FINANCIAL POST

These are the potential tax measures federal budget watchers are speculating about this year

Jamie Golombek: Personal tax rates are high and there's an election on the horizon

Finance Minister Bill Morneau is expected to table the budget the week of March 18, though it could also be delivered sometime in April.*Sean Kilpatrick/The Canadian Press*

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Speculation is rampant in the tax community as to both when the government will deliver its final federal budget before the October election and, more importantly, what tax measures it might contain.

The date

While last year's federal budget dropped on Feb. 27, this year's budget will likely be tabled somewhat later, given that Minister of Finance Bill Morneau is only holding his annual pre-budget meeting with private sector economists in Toronto next week, on Feb. 22. This annual meeting of economists is convened each winter "to gather their views on the Canadian and global economies ahead of the federal budget."

After February, the House of Commons only returns to sit during the third week in March, leading several pundits to speculate on a budget date the week of March 18 although it certainly could be delivered sometime in April, as it was leading up to the 2015 election.

The pre-budget process

With high personal tax rates and an election on the horizon, what personal tax measures could we expect to see in an upcoming federal, pre-election budget?

Traditionally, some hints of what might be in store come from recommendations made by the House of Commons Standing Committee on Finance stemming from its annual pre-budget consultation process. From June through August 2018, over 650 businesses, not-for-profits and individual Canadians participated through written submissions.

This was followed by a series of pre-budget hearings across Canada that began in Ottawa in mid-September and stretched from Charlottetown to Victoria, wrapping up a month later. During these consultation hearings, selected groups and individuals who made a submission were invited to appear as witnesses. In addition, "open mic sessions" were held across Canada to allow any Canadians who were not invited to make a formal appearance to have their say.

The process culminated in the committee's 258-page report, released in December 2018, and entitled "Cultivating Competitiveness: Helping Canadians Succeed." Of the 99 recommendations for the upcoming federal budget, less than half a dozen of them involved personal tax changes. Two recommendations were aimed at improving the personal services business taxation model for truckers. The committee also recommended making the Canada caregiver tax credit refundable and amending the tax rules to add chiropractors to the list of practitioners eligible to assess and certify whether someone has a disability and is entitled to the disability tax credit.

During the consultation process, various submissions were made regarding lowering personal tax rates to make Canada more competitive. Other groups lobbied for an increase in the capital gains inclusion rate. While these were not formally adopted as recommendations by the committee, let's take a quick look at these two perennial areas of interest.

Personal tax rates

Prior to the 2015 election, the Liberals campaigned on a promise to lower taxes for the middle class and raise taxes for Canada's highest income-earners. Those changes became effective for 2016, when the government cut the tax rate on the middle-income bracket to 20.5 per cent from 22 per cent (for 2019 income between $47,629 to $95,259) and introduced the 33 per cent high-income

bracket (for income above $210,371 in 2019). Adding in provincial/territorial taxes puts Canada's combined tax rates between 20 per cent and 54 per cent, depending on your income and province/territory of residence.

Contrast that to the 2019 U.S. federal rates, where the top U.S. federal rate is 37 per cent and is reached only when income tops US$510,300 (about $675,000 in Canadian dollars). With some states, such as Florida, imposing no state personal income tax, the top rate for a high-income Tampa taxpayer is a mere 37 per cent vs. 54 per cent for a top-rate Haligonian.

During the consultation process, the Business Council of Canada supported increasing the federal personal income tax brackets to "more closely align them with the U.S. tax brackets." The Canadian Vehicle Manufacturers' Association advocated lowering the personal tax rate to "encourage the attraction and retention of a highly skilled labour force." Accounting firm MNP LLP recommended the personal income tax bracket thresholds should be expanded "based on a higher multiple of the bottom bracket's threshold" and that the combined federal/provincial marginal tax rate of Canadians should not exceed 50 per cent.

And in the C.D. Howe's annual shadow budget released last week, co-authors William Robson and Alexandre Laurin recommended doubling the threshold at which the top federal tax rate applies as "longer term, heavy taxes on high earners depress entrepreneurial activity and private investment. Excessively taxing the talent that fuels a more innovative, creative and successful economy is counterproductive."

Capital gains inclusion rate

Finally, what pre-budget punditry would be complete without the annual speculation as to whether the government might increase the capital gains

inclusion rate. Under current rules, capital gains are taxed at a 50 per cent inclusion rate. Historically, the inclusion rate has been 66.67 per cent in 1988 and 75 per cent from 1990 to 2000. An increase in the inclusion rate would increase the tax arising on the sale of non-registered stocks, bonds and mutual funds.

During the consultations, the Canadian Centre for Policy Alternatives advocated the "elimination of tax measures that disproportionately benefit the wealthiest Canadians, such as … the preferential tax treatment of capital gains." The Confédération des syndicats nationaux agreed the capital gains inclusion rate should be reassessed.

Increasing the inclusion rate would bring the tax rate on capital gains closer to the rate on dividend income. For example, in Ontario, the top rate on a capital gain is currently 27 per cent while the top rate on Canadian dividend income is 39 per cent for eligible dividends (47 per cent for non-eligible dividends.)

Raising the capital gains inclusion rate may be something the government considers to stop some of the surplus stripping transactions currently being contemplated by private companies looking to extract surplus from their corporations at capital gains rates instead of dividend rates.

This type of behaviour was acknowledged in the C.D. Howe report, which observed that high-income taxpayers "can respond to tax-rate increases by converting their income to different, lower-taxed forms" which "shrink the tax base and reduce tax receipts."

That being said, increasing the inclusion rate could have negative repercussions on Canadians' savings and investment rates and make Canada less attractive compared to other countries, many of which have preferential tax rates for capital gains. According to the Report of Federal Tax Expenditures (2018), the lower

inclusion rate provides “incentives to Canadians to save and invest, and ensures that Canada’s treatment of capital gains is broadly comparable to that of other countries.”

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