Same, same but different: U.S. business and the 2021 Canadian election

September 24, 2021

On September 20, Canadians experienced a collective moment of déjà vu as Liberal Party leader Justin Trudeau won his second consecutive minority government. The balance of power will be mostly Conservative, with third, fourth and fifth place going to the left wing New Democratic Party (NDP), the Bloc Québécois and the Greens, respectively.

The seat count for each party is strikingly similar to the 2019 Canadian election. But does this mean we can expect business as usual, particularly for U.S. companies?

The impact on U.S. business interests will become clearer over time, as the Liberals attempt to make progress on their promises by striking deals with the other parties and tiptoeing around the possibility of a non-confidence vote – both realities of a minority government. Overall, however, federal minority governments are becoming as Canadian as maple syrup and the toque. Five of the past seven federal governments have been minorities, with the longest one lasting just over two-and-a-half years.

Our overall prediction

We expect the overall business climate in Canada to remain similar to pre-election, with few changes to labour and employment, immigration, privacy and competition. If you were comfortable doing business in Canada before September 20, you should maintain the same confidence today. Some changes are worth noting, however. Keep reading for the post-election need-to-knows on tax, trade and climate change for U.S. companies with Canadian connections.

Changes to tax rates

No general tax rate increases were proposed by the Liberals during the election. Their platform did include a three per cent tax increase (to 18 per cent) on large banks and insurance companies earning over C$1 billion per year, as well as a new recovery dividend levy on these entities because of their swift and strong recovery during the pandemic.

The NDP made a tax on the ultra-rich (defined as anyone with wealth over C$10 million) a focus of its election campaign. This suggests that increases in the capital gains inclusion rate (currently 50 per cent) and personal tax rates on executives of Canadian companies may follow.

The Liberals support the multilateral OECD Pillar One and Pillar Two international tax initiatives, which call for a global minimum tax rate of 15 per cent and a tax on digital services.

Modernization of tax compliance

All parties agreed to combat tax avoidance as a priority.

The Liberals proposed to increase funding for the Canada Revenue Agency and expand the scope of Canada's general anti-avoidance rule to focus on economic substance rather than legal form. These proposals continue the anti-avoidance measures passed as part of the 2021 federal budget. The Liberals also plan to restrict federally regulated entities like banks and insurance companies from using tiered structures to direct profits to low-tax jurisdictions.

These measures point to an increased need for timely planning advice and careful documentation to prevent costly and time-consuming disputes with revenue authorities armed with expanded resources. Reach out to Steve Suarez in Toronto or Siwei Chen in Calgary for a corporate tax plan that addresses the cross-border complexities of your business.

The energy transition

Climate change will continue as a top priority for the new government, despite criticism of its policies from the other parties during the election.

Canada's Energy Regulator, which is in charge of cross-border pipes and wires, will continue to conduct comprehensive reviews with particular sensitivity to environmental and Indigenous issues.

Implementation of the federal government's carbon pricing regime will continue as before, with planned price increases to C$170 per metric tonne by 2030. U.S. industrial and commercial companies operating in Canada will need to plan for increasing carbon prices through process improvements and technical alternatives to current operations.

The federal Clean Fuel Standard (CFS) regulations were scaled back under the previous Liberal government and will be finalized and released later this year, with compliance starting in December 2022. Fuel suppliers and other CFS participants may generate compliance credits through process-related emissions reductions, development of low carbon fuels, and switching to lower- and zero-carbon fuels. U.S. energy companies affected by the CFS should determine which of the CFS offset options work best for their business.

The pace of these changes is uncertain. Speed will depend on how quickly Canada and the world recover from the COVID-19 pandemic and the government's appetite for change, given we're the fifth largest crude oil producer and the fourth largest natural gas producer in the world.

Energy and regulatory policies in the U.S., Europe and Asia, as well as ESG factors, will influence whether capital is attracted to the Canadian energy sector and determine whether the federal government's policies are feasible. Technology will affect the pace of the transition to green and blue hydrogen, modular nuclear generation, electricity storage and more. Rapid innovation in any of these areas would change the energy landscape regardless of federal policies.

Reach out to Peter Bryan, Alan Ross and Bruce Lawrence for help on energy-related issues, particularly those unique to transition within the oil and gas sector.

Plastics ban

Legal challenges to the policies, science and jurisdiction of the federal government's plastics ban continue, but the re-election of the Liberals means that, for now, this ambitious plastics strategy will remain in place. American companies supplying plastic or plastic products to Canada will need to consider what alternatives may be available, as the first restrictions on single-use plastics are due to be regulated prior to the end of 2021. Jonathan Cocker, an international circular economy expert, has become the go-to for a number of multinational businesses as they adapt to these changes.

Tax breaks for a green economy

The Liberals proposed enhanced tax breaks for participants in the green economy, including:

- Tax credits of up to 30 per cent of qualifying expenses for technologies like low-carbon and net-zero technologies;
- Reforming the Scientific Research and Experimental Development (SR&ED) program to make it easier to navigate and more beneficial for companies that take on bigger risks and create more jobs; and
- Doubling the mineral exploration tax credit on certain critical materials essential in clean technologies like batteries.

A tax-friendly environment for clean energy may lead to a tsunami of start-ups followed by a wave of insolvencies, flushing out the weak players. We saw this in Europe's solar industry a decade ago and predict a similar pattern in Canada over the next few years.

We eventually expect carbon border adjustments on emission-intensive imports, such as steel and cement.

Trade and foreign policy with China

International trade and foreign policy didn't feature prominently in the election except when it came to China, where we expect debate and disagreement both within the House of Commons and with the public to continue. As long as Canadians are detained by China and the extradition of the former Huawei CFO remains unresolved, we expect the incoming government to continue to engage in quiet diplomacy. Once trade, security and foreign policy issues with China resume their prominence, the government will be forced to choose between the approach advocated by its allies, principally the U.S., or a less confrontational approach with China.

Comprehensive Asia-Pacific strategy in the works

The new government has indicated it wants to launch a comprehensive Asia-Pacific strategy to deepen partnerships in the regions, including with the Association of Southeast Nations. This would presumably include new bilateral trade agreements, although most of Canada's Asia-Pacific trade relationships are covered by the Comprehensive and Progressive Agreement for Trans-Pacific Partnership and the Canada-Korea free trade agreement. The Liberal platform also included a commitment to continue trade negotiations with the Pacific Alliance and to pursue bilateral trade agreements with additional Central American and South American countries. If this heightened trade agreement activity bears fruit, Canada will become a key way for U.S. businesses to receive preferential access to opportunities, particularly in the Asia-Pacific region.

Other post-election trade predictions

The incoming government has pledged to add additional supports for dairy, poultry and egg farmers to compensate them for market share losses resulting from free trade agreements. The ongoing dispute with the U.S. about Canada's application of its dairy trade commitments, as well as softwood lumber and other trade frictions, are expected to continue.

Modern slavery legislation drafted by the government prior to the election was unique compared to forced labour legislation in other countries in its relatively onerous compliance requirements and significant penalties for noncompliance. We expect that those provisions will remain in the new legislation.

Management of digital trade will also feature prominently in Canada's approach to international trade. The incoming government has indicated that it wants to play a prominent role in the global governance of data and privacy rights, digital taxation and the application of new technologies. In this sense, Canadian digital trade policy is moving more in line with the EU and less with that of the U.S.

For further analysis or advice regarding international trade, reach out to Jesse Goldman.

We'll wrap up this recap with an old adage: better the devil you know than the devil you don't. While Canada could never be confused with a devil – we're far too polite, for one – certainly the political status quo north of the border should give our friends to the south some comfort.

Reach out to the authors if you'd like to take full advantage of opportunities such as net-zero incentives, mining credits, corporate restructuring and Asia-Pacific trade, or avoid the risks that may arise from a better resourced tax authority, changing environmental regulations and higher carbon prices.

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