentially obtain a refund of taxes paid for a previous year.

Reduced regulatory burden
Budget 2019 proposes additional funding to reduce the regulatory burden on Canadian businesses. Such measures include:

- Up to $219.1 million over five years for the Canadian Food Inspection Agency, Health Canada and Transport Canada to modernize their regulatory frameworks
- $3.1 million per year to the Treasury Board Secretariat starting in 2020-21 to harmonize regulations across provincial and territorial boundaries, and regulations with international trading partners, to make internal and international trade more seamless for Canadian businesses
- $50 million over five years for the Canada Revenue Agency starting in 2019-20 to facilitate the processing of T1 adjustments and improve its telephone services

Helping you realize your potential

Budget 2019 offers Canadians various new spending initiatives and tax measures. However, it does little to relieve the global economic pressures faced by Canadian businesses or address the areas where Canada has lost its competitive edge in the global marketplace.

As a business owner, you continually strive to grow your business, for the benefit of your employees, communities and your own family and retirement. Grant Thornton continues to work with Canadian business owners, like you, to help you achieve your goals. Please contact a Grant Thornton advisor if you wish to know more about how we can assist you and your business in the wake of Budget 2019.