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e-brief

Revised Corporate Tax Cuts in Federal Budget Will Reduce Investment Gains by Half: C.D. Howe Institute Report

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The recently announced agreement between the federal government and the New Democrats to roll back some of the planned corporate tax cuts in the 2005 Budget to gain NDP support for its passage may significantly damp efforts to raise Canada's standard of living. Since the release of our e-brief, *Federal Corporate Tax Cuts Would Lift Canada's Standard of Living*, on April 26, detailing the gains from the government's 2005 budget and elimination of the remaining large corporation surtax by 2010 — including stimulating $56 billion in capital investments by Canadian businesses — many commentators asked for an estimate of the economic impact of the new accord.

For starters, under the agreement, corporate tax cuts may still take place if the Liberals have an opportunity to introduce a bill separate from the budget that would reinstate the planned cuts and win Commons approval.

Otherwise, only the new capital cost allowance rates and the elimination of the corporate surtax for small businesses would be contained in the revised budget that the government will ask the House to pass. (Under the Income Tax Act, small companies are defined as Canadian-controlled private corporations that have about $15 million in assets.)

If all the revised budget does is reduce the corporate surtax for small companies, that would result in the general federal-provincial corporate income tax remaining at 35 percent by 2010. As well, the effective tax rate on capital for medium and large corporations, as shown in Table 1, will decline to 26.8 percent by 2010 from 28.8 percent in 2005. Had the government preserved the original corporate tax cuts, however, the effective tax rate on capital would have been 25.0 percent by 2010, according calculations by the Institute's Tax Competitiveness Program.

Under the new budget plan, the remaining corporate tax cuts and reduction of the large corporations tax will lead to $25 billion in capital investment, compared to the initial estimate of $56 billion when all the reductions were intact. Annual gross domestic product (GDP) will increase after 2010 by $2.3 billion instead of the estimated $5 billion under the previous measures.

Table 1: *Changes in the Effective Corporate Tax Rate by Industry on Medium and Large Businesses Under April 26 Proposed Changes to Federal Budget*

	2005	2010 Federal Budget Fully Implemented	2010 Rollback of Some Tax Cuts
		percent	
Forestry	28.0	23.8	25.9
Mining	7.9	3.5	4.2
Oil and Gas	6.3	5.1	5.8
Manufacturing	28.6	24.5	26.6
Construction	33.2	29.2	31.4
Transportation and Storage	30.2	26.0	27.8
Communications	27.8	23.5	25.2
Electrical Power, Gas & Water	23.3	18.7	20.5
Wolesale Trade	37.2	33.7	35.9
Retail Trade	40.0	36.4	38.5
Services Total	33.5	29.7	31.7
Aggregate	28.8	25.0	26.8

Overall, the rollback of the planned federal corporate tax cuts will have an economic cost of about $31 billion in capital expenditure and $2.7 billion in GDP. Those are figures that not only count; they matter.