A tax to-do list for Canada’s next government

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The recent prorogation of Parliament is unfortunate on many levels, most notably for extending by some months the period of time that many government initiatives remain in limbo. The business community is used to managing risks, but some are more avoidable than others. In these particularly trying times, the last thing people making important economic decisions need to be dealing with is a lengthening of the period (entirely for political reasons, it would seem) during which they have no reasonable idea which laws will or won’t be changing.

The tax system is one of the many areas affected. If 2024 demonstrated nothing else, it certainly showed how profoundly politics can impact taxation, the (ostensible) increase in capital gains taxation being the most prominent example.

With an election very likely in the spring, a new government is imminent. The tax system will be one of many items urgently clamouring for that government’s attention at a time when people need some reasonable degree of certainty to make informed decisions. The major political parties need to be thinking now about the many important tax issues that require immediate attention.

1. Focus on improving Canada ’s productivity

The persistently low productivity of Canada’s economy has been a problem for decades. In 2024 a senior Bank of Canada official described it as a “break the glass” emergency, and indeed it is. Any incoming government needs to acknowledge that to compete internationally and generate the tax dollars needed to pay for Canada’s social programs, we can no longer afford to keep lagging behind. Canada urgently needs to recalibrate its approach to this problem based on the realities of today’s economy.

While the solutions to this issue go beyond the tax system, tax policy is certainly part of the answer. Tax measures to improve capital intensity and labour productivity must be at the top of our list for 2025. The current government’s announcement in the 2024 Fall Economic Statement to fully re-instate for a five-year period both the Accelerated Investment Incentive and immediate expensing of manufacturing or processing machinery and equipment, clean energy generation and energy conservation equipment is a positive step. Studying a patent box regime to encourage the development and retention of intellectual property stemming from R&D conducted in Canada is another. Now is the time to re-evaluate how best to support SR&ED in Canada, both within and outside the tax system. We must use everything in our toolkit to boost our productivity, including tax policy. We cannot pay for the things we want without it.

2. Commit to comprehensive tax reform

Not since the late 1960s has Canada undertaken a comprehensive big-picture review of what it should be taxing, in what different ways, and in what proportions. The world has changed dramatically since then, and Canada's system of taxation (including tariffs) is in dire need of an overhaul to make it fit for purpose.

A new government must grasp the nettle of beginning this process. There are many questions to consider, viewpoints to be heard and decisions to be made, based on a thorough examination of all the possibilities. A willingness to start at square one and look at what other countries have tried (good and bad) without preconceived notions is essential. The looming threat of potential U.S. tariffs makes it more important than ever for Canada to design and enact a pro-growth tax regime.

Tax laws both raise revenue and strongly affect commercial decision-making: getting them right is vitally important. Whatever resources are needed to design and implement the "best" tax regime for Canada, its economy and its people are worth the investment, which will pay for itself many times over.

3. Streamline tax compliance

The time and effort involved in meeting tax compliance obligations, auditing that compliance, and resolving disputes is an enormous deadweight on the economy. It must be done, but there are better and worse ways to do it. While one of the benefits of tax reform will be a system that is simpler and cheaper to administer for both taxpayers and authorities, in the nearer term we should pursue every opportunity to streamline the existing regime, rather than continuing to pile one obligation upon another. Canadian taxpayers are being smothered and are near (or at) their breaking point.

Every new demand, form or rule has a cost associated with it, and in many cases the cost of penalizing the compliant many doesn't warrant the benefit of catching the non-compliant few. Overburdened taxpayers deserve an immediate moratorium on any incremental filing and reporting requirements: no more, not now. A self-assessing system depends on the goodwill of taxpayers to participate, and the faith of Canadian taxpayers has been sorely tested in the past few years (last year's bare trust "debacle" being but one recent example). Other countries are exploring a variety of ways to simplify tax collection and reporting: Canada should be adopting these best practices. The government can also greatly reduce taxpayer compliance costs (while lessening the number of disputes being litigated every year) by allocating more resources to explaining new tax legislation (e.g., users guides, flowcharts, articulation of overall object, spirit and purpose, etc.). Every reasonable effort must be made to make it cheaper and easier for those who want to comply to do so, and to make pragmatic decisions about when asking taxpayers to do more is worth it.

4. Communicate positions on major issues

One of the most frustrating aspects of the current state of legislative limbo resulting from proroguing Parliament is that months of uncertainty have been added to the period during which businesses don't know whether previously announced tax changes will be made or retained and what new rules are coming. In some cases, these involve rules that could apply retrospectively back before 2025. No one expects perfect clarity, but this level of doubt is completely unreasonable and suffocating to the economy, as economic decisions must be delayed until we see what the law will be.

It will be months before a new government is in place, and longer still until it has introduced a budget. Taxpayers deserve to know much sooner than that what the rules are likely to be. Those seeking to govern should formulate and express a position on the major tax issues of the day as soon as possible, so that taxpayers have something to go on before then and know what to expect once the election has been held. For example, uncertainty as to what the future is of the clean economy investment tax credits previously announced (some of which were enacted last summer) has contributed to delays in many new power projects, as developers, financers and power purchasers must wait to see what happens before proceeding with new commitments. This is the last thing our economy needs, and waiting until May or June is too late.

5. Drop the capital gains tax increase

The rules implementing the 2024 increase in capital gains taxation (effective as of June 24, 2024) were never passed, as Parliament ground to a halt last fall. This tax increase was very dubious tax policy to begin with, implemented in a manner very unfair to taxpayers, that has left tax authorities in Ottawa holding the bag for political decisions they did not make. The resulting situation for taxpayers is completely intolerable, as tax reporting and compliance based on laws that have not been passed creates enormous cost and confusion for everyone involved.

The government's January 31 announcement to defer this change until 2026 at least creates some clarity for taxpayers and the CRA on the immediate issue of how to report gains and losses from 2024. However, this proposal should be scrapped entirely and consideration given as to potential relief for the many thousands of taxpayers who incurred substantial costs in planning and executing transactions in 2024 based on the original announced effective date, which was consciously designed to provoke them into triggering accrued but unrealized gains before the effective date. An election to allow people to realize gains for solely tax purposes without the cost and work of undertaking actual transactions would have been easy to offer and would also have been relatively simple to reverse today in light of the legislation not being enacted. The government chose not to do so, and taxpayers who acted in good faith suffer the consequences. Canada's self-assessing tax system is premised on the active participation of taxpayers doing their part by fully and fairly reporting their income and transactions and filing the requisite returns. This entire episode has further eroded taxpayer faith in and respect for that system, discouraging people from playing by the rules of a process they decreasingly see as fair and reasonable. Taxpayers are not chew toys for politicians to play with: they deserve better.

6. Scrap the DST

In mid-2024 Canada enacted a digital services tax (retroactively back to 2022 no less), ignoring condemnation by the business community in both Canada and the U.S.. While ostensibly this tax is levied on foreign multinationals providing digital services to Canadians, in reality it is simply being passed onto Canadians in the prices they are charged. Worse yet, because it applies almost exclusively to U.S. companies, U.S. lawmakers (in both parties) are pushing hard for highly punitive tariff and trade penalties on Canada as a response. If enacted, these will cost Canada far more than whatever relatively small tax revenue the DST will raise.

There are better and worse ways to raise money. One of the worst (particularly today) is needlessly provoking your largest trading partner into a trade war you can't win, on an issue that matters much more to them than it does to you. Refusing to scrap the DST is effectively affixing a "Kick Me, Trump" sign to ourselves, for negative net benefit.

Anyone presenting themselves as a responsible choice to govern this country needs to consider these issues urgently and tell Canadians as soon as possible what they propose to do on them. Canada no longer has the luxury of time.

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