Will Morneau's tax breaks really spur new business investments?

By Barrie McKenna
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Nearly a year after U.S. President Donald Trump slashed corporate taxes, Ottawa has responded with measures that it says will restore Canada's tax advantage – at least when it comes to new business investment.

The incentives, projected to cost the federal government $14.4-billion over six fiscal years, are aimed at getting Canadian businesses investing now. The measures include allowing companies to immediately write off the full cost of certain investments, including plant machinery and clean-energy equipment, rather than gradually over time.

The big question now is whether Canadian companies will take the bait.

The evidence that tax relief drives investment is mixed. Until the recent U.S. tax cuts, Canada enjoyed a significant corporate tax advantage, but had still been falling behind in business investment. Business investment as a share of GDP has fallen significantly in the past four years, while remaining steady in the U.S., according to a recent report by the Vancouver-based Fraser Institute.

The measures, contained in Finance Minister Bill Morneau's fall economic update, come amid growing economic unease in Canada, particularly in the oil sector, where record low prices for Canadian heavy crude have plunged the sector into crisis.

Experts have warned for months that a combination of the U.S. tax breaks and rising trade protectionism are weighing heavily on business investment.

Overall business tax rates remain slightly higher in Canada than in the U.S. But the federal government says the changes announced Wednesday will result in a lower tax rate on new investment than in the U.S. and all other Group of Seven industrialized countries. The measures will lower the marginal effective tax rate on new investment in Canada to 13.8 per cent from 17 per cent. The comparable rate in the U.S. is 18.7 per cent.

Mr. Morneau said the tax relief is about sending a signal to businesses that "if they have a choice to invest on either side of the border, Canada is the smart and sensible choice."

Mr. Morneau also acknowledged the struggles facing the oil industry, which is reeling from a record-low price for heavy Canadian crude of less than US$15 a barrel. But he didn't announce any specific measures to help the sector.

However, given that the oil and gas industry accounts for a fifth of business investment in Canada, roughly the same share of the tax relief is expected to go to energy companies.

The new rules on investment writeoffs will apply to all capital purchases made after Nov. 20. Under current rules, manufacturers can deduct 25 per cent of the cost of any new machinery in the year they purchase it, and then gradually deduct the rest over the life of the equipment. Companies will now be able to claim a 100-per-cent tax deduction immediately, giving significant upfront savings they can apply to other business activities.

Mr. Morneau also announced up to a tripling of what companies will be able to deduct on all other capital purchases – ranging from software to motor vehicles.

The applicable rate of accelerated depreciation will depend on the type of equipment. Companies will be able to write off 100 per cent of the cost of computer software in year one, up

from 50 per cent now. The rate for new motor vehicles and data networking equipment is going to 45 per cent, from 15 per cent.

Mr. Morneau is betting that the incentives will be enough to change the calculus for companies looking at where to put new investments.

Unfortunately, corporate taxes are not the only thing that drive business investment. Rising protectionism, including recently imposed U.S. duties on Canadian steel, aluminum and lumber, have created incentives for companies to locate production inside the large U.S. market.

Labour laws, proximity to markets and suppliers as well as the regulatory burden can also influence business decisions.

Some key Canadian industries face longer-term existential challenges that have little do with tax policy. Global automakers have been steadily shifting production to the southern U.S., Mexico and offshore, leaving Canada with fewer assembly plants. Canada’s oil industry, meanwhile, is facing challenges related to a lack of pipeline capacity, high production costs and climate change.

Ottawa, the provinces and municipalities will have to work a lot harder to make sure that the broader business environment remains competitive in Canada.

That will mean resisting further U.S. protectionism and breaking down regulatory barriers in Canada.