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Pre-budget alert 2021

Setting the stage for what's next.

The federal government is expected to release its budget (Budget 2021) this spring. This will be the first budget tabled since March 19, 2019, before the Liberal government was re-elected, and comes at a time of economic uncertainty caused by the pandemic.

Since the pandemic began in early 2020, some sectors have rebounded and are performing relatively well. Yet others are still struggling to survive, with many Canadian businesses having closed over the past year. As a result, the federal government has spent heavily to combat the negative economic impact of the pandemic and to support Canadians and Canadian businesses. It's difficult to predict what the government's economic plan might look like as the country works to spark an economic recovery while managing the significant debt that has accumulated.

Setting the stage: Economic overview

Since COVID-19 began its spread in March 2020, its impact has reverberated across the Canadian economy. Individuals and businesses, from the largest cities to the smallest communities, have been affected—however, the impact has been varied, making it particularly difficult to deal with the economic fallout. While some communities have opened up and life is returning to normal, others are still labouring under restrictions. Compounding this problem, delays in COVID-19 vaccine deliveries and new variants of the virus continue to create uncertainty as to when the country will truly be on the road to recovery.

The federal government has announced its intention to continue supporting individuals and businesses through the ongoing pandemic. These announcements, coupled with the fact that significant uncertainty remains, suggests that there will be more stimulus spending in the upcoming budget. The most up-to-date breakdown of spending on the more significant COVID-19 support programs can be found in the Appendix section. Spending on these programs has significantly contributed to the federal budget deficit for the government's 2020-21 fiscal year, which is projected to be $381.6 billion, the largest deficit since Canada began keeping track in 1966.

In addition to the challenges of COVID-19, the government is also facing trade pressure from the United States. Despite his less adversarial approach with Canada (and other countries) than the previous US administration, US President Joe Biden signed an executive order for his "Buy American" policy to block any foreign companies from bidding on American government contracts. This order was signed days after President Biden cancelled the Keystone XL pipeline project, significantly impacting Canada's oil and gas sector. Although it is too soon to tell what impact the new US administration's policies will have on the Canadian economy, it does appear that Canadian businesses, particularly in some sectors, may continue to need government support.

An uncertain road ahead: Economic stimulus expected

When Canadian Finance Minister Freeland launched the government's consultation on Budget 2021, she stated that this budget will be about jobs, growth, the middle class, COVID-19 recovery and building a "more innovative, more competitive, greener, more sustainable"[1] economy. Here is what that might mean for Canadians:

Possible extension of COVID-19 support programs

The government's most significant aid program for businesses, the Canada Emergency Wage Subsidy (CEWS), is currently available for periods up to March 13, 2021. The same is true for the more recent program, the Canada Emergency Rent subsidy (CERS), which helps businesses cover the costs associated with real property used in the business. The government recently announced that they will be extending the CEWS and CERS programs until June 5, 2021, which is the furthest out that these programs can be extended without further Parliamentary approval. If Canadian businesses continue to struggle past June 5, the government will have to consider if it will introduce new legislation to do extend these programs beyond June 2021.

Both the CEWS and CERS have hard filing deadlines. If these deadlines are missed, the subsidy is lost—and these subsidies are significant. Changing legislation to allow for the late filing of these subsidies would more accurately reflect the government's intention to support Canadian businesses rather than penalizing them for missing a legislated filing deadline.

The government has also made it much simpler for qualified individuals to access the Employment Insurance (EI) program, and proposed extending the length of time that individuals can benefit from the program. For those not entitled to EI, the Canada Recovery Benefit (CRB), Canada Recovery Caregiving Benefit (CRCB) and Canada Recovery Sickness Benefit (CRSB) are all still available. The government recently announced its intention to extend the amount of time that individuals can claim each of these supports as well.

Job creation

The government mentioned in various communications that job creation will be its top priority while working toward a strong economic recovery.

The government proposed developing a national childcare program in its 2020 FES to expand the number of affordable daycare spaces across the country. This program aims to help more women return to and enter the workforce following their significantly reduced participation in the labour force, which occurred when the pandemic negatively affected employment

1 https://www.theglobeandmail.com/politics/article-freeland-launches-consultations-on-2021-budget-says-it-will-be-most/

at schools, daycares and other sectors where women's employment is more predominant. The government signaled its intention to provide more details on the national childcare system in the upcoming Budget 2021.

Targeted aid for struggling sectors

In its 2020 FES, the government shared details about its Highly Affected Sectors Credit Availability Program (HASCAP). This program is designed to support businesses that experienced a year-over-year revenue decline of 50 percent or more during three of the last eight months prior to applying. This is particularly welcome to businesses in industries that have been especially hard-hit by the pandemic, such as those in tourism, hospitality, hotels and arts and entertainment. The program will provide eligible businesses 100 percent government-guaranteed low-interest loans of up to $1 million over extended terms, for up to ten years.

Although this program provides real support for many struggling businesses, some industries fear it's not enough. In particular, the airline industry has indicated that airlines may not survive the pandemic without a specific aid package from the government. Canadian airlines have faced extreme challenges due to both the international and inter-provincial travel restrictions imposed during the pandemic. The government is reportedly in late-stage negotiations with the airlines, and more details of industry-specific support may be provided in Budget 2021.

Additionally, the oil and gas sector has been struggling since before the start of the pandemic and was dealt an additional blow when the US government recently announced plans to cancel the Keystone XL project. Although the Canadian government has introduced measures to support the oil and gas sector over the past year, it remains to be seen whether more targeted aid will become available going forward.

Investment in sustainability

The government announced its objective to achieve "net zero" greenhouse gas emission by 2050. There has been much speculation that the government will fuel Canada's economic recovery with significant investments in green energy projects and initiatives. In December 2020, the government released its plan to address climate change. This included initiatives focused on clean electricity and zero-emission vehicles, as well as the conservation and restoration of natural spaces. Additional details of such investments may be announced in Budget 2021.

One example is the government's pledged investments into public transit. Prime Minister Trudeau recently announced that the government will invest $14.9 billion over the next eight years in transit projects across the country. The government expects that this new investment will help Canada reach its climate targets by electrifying fleets and improving service, with the goal of getting more people to use public transit.

Pandemic support has had a significant cost: Who will foot the bill?

According to the 2020 FES, the government projected a record-breaking $381.6 billion deficit for 2021 amid unprecedented temporary stimulus spending. The question remains—if and when the government plans to reduce the deficit and return to a balanced budget.

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Due to the significant amount of government spending over the last year, there is speculation that taxes will be raised, strategically, by focusing on measures that would have less impact on the middle class. This section explores some possible tax measures that may be implemented in Budget 2021, based on what was previously announced in the 2020 FES.

Stock option deduction change

In Budget 2019, the government proposed eliminating the stock option deduction for employees of large and mature firms. The 2020 FES provided additional details on the proposed legislation. It's almost certain that this measure will be included in Budget 2021, as it generally targets individuals not considered middle class because the measure only applies when stock options exceed $200,000 in a given year.

When applicable, the stock option deduction currently taxes the stock option benefit (i.e., the difference between how much the purchaser pays for the stock versus how much its actual value is on the date of purchase) at 50 percent, similar to a capital gain. The removal of the stock option deduction would mean that the stock option benefit would be fully taxable to those employees who exercise stock options for companies to which the new rules would apply. The proposed legislation carves out stock options in Canadian-controlled private corporations (CCPCs) as well as non-CCPCs with gross revenue of $500 million or less. Furthermore, for employee stock options where the rules do apply, the proposed legislation indicates that $200,000 per year would continue to be eligible for deduction. Given the government's significant deficit, it's uncertain if these proposed rules will remain the same or will be further expanded. This change in the stock option deduction is expected to generate an additional $52 million tax revenue over the next five year.

Sales tax in a digital environment

As announced in the 2020 FES, the government has proposed legislation to make foreign-based vendors selling digital products or services to consumers in Canada subject to the GST/HST regime. Currently, a non-resident vendor that is not considered to be carrying on business in Canada would not be required to register for or collect and remit GST/HST on their sales in Canada. The proposed legislation would require these non-resident vendors to register as part of a simplified registration system and charge GST/HST on their sales. Non-resident vendors that register through the simplified system would not be entitled to claim an Input Tax Credit or rebates on any GST/HST incurred in Canada. This measure is expected to apply to supplies made on or after July 1, 2021 and could generate approximately $1.3 billion in federal tax revenue over the next five years.

In addition, non-resident vendors who sell goods directly to Canadian customers that are shipped from a location in Canada (e.g., a fulfilment warehouse) will be required to register for and charge GST/HST. This measure is expected to bring in $604 million tax revenue over the next five years.

The GST/HST will also apply to all taxable supplies of short-term accommodation booked through digital platforms—a measure expected to bring in an additional $314 million in revenue over the next five years.

The rules are somewhat complex and include several exceptions. It remains to be seen if further details on these measures will be included in Budget 2021.

International corporate tax and digitalization

The government has proposed a new corporate income tax for companies offering digital services starting January 1, 2022, with the hopes of generating $3.94 billion in revenue over five years. While no additional details were provided in the 2020 FES, the government promised to release further details on this new tax measure in Budget 2021.

Other possible tax measures

There is speculation that the government may introduce more tax changes to increase its tax revenues in order to reduce the significant deficit that has accumulated over the past year. As recently as December 2020, the government has pledged not to raise taxes. However, if the number of COVID-19 cases continues to surge, and the government continues to accumulate more debt to pay for ongoing support programs, we may see additional tax changes, particularly those targeting wealthier individuals, as well as corporations.

Increasing taxes on capital gains

The capital gain inclusion rate currently stands at 50 percent, meaning only half of a capital gain on the disposition of a capital property is taxed. In the most recent federal election, the NDP and Green Party campaigned to increase the capital gains inclusion rate to 75 percent and 100 percent, respectively. A recent CIBC report showed that raising the capital gains inclusion rate will impact approximately 10 percent of Canadian taxpayers. In addition, countries like the United Kingdom and United States are already proposing higher capital gain taxes. This change could create an estimated $22 billion in additional revenue in 2021, assuming an inclusion rate of 100 percent. Despite the government's statement that it will not increase taxes, this could become an attractive option due to its simplicity, the potential for tax revenue and the low percentage impact on the majority of Canadians.

Another idea that is not part of the government's official policy, but has been mentioned in several news reports, is the removal or reduction of the principal residence exemption on the sale of a primary residence. Currently, taxpayers don't pay tax on any gain when selling their home, provided it's the only home they own in the year. Since 2016 they have been required to report the sale on their personal tax return. Changes to the principal residence exemption may result in a portion of a capital gain realized on the sale being taxed. Although implementing such a measure may result in significant political backlash, if the country's debt continues to rise, other less-popular measures, such as this one, may be considered.

Finally, the government has previously attempted to modify related tax provisions to address so-called "surplus stripping" transactions, which allow shareholders to access the retained earnings in their corporation at a reduced tax rate. These proposed changes were dropped in 2017 due to the significant pushback from business owners and the professional community. However, if the government does not raise the capital gains inclusion rate, this may be an area that they revisit for a more targeted approach.

Introducing a wealth tax

Canada does not currently have a wealth tax. Such a tax would likely be an annual tax that an individual would pay based on the net value of their accumulated wealth (i.e., assets less liabilities). The closest thing to a wealth tax that we currently have are the rules that impose taxes at death. Individuals are deemed to have disposed of all their assets, with some exceptions, at fair market value when they pass. This triggers tax on all of the accrued increase in value. This is a one-time tax, which fits within the existing income tax regime.

The NDP and Green Party have been advocating for a one percent "super-wealth" tax on net wealth (assets less liabilities, excluding lottery winnings) over $20M. A wealth tax also aligns with the Liberal government's oft-repeated policy position to tax "extreme wealth inequality". The government estimated this measure could potentially bring in $5.6 billion in fiscal year 2020-21.

A recent survey by Abacus Data shows the majority of Canadians (79%) favour the idea of a new wealth tax in Canada. This includes those individuals in the highest income bracket (73%).

Several European countries have implemented a wealth tax payable based on a portion of an individual's net worth, but some abandoned it following minimal revenue increases and difficulty with administration. Although this change is less likely than increasing the capital gain inclusion rate, it's still possible that Canada will implement a wealth tax given the unprecedented pandemic spending and deficits.

What's next?

Budget 2021 will be one of the most important federal budgets in recent history. The question remains as to whether there will be any tax increases to pay back the massive and growing debts that we're incurring during the pandemic. It was widely regarded that the government's pandemic support programs were necessary to keep Canadians and the economy afloat. However, the current level of spending cannot be sustained indefinitely, and eventually the spending on support programs will need to be scaled back. The government is in a precarious position as it attempts to balance maintaining the support programs that have played a significant role in Canada's slow economic recovery, thus far, while at the same time leveraging off of the country's economic future. We're hoping to see if Budget 2021 will provide greater clarity on Canada's economic outlook and if it will help to set Canada's recovery in motion.

Visit Budget 2021 to get the latest information and analysis on provincial and federal budgets.

Appendix

Federal COVID-19 support programs – estimated costs

Program	2020-2021	2021-2022
Canada Emergency Wage Subsidy (CEWS) *March 2020 – June 2021*	$74 billion*	$12 billion*
Canada Emergency Rent Subsidy (CERS) and Lockdown Support *Up to June 2021*	$2.6 billion*	$1.4 billion*
Canada Emergency Business Account (CEBA)	$43.65 billion***	Nil*
Canada Emergency Response Benefit (CERB) *Up to October 4, 2020*	$6.5 billion** in 2019-2020 $76.5 billion** in 2020-2021	Nil**
Canada Recovery Benefit (CRB)	$6.3 billion**	$3.4 billion**
Canada Recovery Sickness Benefit (CRSB)	$2.6 billion**	$2.4 billion**
Canada Recovery Caregiver Benefit (CRCB)	$4.9 billion**	$4.5 billion**
Enhanced Employment Insurance	$3.1 billion**	$6.4 billion** in 2021-2022 $0.7 billion** in 2022-2023

* Numbers obtained directly from Parliamentary Budget Office report "Costing Fall Economic Statement 2020 Measures" published on January 14, 2021
** Numbers obtained directly from the 2020 Fall Economic Statements published on November 30, 2020
*** https://ceba-cuec.ca/

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