



Investment Industry Association of Canada Association canadienne du commerce des valeurs mobilières

GET ON WITH PRO-GROWTH BUSINESS TAX REFORMS

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INTRODUCTION

The Investment Industry Association of Canada (IIAC) advocates for smart public policies and regulatory reforms that:

- Enhance economic opportunities for Canadians, wherever they may live across the country,
- Promote savings and investment,
- Encourage foreign direct investment,
- Stimulate entrepreneurship, and
- Enable Canadian businesses to prosper and compete both here and internationally.

A pro-growth tax regime can be a catalyst for positive change.

This paper focuses on the role business taxation plays in achieving these objectives.

EXECUTIVE SUMMARY

Canadians' standard of living is sagging, and Canada's abysmal productivity performance is much to blame.

Business capital investment – the main driver of growth in productivity – has stalled. Canadian workers are not as well equipped with the tools and technologies to do their jobs as their American counterparts.

Additionally, more direct investment is leaving the country than coming in, a sign that Canada is not a competitive place to invest. Foreign investment can provide capital that may not be available domestically and lead to a more dynamic, productive and competitive economy.

Corporate income taxes discourage capital accumulation and productivity improvements and are the most harmful form of taxation for economic growth. Yet, Canada relies heavily on the most economically damaging taxes to generate revenue and more so than the U.S. or OECD countries overall.

Canada's average combined federal-provincial general corporate income tax rate is now higher than the average combined central-subcentral rate in the OECD and higher than the combined federal-state rate in the U.S. According to the U.S.-based [Tax Foundation](#), in 2024 Canada ranks 26th overall among OECD countries on business tax competitiveness. Lower, more competitive corporate tax rates would make Canada a more attractive location for business.

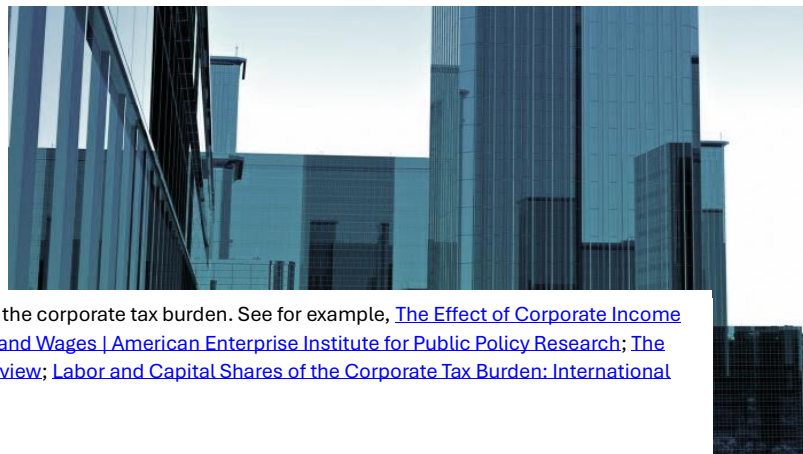
When it comes to making new investments, businesses look at the marginal effective tax rate (METR) on capital. Canada has been using accelerated tax depreciation for qualifying assets to reduce the tax burden on new investment for taxpaying companies, rather than reducing corporate income tax rates.

As a result, METRs vary widely by industry, with some industries facing a lower tax burden than others. This can distort investment decisions as capital tends to flow to sectors with the most favourable tax treatment. It also ignores a long-standing principle of good tax policy – neutrality.

Business tax reform is more urgent and critical than ever to spur capital investment, competition, productivity, economic growth, job creation and higher wages¹ that ultimately benefit Canadians.

To support economic growth through the corporate income tax system, the IAC recommends that the federal government:

- Reduce the federal general corporate income tax rate from 15% to 13%.
- Encourage the provinces that have not harmonized their provincial sales taxes with the GST to do so.
- Re-balance Canada's tax system so it relies less on taxes that are most harmful to economic growth, i.e. income and profit taxes, and more on consumption taxes which have less adverse effects on economic growth.
- Undertake an independent and comprehensive review of the federal tax system to ensure it adheres to long-standing principles of good tax policy: neutrality, equity and fairness, efficiency, simplicity, and competitiveness.



¹ A growing body of research suggests that workers bare a significant share of the corporate tax burden. See for example, [The Effect of Corporate Income and Payroll Taxes on the Wages of Canadian Workers | Fraser Institute](#); [Taxes and Wages | American Enterprise Institute for Public Policy Research](#); [The Direct Incidence of Corporate Income Tax on Wages | European Economic Review](#); [Labor and Capital Shares of the Corporate Tax Burden: International Evidence | Harvard University - University of Michigan](#)

CANADA'S PRODUCTIVITY CRISIS

On November 29, 2024, Statistics Canada [reported](#) that GDP per capita in Canada declines in the third quarter of 2024, the sixth consecutive quarterly declined (and the eighth decline in the last nine quarters). According to World Bank [data](#), in 2023, real GDP per capita in the U.S. stood at approximately \$73,600 (PPP 2021), compared to Canada's \$55,800 – representing a gap in living standards of \$17,800.

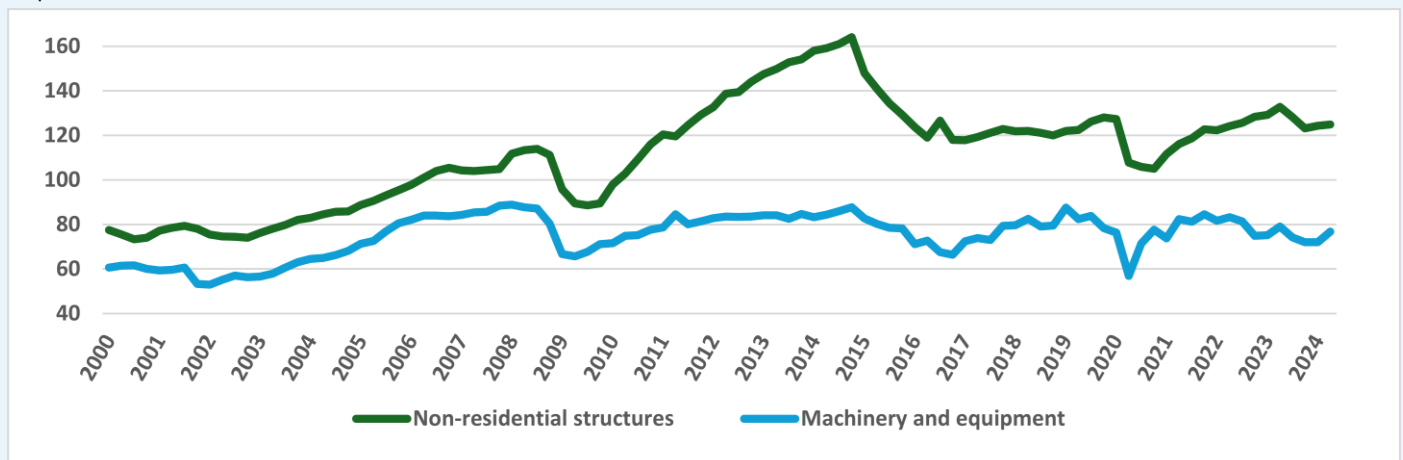
Canada's [poor productivity](#) is much to blame. Canada ranks 18th in productivity (GDP per hour worked) in the [OECD](#) (2022). In 1970, Canada was the 6th most productive economy in the OECD.

Two factors stand out as [contributing factors](#) to Canada's poor productivity performance – weak business investment and limited levels of competition.

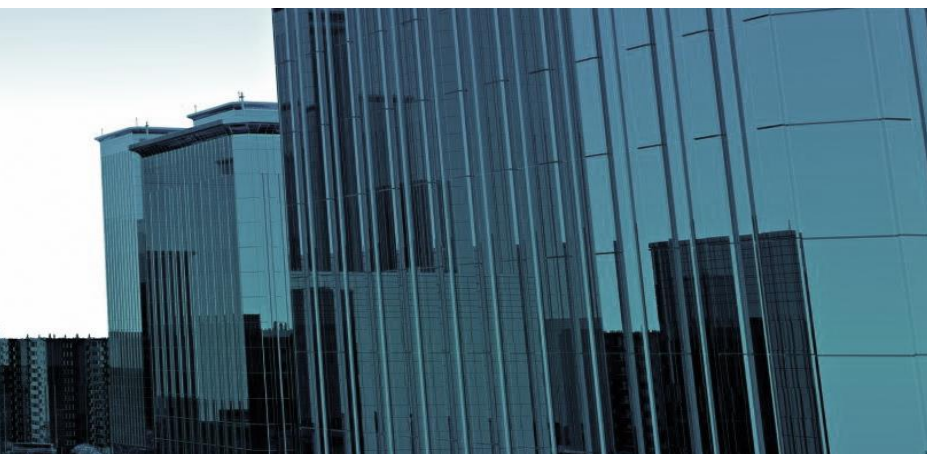
Business Investment Has Stalled

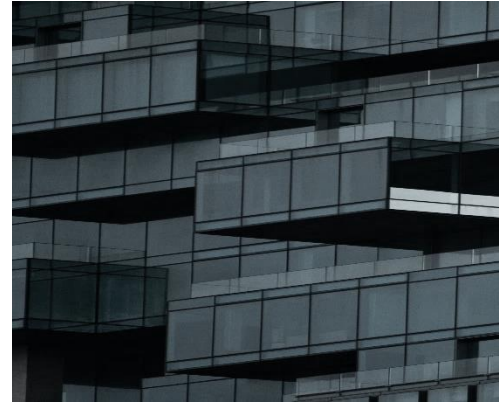
Statistics Canada [data](#) indicates that over the last decade, total business investment in non-residential structures (plants, factories, warehouses, for example) and in machinery, equipment and new technologies in Canada has declined by roughly \$45 billion, while in other countries, including the U.S. it has continued to increase.

Business Investment in Machinery and Equipment and Structures C\$ billion



Data Source: Statistics Canada. Table 36-10-0104-01 Gross domestic product, expenditure-based, Canada, quarterly.





Moreover, the level of capital spending per worker in Canada is lower than it was a decade ago. [According](#) to the C.D. Howe institute:

“In 2024, Canadian workers will likely receive only 66 cents of new capital for every dollar received by their counterparts in the OECD as a whole, and 55 cents for every dollar received by their US counterparts.”

It has long been recognized that equipping workers with the tools and technology to do their jobs efficiently can unleash innovation and productivity and ultimately stronger growth.

More Direct Investment is Leaving the Country Than Coming In

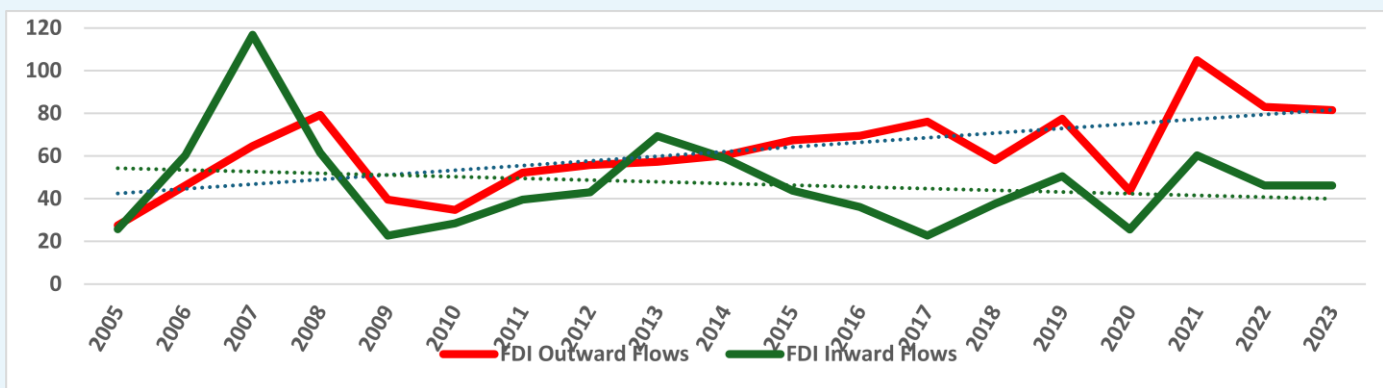
Foreign direct investment (FDI)² can provide capital that may not be available domestically. It also contributes to making the economy more dynamic, productive and competitive by facilitating the transfer and diffusion of technologies, knowledge, and managerial expertise, and by promoting international trade through access to foreign markets and global supply chains. It can lead to increased employment opportunities and better wages.

While Canada continues to attract foreign direct investment, Canadians are investing even more abroad. According to OECD [data](#), in 2023 Canada attracted US\$50.3 billion in foreign direct investment but Canadians invested US\$89.6 billion abroad resulting in a net outflow of US\$39.3 billion.

Canada’s foreign direct investment balance has grown more negative over the years. Based on our calculations using OECD data, from 2010 to 2015, Canada posted net outflows of US\$7.4 billion per year, on average. From 2016 to 2020, net outflows averaged US\$30.5 billion per year. From 2020 to 2023, the negative foreign direct balance was US\$39.9 billion per year.

In the last 10 years (2014 through 2023), there has been a giant sucking sound of capital leaving Canada to the tune of a net US\$294 billion.

Canada – Foreign Direct Investment Inflows and Outflows US\$ billion



Data Source: OECD, [Measuring foreign direct investment](#) | OECD, October 31, 2024.

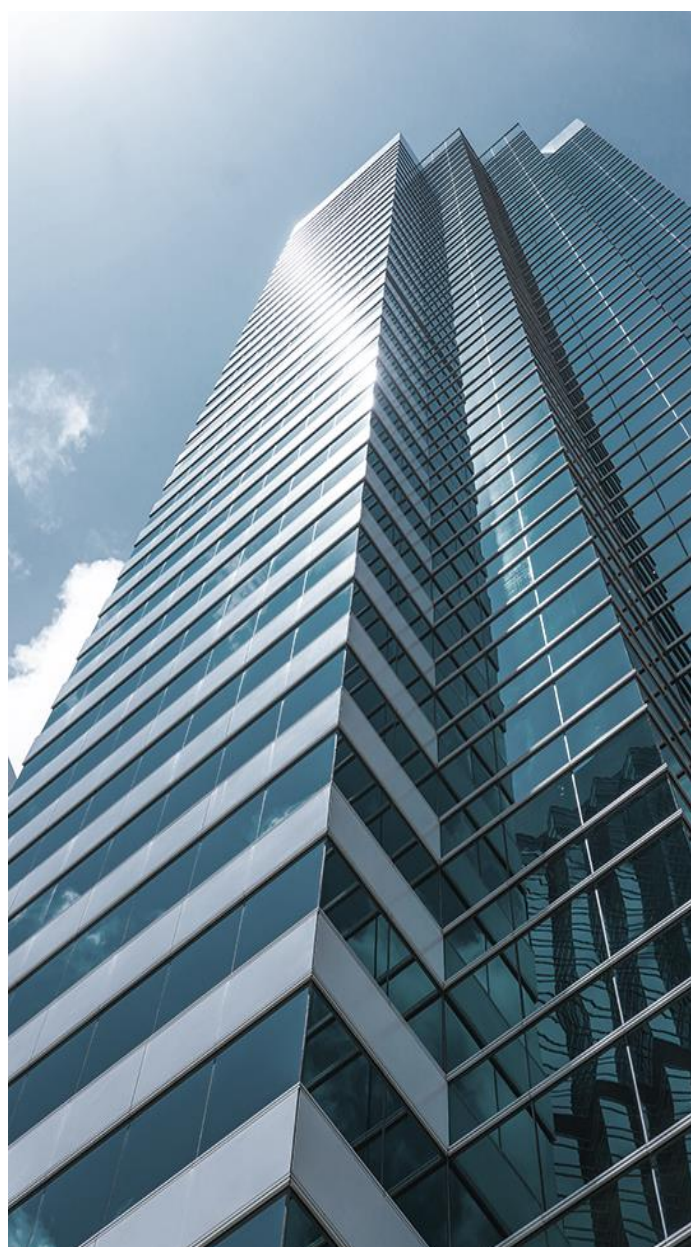
² The OECD defines foreign direct investment (FDI) as follows: “FDI is when an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy. Financial flows consist of equity transactions, reinvestment of earnings, and intercompany debt transactions.”



THE ROLE OF TAXATION

The OECD has extensively [studied](#) the link between taxes and economic growth and has found that corporate income taxes are “the most harmful for growth as they discourage the activities of firms that are most important for growth: investment in capital and productivity improvements. In addition, most corporate tax systems have a large number of provisions that create tax advantages for specific activities, typically drawing resources away from the sectors in which they can make the greatest contribution to growth.”

All else being equal, countries with lower taxes appeal more to multinational companies and foreign direct investment. A [synthesis of empirical research](#) has found that, on average, a 1 percentage point reduction in the host country tax rate results in a 3.3% increase in foreign direct investment in that country.





THE IMPERATIVE FOR BUSINESS TAX REFORM

Canada relies heavily on the most economically damaging taxes – 12.3% of tax revenue in Canada is [raised](#) from corporate income taxes versus 5.1% in the U.S. and 9.2% on average in OECD countries.

The Washington-based Tax Foundation [International Tax Competitiveness Index 2024](#) ranks Canada at 26th overall among 38 Organisation for Economic Co-operation and Development (OECD) countries on business tax competitiveness.

Canada’s average combined federal-provincial statutory (general) [corporate income tax rate](#) (26.1%)³ is now (2024) higher than the OECD average combined central/sub-central rate (23.7%)⁴ and higher than the U.S. average combined federal-state corporate tax rate (25.6%) and the third highest in the G7. In 2017, Canada had a 12.3 percentage point advantage relative to the U.S. – an advantage that disappeared with the passage of the United States’ 2017 [Tax Cuts and Jobs Act](#) (under President Donald Trump) which reduced the U.S. federal corporate income tax rate from 35% to 21%.

Small businesses in Canada are taxed at an average combined federal-provincial rate of 11.6% (up to \$500,000 in active business income earned by small Canadian-controlled private corporations) – 14.5 percentage points less than the average combined federal-provincial rate that applies to large corporations. “However, since receiving benefits is conditional on staying small, [some](#) have argued that these programs could act as a barrier to growth.”

³ 15% federal general corporate income tax rate plus an average provincial corporate income tax rate of 11.14%. Provincial rates vary from 8% in Alberta to 16% in Prince Edward Island.

⁴ 21% federal general corporate income tax rate (19.77 after deductions for state taxes) plus an average state tax rate of 5.86%.



While the general corporate tax rate affects where businesses locate, the marginal effective tax rate (METR) on capital affects capital investment decisions. The METR encompasses statutory federal and provincial tax rates as well as tax depreciation allowances, investment tax credits and retail sales taxes on capital inputs that influence the real cost of capital investment. The METR is the effective tax rate on new business investment.

In 2016, Canada had a METR of 20.7%. [According](#) to the Department of Finance Canada, the METR in 2024 is 14.5%, the lowest in the G7 and well below the OECD average (17.8%). Canada achieved this not by reducing tax rates but mostly through accelerated tax depreciation which tends to overstate the true economic depreciation of assets. In 2018, in response to the [overhaul of the federal tax code](#) in the U.S. (which reduced the federal corporate tax rate from 35% to 21%), the Canadian federal government introduced the [Accelerated Investment Incentive](#) to support investment by businesses of all sizes and across all sectors of the economy. It also allowed businesses to immediately write off the full cost of machinery and equipment used for the manufacturing or processing of goods and for specified clean energy equipment. “temporary” to be phased

These measures are “temporary” to be phased out during the 2024-2027 period. When they do expire, Canada’s METR is projected by Finance Canada to rise to 16.8% in 2028. Estimates by the [University of Calgary](#) put the METR at 19.5% in 2028.

METRs on capital investment [vary](#) widely by industry. Manufacturing and forestry are very much favoured over other industries, with an METR of 7.4% and 7.2%, respectively (2022), while service providers (e.g., retail trade, wholesale trade and construction) face METRs in excess of 20%. Canada’s business tax system distorts the efficient allocation of capital – capital tends to flow to those sectors with the most favourable tax treatment rather than to those where growth prospects may be higher, reducing the productive capacity of the economy. By allocating capital inefficiently, the tax system also impedes technological innovation.

While accelerated depreciation reduced the tax burden on new investment, it may be of little or no value to companies that are not able to use the deduction because of insufficient profitability – they do not earn enough profits to absorb all the writeoffs available to them.

According to Statistics [data](#) derived from T2 returns, 53% of Canadian corporations were paying no tax in 2021 (latest data available). In a report titled *Is [Accelerated Depreciation Good or Misguided Tax Policy](#)*, Philip Bazel and Jack Mintz write that accelerated appreciation and other preferences have resulted in an “increasingly complex, inefficient, and unstable” corporate tax system.

They go on to say, “instead of relying on such incentives, the federal and provincial governments should be pursuing a more comprehensive approach to tax reform in order to improve efficiency, fairness, simplicity, and competitiveness.”

There is now a greater urgency for business tax reform to stave off the potential loss of business investment and corporate headquarters to the U.S. President-elect Donald Trump has pledged to reduce the federal corporate tax rate from 21% to 20% generally, and reduce the rate to 15% for companies that make their products in the U.S. This will reduce the U.S. average combined federal-state corporate tax rate from 25.6% to 24.6% generally (versus 26.1% in Canada).



A PRO-GROWTH BUSINESS TAX POLICY AGENDA IS A CRITICAL PART OF THE SOLUTION

The Investment Industry Association of Canada (IIAC) recommends that the federal government:

- Reduce the federal statutory (general) corporate income tax rate by one percentage point in 2025 and by a further one percentage point in 2026 – i.e. from 15% to 13% -- to make Canada a more attractive place to locate businesses and invest, and to counter the anticipated federal corporate income tax rate cut in the U.S. once President Trump returns to office. Rate reductions are preferable to accelerated tax depreciation which tends to favour investments in some industries and asset classes over others, and results in inefficient allocation of capital.
- Encourage the remaining provinces (British Columbia, Saskatchewan and Manitoba) to harmonize their provincial sales tax (PST) with the GST. Under a PST, business inputs such as machinery and equipment are taxed, which lowers returns on investment. Lower investment hinders productivity and economic growth.
- Re-balance Canada's tax system so it relies less on taxes that are most harmful to economic growth – i.e. income and profit taxes – and more on consumption taxes which are less distortionary and have significantly less adverse effects on economic growth than taxing income.
- Undertake an independent and comprehensive examination of the federal tax system, including a thorough review of tax expenditures/preferences, to ensure it adheres to long-standing principles of good tax policy, including neutrality (the businesses tax system does not favour or disadvantage particular sectors of the economy), efficiency (the business tax system does not distort important economic decisions about what industries and assets to invest in, where to produce, and how to finance investments), and simplicity (taxpayers should not have to spend significant time and resources trying to comply with the tax code).

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