

Intelligence MEMOS



From: Don Drummond, Alexandre Laurin and William B.P. Robson
To: Potential Federal Finance Ministers
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Re: **SUSTAINABLE GROWTH-FRIENDLY TAX REFORM: THE 2025 SHADOW BUDGET**

The federal government's fiscal policy over the past decade has featured ballooning spending, excessive borrowing, and growth-discouraging taxation. With US trade aggression darkening the picture, Canada urgently needs tax changes that will encourage work, saving and investment.

The C.D. Howe Institute 2025 [Shadow Budget](#) takes aim at this problem. It lowers taxes on personal income and business profits. It provides tax changes to unlock innovation and commercialization of Canadian ideas. It eliminates tax measures that are administratively complex and costly, eroding confidence in the system's integrity and encouraging lobbying for special treatment. Critically, it ensures that these changes are durable by returning the Goods and Services Tax (GST) to its original 7-percent rate and rigorously restraining federal non-defence spending, while reaching NATO's 2-percent of GDP defence spending target.

An overhaul of Canada's tax mix is a centrepiece of the Shadow Budget. Reducing incentives for people to earn more and to invest in training, and for companies to expand and take risks, saps economic vitality. Well-designed consumption taxes do less harm to economic performance than taxes on personal income and business profits.

A two-step GST rate increase from 5 to 6 percent in mid-2025, and then to 7 percent in mid-2026 would increase federal revenues by \$27.5 billion by 2027-28. In addition to letting the federal government balance its budget – critical to confidence in the fiscal plan overall – it creates room for lower taxes on personal and business incomes.

Mid-income earners in Canada face the double-whammy of clawbacks on income-tested benefits and high tax rates. The Shadow Budget offers them \$9 billion in tax relief by cutting the second tax bracket significantly by 2028, with the goal of merging with the lowest bracket. This change strengthens the reward for additional earnings by helping families keep more of each extra dollar.

Business investment fuels jobs, innovation, and higher wages. Yet Canada's business investment performance lags key competitors, especially the United States. The Shadow Budget proposes trimming two percentage points from the corporate tax rate by 2027 – \$7 billion in tax relief – boosting firms' ability to expand, hire, and invest in new productivity-enhancing capital. The corporate tax rate is also a key factor driving investment location decisions, which can soften the impact of US tariff threats.

A modern economy thrives when entrepreneurs innovate and grow their businesses. The Shadow Budget reforms the Scientific Research and Experimental Development (SR&ED) credit, phases in full refundability, and adds a [patent box](#) that lowers tax rates on intellectual property income. It also relaxes capital gains taxes for patient investors who hold qualified small-business shares for at least five years. These steps nurture the deep pools of capital that entrepreneurs need to build and commercialize game-changing ideas.

Tax changes that put populist messaging ahead of good policy over the past decade have made federal taxation less coherent, undermined confidence in the system, and encouraged lobbying for special treatment. The Shadow Budget revokes the luxury tax on vehicles, boats, and planes. It also revokes the tax on share buybacks. It removes financial-sector surtaxes and taxes on inter-corporate dividends for financial institutions to prevent double taxation. To curb housing demand and inflation, it phases out the first-time homebuyers credit and the First Home Savings Account. It withdraws reforms to the alternative minimum tax that would have subjected charitable donations to tax.

Like unfunded spending increases, tax cuts that increase government borrowing do not inspire confidence in their permanence. Sooner or later, faster or slower, rising debt forces reversals. The 2025 Shadow Budget breaks this cycle. GST revenues and savings from a thorough review of non-defence government spending – yielding \$44 billion by 2029/30 – put the government on a path toward a balanced budget and a falling debt burden. Individuals and businesses, knowing the lower rates are durable, can invest in education and training, and in capital and R&D.

Canadians need federal fiscal policy that fosters productivity, encourages investment, and secure a healthy government balance sheet for future generations. The C.D. Howe Institute's 2025 Shadow Budget shows the way.

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