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Government mandate letters highlight tax priorities; Fall Economic and Fiscal Update quiet on new measures

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In this Update

- The Liberal government's Fall Economic and Fiscal Update contained no new significant tax measures, but the mandate letters given to federal cabinet ministers provide insight into what the government's tax priorities may be in the coming months.
- Corporate tax priorities based on the mandate letters include following through on changes to stock option rules; a digital services tax and addressing certain hybrid debt mismatch arrangements; and more.
- Both the Fall Economic and Fiscal Update and the mandate letter make reference to undertaking a comprehensive review of spending and tax expenditures, resulting in annual savings of $1.5 billion.

The Liberal federal government's Fall Economic and Fiscal Update published on December 16, 2019, contained no significant new tax measures. However, the mandate letters given to federal cabinet ministers suggest that the government intends to move forward with a potential new tax on digital services, a cap on certain interest deductions, and a limitation on deductions related to certain hybrid debt mismatch arrangements and stock option benefits, and a tax cut for zero-emissions technology manufacturers.

Fall Economic and Fiscal Update

The government's Fall Economic and Fiscal Update does not contain any new tax measures. It contains revised fiscal projections from Budget 2019, with a revised budgetary deficit of $26.6 billion forecasted for 2019-2020, resulting in the debt to GDP ratio rising slightly to 31%. The deficit is forecasted to rise to $28.1 billion in the following year with deficits continuing for the remainder of the forecasted period (reaching $11.6 billion in 2024-2025).

Mandate letters

The mandate letters given by the government to each federal cabinet minister provide insight into what the government's tax priorities may be in the coming months as it tries to govern in a minority parliament.

The corporate tax priorities outlined in the mandate letter given to the Minister of Finance Bill Morneau are generally geared toward raising revenue by closing, in the government's view, loopholes whereby taxpayers are taking advantage of excessive debt deductions and complex cross-border structures, or are providing digital services within Canada without paying appropriate Canadian tax. The mandate letter envisions a tax cut for companies designing or manufacturing zero-emissions technology, and plans to move forward with the stock option rules previously introduced.

On the personal tax side, the focus of the government appears to be increasing the basic personal amount and imposing a new tax on luxury vehicles.

Most of the priorities draw upon items contained in the Liberal party's campaign platform. Whether these items turn into legislative proposals, and ultimately law, remains to be seen. A summary of the more significant measures noted in the Minister of Finance Mandate letter follows.

Corporate tax priorities

Following through on changes to stock option rules

The Minister of Finance is tasked with finalizing amendments to the *Income Tax Act* (Canada) limiting the benefit of the employee stock option deduction for high-income individuals employed at large, long-established mature firms. The government introduced draft legislation in June 2019 which set out two types of regimes: one regime for qualified options that would maintain the current tax regime of allowing a deduction to employees to enable capital gains treatment, and one regime for non-qualified options that will see the employee no longer entitled to capital gains treatment on the benefit (with the employer potentially being entitled to a deduction). See our Osler Update, "Canadian government introduces tax legislation applying to employee stock options granted on or after January 1, 2020," for more details on the proposed legislation.

Limiting interest deductions and complex cross-border structures

The mandate letter states that the Minister of Finance will modernize anti-avoidance rules to stop large multinational companies from being able to shop for lower tax rates by constructing complex schemes between countries. Similarly, the Minister of Finance is tasked with closing corporate tax loopholes that allow companies to excessively deduct debt to artificially reduce the tax that they pay.

While no additional detail is provided, the Liberal party's 2019 election platform contained a proposal limiting the amount of interest a corporation may deduct (for corporations with net interest expenses of more than $250,000) in computing its income to no more than 30% of its income before interest, taxes, depreciation and amortization (EBITDA). Interest would be deductible above the 30% threshold if the corporation is part of a corporate group, up to the worldwide group ratio of interest expense to EBITDA. The Liberal party also proposed to limit hybrid debt mismatch arrangements. The Liberal party has not indicated how these proposals will interact with Canada's existing rules (such as the thin capitalization rules that generally limit interest deductibility where a 1.5:1 debt to equity ratio is exceeded).

Digital services tax and working with OECD approach

The mandate letter has two items that relate to the taxation of digital services. The Minister of Finance is tasked with ensuring that multinational tech giants pay appropriate corporate tax on the revenue that they generate within Canada, and to work with the OECD to ensure

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that international digital corporations whose products are consumed in Canada collect and remit the same level of sales tax as Canadian digital corporations.

The Liberal party campaign platform contained a proposal for a 3% digital services value-added tax on targeted advertising services and digital intermediation services. The tax would apply only to businesses with worldwide revenues of at least $1 billion and Canadian revenues of more than $40 million. This proposal was modelled upon a similar tax introduced by the French government which has recently led to the United States threatening to impose 100% tariffs on a number of French products. These proposals are playing out while the OECD seeks to convince countries to abandon similar "unilateral" approaches to the digitization of the economy, and instead pursue a consensus "unified approach". The OECD proposal forms part of a larger project aimed at significantly changing how multinationals are taxed. For details on these proposals, see our Osler Updates, "OECD proposes significant international tax changes that will impact multinationals" and "OECD releases consultation document on its Global Anti-Base Erosion Proposal," and Osler's submissions to the OECD regarding its proposed changes – see "Osler submission to OECD on Public Consultation Document for 'Unified Approach' under Pillar One". [PDF] and "Osler submission to OECD advocates for narrow application of Global Anti-Base Erosion Proposal."

Last week, Minister Morneau indicated that Canada intends to move ahead with a digital services tax; however, no proposed legislation has been released yet.

50% cut to tax rates for companies that develop and manufacture zero-emissions technology

The government envisions pursuing a 50% cut to the tax rates for companies that develop and manufacture zero-emissions technology (from 9% to 4.5% for small business income and 15% to 7.5% for general income). The mandate letter stipulates eligible activities include manufacturing related to renewable energy, renewable fuels production, zero-emission vehicles, carbon sequestration and removal technology, batteries for use in zero-emission vehicles, and grid storage and electric vehicle charging systems.

Personal tax priorities

The top personal tax priority of the government is an increase to the basic personal amount to $15,000, although the mandate letter states that higher income individuals should not benefit from this tax cut (but will still be entitled to the existing basic personal amount).

The government also intends to move forward with a 10% tax on personal luxury boats, cars and personal aircraft over $100,000, that the Parliamentary Budget Office has projected could raise over $600 million annually.

There are also mandates for the Minister of Finance to support the Minster of Agriculture and Agri-Food to work on tax measures to facilitate the intergenerational transfer of farms, and to support the Minister in charge of Canada Mortgage and Housing Corporation to limit housing speculation by developing a framework and introducing a 1% annual vacancy and speculation tax on applicable residential properties owned by non-resident non-Canadians.

Review of tax expenditures

Both the Fall Economic and Fiscal Update and the mandate letter make reference to undertaking a comprehensive review of spending and tax expenditures, resulting in annual savings of $1.5 billion. The government envisions targeting existing tax expenditures to ensure that wealthy Canadians do not benefit from unfair tax breaks.

If you have any questions about the information in this Update or any other tax matters, please contact any member of our National Tax Group.