



# **Alberta Enterprise Group - *Annual Economic Update: Crystal Ball Predictions on Future Tax Policy Responses to Current Challenges***

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# Agenda

- Quick Review of Recent Geopolitical Developments
- Impact on Canada
- Predictions – Crystal Ball – on Tax Policy Impacts to Canada



# Quick Review of Recent Geopolitical Developments

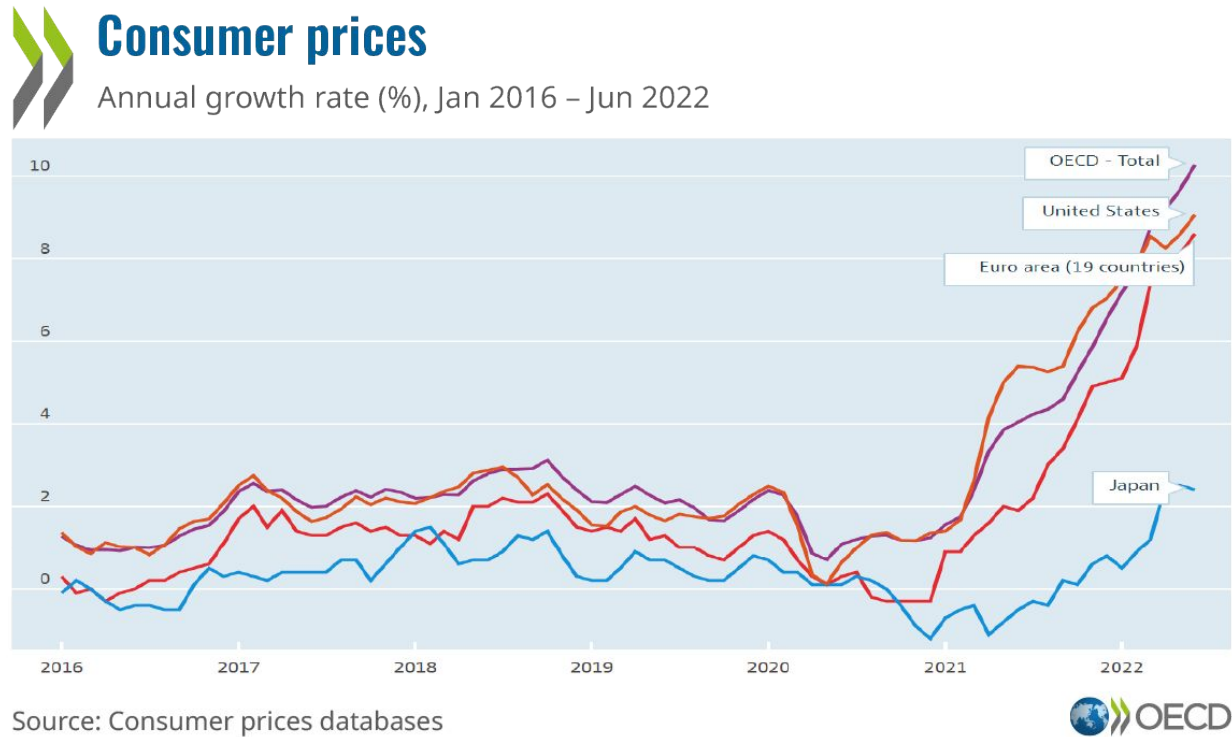
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# COVID-19 Global Pandemic

## General Comments

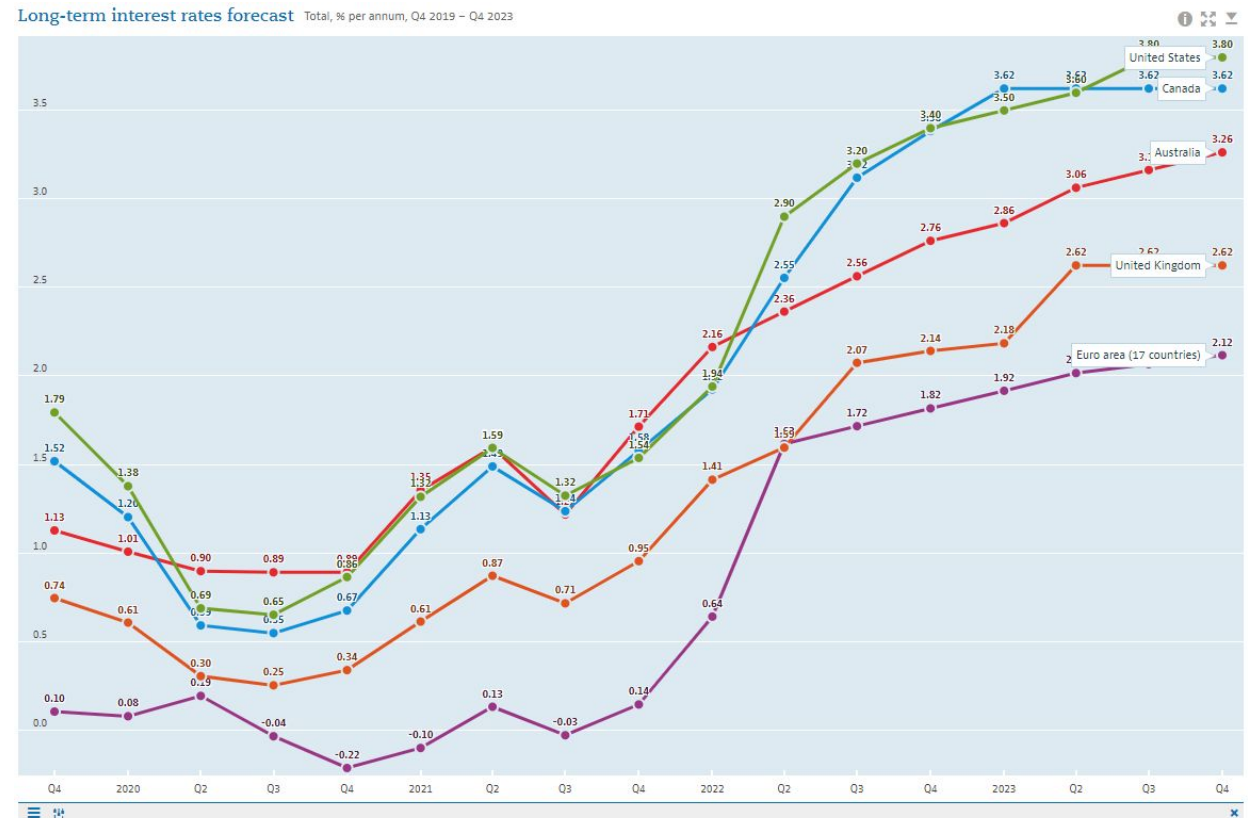
- COVID-19 resulted in unprecedented amounts of government stimulus worldwide as countries scrambled to contain the pandemic and blunt the economic impact of containment measures.
- Now starting to see the effects of stimulus and increased money supply in the global economy: Inflation.
- Russian invasion of Ukraine in late February 2022 exacerbated existing conditions, and lead to spike in (already increasing) oil prices.
- China's "zero-COVID" policy affecting existing supply chains.

# Inflation Amongst OECD Countries



# Global Interest Rates

- Central bank policies around the world are shifting to more restrictive levels interest rates to combat inflation.
- High interest rates reduce consumer spending and business growth but increase likelihood of recession.



# Global Interest Rates

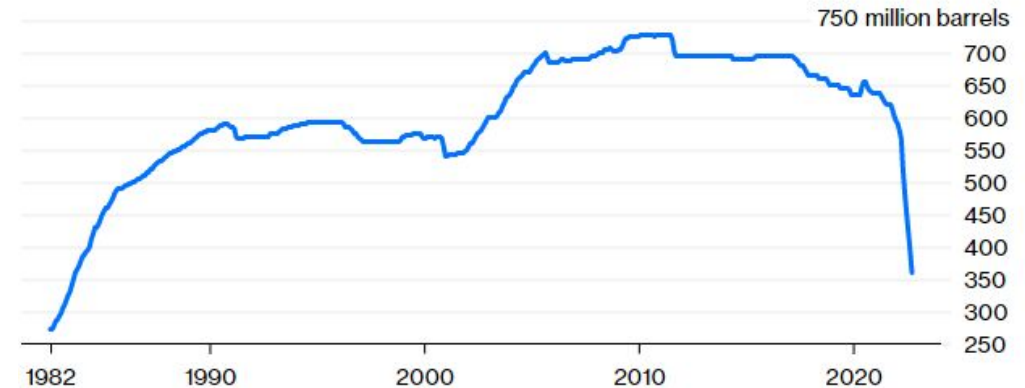
- Inflation remains high in the U.S.
- Although according to August 2022 CPI report, inflation only rose 0.1%, this was still more than expected.
- U.S. Federal Reserve in September 2022 – 0.75%
  - Fed Chair Jerome Powell: *“I can assure you that my colleagues and I are strongly committed to this project [controlling inflation] and we will keep at it until the job is done”*
  - More rate hikes expected

# Energy Prices

- Threat of new global energy crisis spurred on by increased oil demand as countries open back up from pandemic lockdowns, and war in Ukraine / Russian cutting off gas exports.
- High energy prices represent political threat:
  - See U.S. release of Strategic Petroleum Reserves
  - Concerns of European social unrest over high gas prices during winter – again due to war in Ukraine.

## Oil Piggy Bank

By October, the US Strategic Petroleum Reserve will shrink to a 40-year low as the White House taps it to put a lid on global oil prices



Source: US Department of Energy

Source: Jun-Oct 2022 is forecast based on releases already pre-announced

# Energy Prices

- Countries are reassessing investments in renewables versus fossil fuels.
- Despite push for renewables, fossil fuels still make up 82% of global energy use.
- There are limits to how fast renewables can replace fossil fuels – EU to spend at least \$50 billion on gas and coal infrastructure.
- Opinion: oil and gas will continue to be integral to the world economy for the foreseeable future.

## Elizabeth Truss – UK PM “Controversial” Tax Cuts

- Unfunded tax cuts cause significant concerns to public markets
- Ultimately led to her tenure being the shortest in British history
- Tax cuts, in my opinion, are a step in the right direction but ultimately should be supported by proper budgeting.

in...

Liz Truss on Twitter: "“Individuals do ...  
[twitter.com](https://twitter.com)



Liz Truss doubles down on tax cuts at £1,500...  
[www.telegraph.co.uk](https://www.telegraph.co.uk)

## Elizabeth Truss – UK PM “Controversial” Tax Cuts

- New UK PM has signaled that tax increases are on the way with the “wealthy” likely being “asked” to shoulder a good chunk of the burden.
- You can bet other countries, like Canada, have paid close attention to this debacle.

in...

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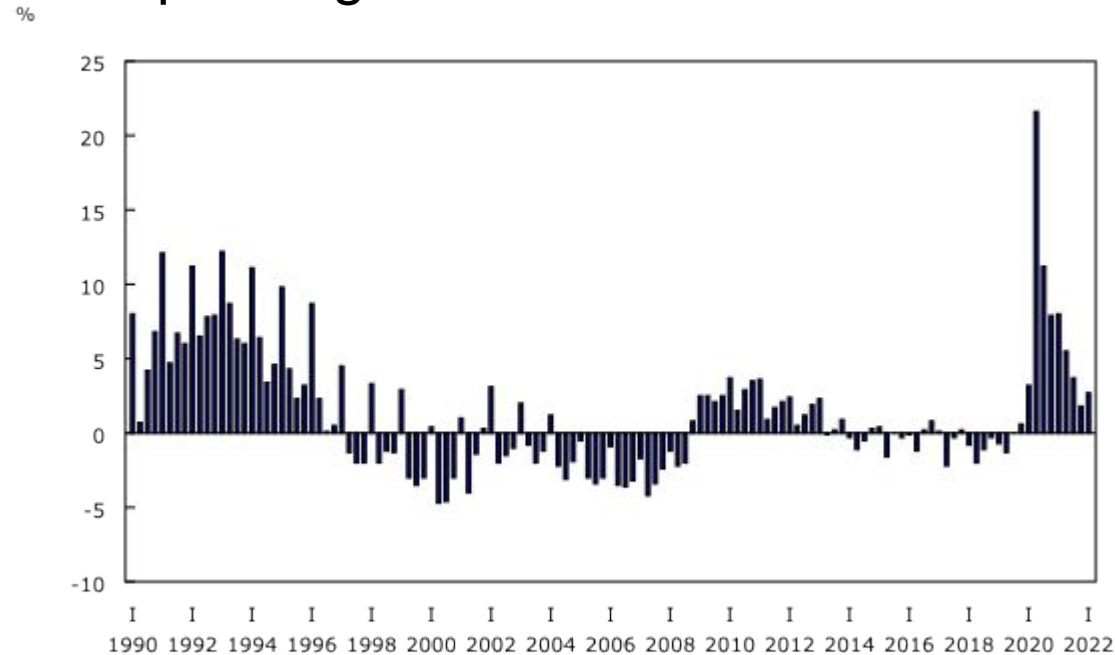


# Impact on Canada

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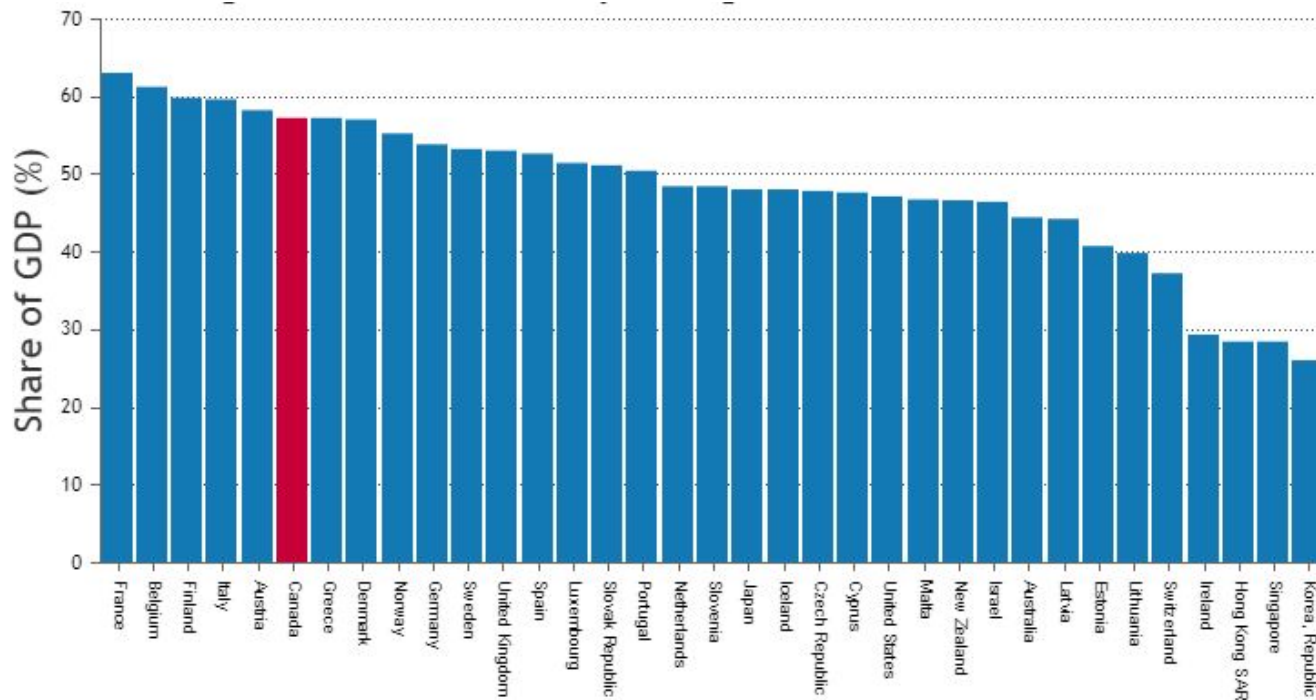
## What About Canada?

- Of course, Canada is not immune to any of these geopolitical risks.
- Canadian general government deficit as percentage of GDP rose to 20-year highs as a result of pandemic spending:



# What About Canada?

- Canadian government spending ranked 6th highest of 35 high-income countries in 2020.



## What About Canada? Cont'd

- Inflation is at its highest levels since the 1980s



## What About Canada? Cont'd

- Bank of Canada's response to rising inflation: increase interest rates.
- We have already seen our seventh rate-hike since beginning of 2022, with no end in sight.
- Latest rate hike on October 26, 2022 by 0.5% (less than expected). Other rate hikes during 2022:

Date*	Target (%)	Change (%)
September 7, 2022	3.25	+0.75
July 13, 2022	2.50	+1.00
June 1, 2022	1.50	+0.50
April 13, 2022	1.00	+0.50
March 2, 2022	0.50	+0.25
January 26, 2022	0.25	---

# What About Canada? Cont'd

- Based on August and September CPI reports, there is some sign inflation is slowing down.
- CPI fell 0.3% in August, driven mainly by decreases to gasoline (-9.6%) and energy prices (-6.5%).
- Overall inflation is down from 7.6% to 7.0% year over year between July and August.
- September 2022 declined to 6.9%...still very high.
- Step in the right direction, however we are still well above Bank of Canada's target rate of 1 to 3%.
- Perhaps slowing inflation will limit future rate hikes, but hard to tell.

**Chart 1 - Canada — CPI**  
(month/month % change)

		Aug	Jul	Jun	(3-mo. % chg : a.r.)	(12-mo. % chg) Aug	Jul
All Items	(s.a.)	0.1	0.1	0.5	2.9	7.0	7.6
	(n.s.a.)	-0.3	0.1	0.7	1.9	7.0	7.6
Ex. Food & Energy	(s.a.)	0.2	0.5	0.4	4.6	5.3	5.5
BoC Core — Trim						5.2	5.4
Median						4.8	4.9
Common						5.7	6.0
Food	(s.a.)	1.0	0.9	0.2	8.8	9.8	9.2
Energy		-6.5	-5.4	3.9	-28.7	19.0	28.0
Services		0.1	0.9	0.4	5.8	5.5	5.7
Shelter	(s.a.)	-0.1	0.4	0.4	2.7	6.6	7.0
Alcohol/Tobacco	(s.a.)	0.4	0.6	0.3	5.2	3.5	3.8
Clothing/Footwear	(s.a.)	-0.1	-0.5	0.2	-1.7	1.4	1.4
Automobiles		-0.2	0.3	1.5	6.5	7.3	8.1
Gasoline		-9.6	-9.2	6.2	-42.2	22.1	35.6
Auto Insurance		0.2	3.0	-1.7	5.4	3.4	3.3
Mort. Interest Payments		2.4	1.7	1.4	24.4	4.8	1.7

Source: BMO Economics, Haver Analytics

## What About Canada? Cont'd

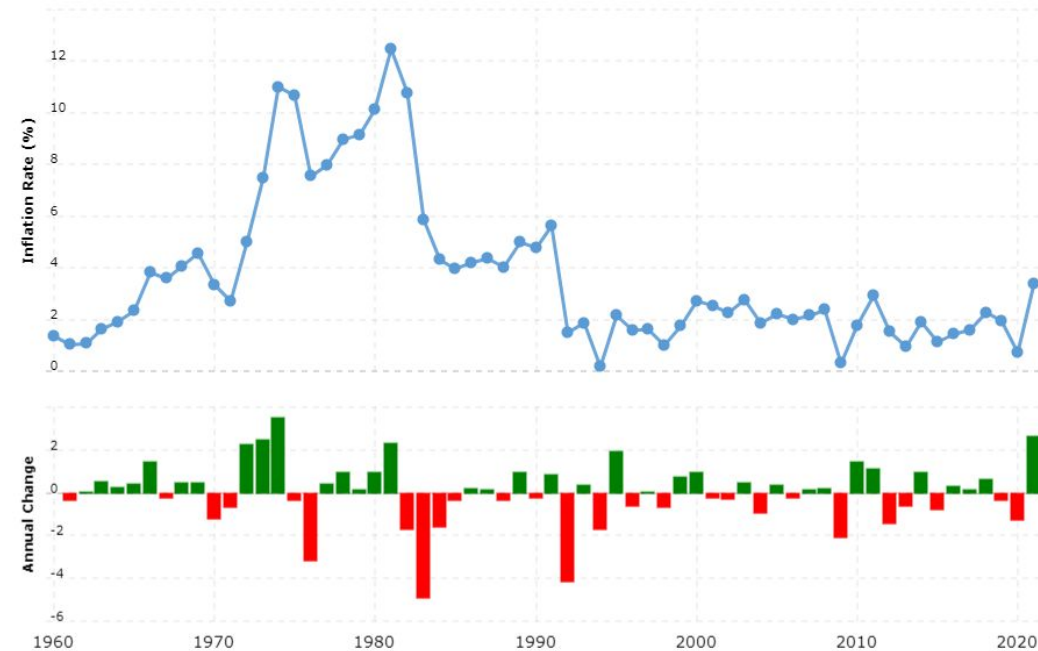
- Bank of Canada projections:
  - Inflation to average 8% for 2022, then fall to ~3% by end of 2023, then ~2% by 2024.
- Bank of Canada governor Tiff Macklem to businesses on whether to raise wages to retain employees:
  - *"So as a business, don't plan on the current rate of inflation staying. Don't build that into longer-term contracts. Don't build that into wage contracts. It is going to take some time, but you can be confident that inflation will come down."*
- Fear of a “wage-price spiral” – higher wages results in higher consumer spending, resulting in higher prices.
- Disconnect from reality – skilled employees are always in demand. If the business owner isn't willing to pay market wages, then someone else will.

## What About Canada? Cont'd

- Some additional recent quotes from Tiff:
- July 2021 – *“Shouldn’t overreact to these temporary price increases”*
- October 2021 - *“We think there’s good reasons to believe that these are one-off price increases, they won’t create ongoing inflation”*
- November 2021 – *“I think to a lot of people, transitory means it's going to be over quickly and maybe I don't know exactly what the right word is, but it's probably something like you know, transitory but not short-lived.”*
- April 2022 – *“We got a lot of things right. We got some things wrong, and we are adjusting”.*
- Hindsight 20/20, but CPI increases were evident mid-2021 and easily predictable with massive and never ending government stimulus.
- First rate hike occurred March 2022.

# Inflation in Canada

- How long will it take to get inflation down to manageable levels?
  - At least 2+ years perhaps.
- Some context: inflation in Canada remained elevated for years during the 1970s-80s, could we be in for the same ride?



# Inflation in Canada

- “Taylor Rule” – To control inflation, central banks need to boost interest rates 1.5x as much as the rate of inflation.
- Risk of triggering a recession as BoC tries to get inflation under control.
  - Some even consider that a recession is a necessary trade off.
- Should get federal budgets under control, reduce amount of money in the system so there are no longer “*too many dollars chasing too few goods*”.
  - But federal government seems content to continue spending.
  - Some banks – ScotiaBank as an example – are sounding the alarm on continued government spending

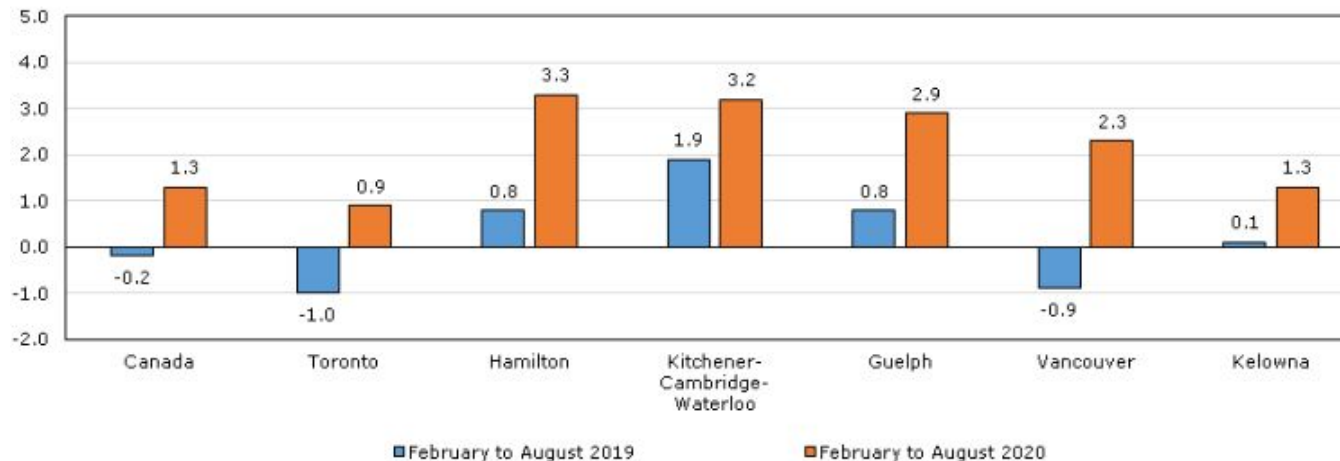
# Housing

- Canada experiencing record housing affordability crisis.
- Counter-intuitively, house prices increased during COVID.

Chart 1

Many major markets showed increased momentum in new house prices between February and August 2020

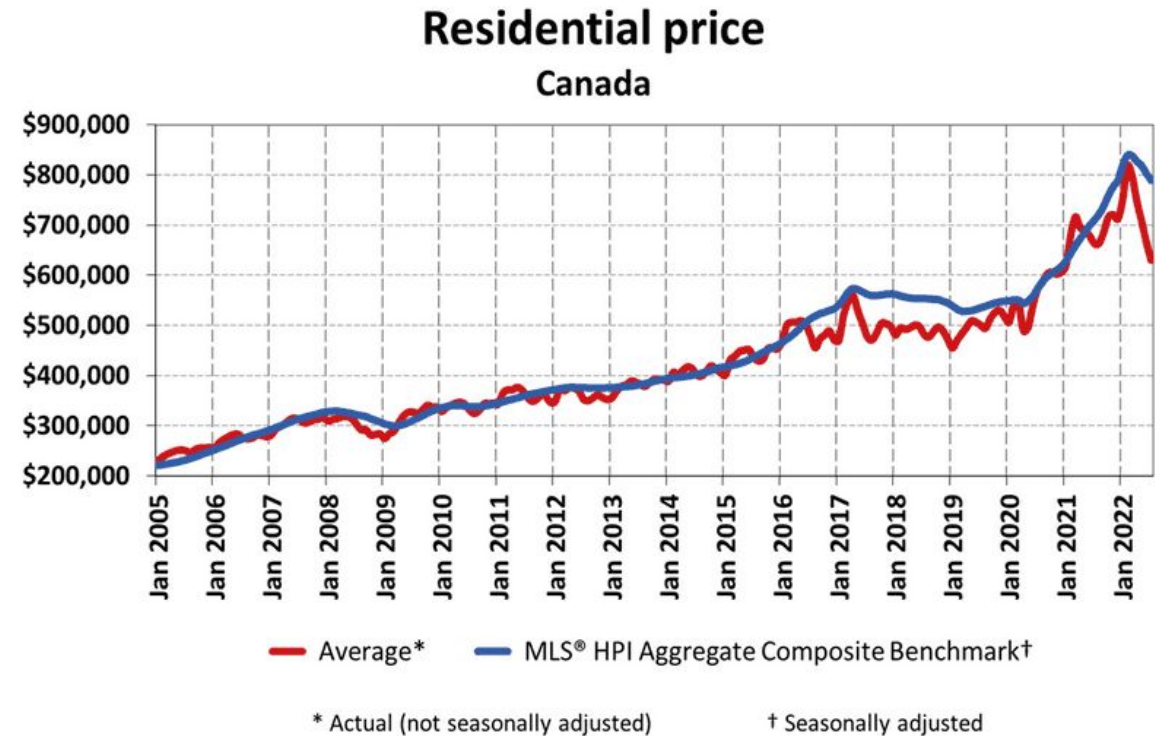
% change



Source: Statistics Canada, Table 16-10-0205-01 New housing price index, monthly.

# Housing cont'd

- Many given reasons for trend:
  - Foreign speculation?
  - Record low interest rates?
  - Demand exceeds supply?
  - House flippers?
- Recent interest rate hikes have cooled the market somewhat, but prices are still at record levels historically speaking.



Source: The Canadian Real Estate Association

# Housing cont'd

- Per BMO study for August 2022:
- Canadian home sales down 24.7% year over year, meaning activity is back in pre-COVID range.
- New listings down, but no signs of forced selling / defaults yet.
- Housing market is still adjusting to higher interest rates.
- Recession could lead to forced selling / defaults, but currently dip is merely a “price adjustment”.

**Table 1 - Canada — Existing Home Sales**

(% change)

August 2022	Sales			Prices	
	m/m <sup>1</sup>	y/y	y-t-d	y/y	y-t-d
Canada	-1.0	-24.7	-20.7	-3.9	6.7
Halifax	-12.9	-29.7	-23.7	7.3	21.1
Toronto	11.1	-34.5	-34.3	0.8	14.1
Montreal	-9.9	-19.9	-15.8	6.1	12.4
Winnipeg	-10.4	-13.1	-16.2	4.0	11.3
Vancouver	-5.7	-40.9	-28.8	1.8	9.6
Ottawa	0.5	-27.3	-19.8	4.4	9.4
Calgary	-2.4	-4.9	13.6	2.8	6.4
Edmonton	-5.6	-10.9	4.1	-1.6	3.7
Regina	-0.5	10.2	-1.7	-6.9	0.6
MLS Home Price Index (national)				7.1	20.4
<sup>1</sup> (seasonally adjusted)					

Source: BMO Economics, Haver Analytics, CREA

## Housing cont'd

- Housing is clearly top of mind for many voters.
- Liberal government already proposing myriad of new housing related legislation:
  - Tax-Free First Home Savings Account (FHSA)
  - Anti house “flipping” rules – houses sold within 12 months of acquisition treated as on account of income, unless “life event” exception applies...very unnecessary new rules.
  - First-time home buyer’s tax credit doubled from \$5,000 to \$10,000.
  - 2-year prohibition on foreign home buyers....new Act received Royal Assent in June, 2022 – commences January 1, 2023 and automatically expires January 1, 2025
  - Bill C-8 Underused Housing Tax Act - 1% annual tax on Canadian residential properties owned by non-citizens / non-permanent residents of Canada unless specifically exempted....applicable for 2022 calendar year forward.

# Ban on Foreign Investment in Canadian Housing

- *“To make sure that housing is owned by Canadians instead of foreign investors, Budget 2022 announces the government’s intention to propose restrictions that would prohibit foreign commercial enterprises and people who are not Canadian citizens or permanent residents from acquiring non-recreational, residential property in Canada for a period of two years.”*
- New Act - *Prohibition on the Purchase of Residential Property by Non-Canadians Act* - has now received Royal Assent in June 2022 to take effect January 1, 2023 – December 31, 2024 - <https://laws-lois.justice.gc.ca/eng/acts/P-25.2/page-1.html>

## Housing cont'd

- Liberals have pledged to introduce new rent-to-own program:
  - Commit \$1 billion in loans and grants to develop and scale up rent-to-own projects with private, not-for profit, and co-op partners.
- Ultimately housing is tough to control / predict.
- Affordability has been noted as an issue for awhile now.
- CMHC has stated that *“the last time housing was affordable was in 2003 and 2004”*.
- CMHC estimates 3.5 million additional housing units needed by 2030 to restore affordability.
- Let's say government policy succeeds in lowering house prices – what about those who bought at the “top”?

# Some Crystal Ball Predictions

# Some Crystal Ball Predictions

- Given the geo-political situation, huge deficit spending, inflationary results and recent tax and spending policies, the need for increased government revenues will continue.
- Will we see expenditure restraint? Doesn't appear so.
- Although we have seen recent media reports of the Finance Minister basically saying that any new spending will have to be done with inter-program transfers...
- Fall Economic Update – November 3, 2022....any guesses on tax policy?

# Some Crystal Ball Predictions

## Capital Gains Inclusion Rate Increase?

- Yes...I think so. But my guess is not tomorrow.
- My prediction – goes to 75% from existing 50% but I'm guessing won't happen right away.
- 1972-1987 = 50%; 1988 – 1989 = 66.67%; 1990 – February 26, 2000 = 75%; February 27, 2000– October 17, 2000 = 66.67%; October 18, 2000 – present = 50%.
- As noted, the NDP in its 2021 election platform proposed to increase capital gains inclusion rate to 75%.
- Question is when this would happen?
- Given no mention in 2021 Fall Economic Update and 2022 Budget, perhaps this increase will not occur?

# Some Crystal Ball Predictions

## Capital Gains Inclusion Rate Increase?

- Increased capital gains inclusion rate would “fix” some tax issues such as disincentivizing surplus stripping.
- However, I worry about the negative implications such as making it less attractive for investors to risk capital....both domestic and foreign capital.
- If you believe capital gains inclusion rates are going up, then perhaps look for ways to trigger dispositions to lock in lower inclusion rate. Obviously, get advice on this before acting....

# Some Crystal Ball Predictions

## Personal Tax Rate Increases?

- No personal tax rate increases in Budget 2022
- However, NDP election policy platform proposes 2% personal tax rate increase.
- Wouldn't surprise me to see the Liberal minority government adopt this proposal...especially with new UK prime minister suggesting tax increases are on the way.
- Would put top marginal personal tax rates in some provinces like BC, ON, QC and some Atlantic provinces in the 56% range.
- Way too high in my opinion...would have a negative impact on attracting the “best and brightest” and see a continued exodus of capital outside of Canada.
- Would continue to discourage entrepreneurship.

# Some Crystal Ball Predictions

## Principal Residence Changes?

- It's my opinion that the PRE should be revised...way too generous.
- A US style approach that has a ceiling on a maximum claim seems more reasonable to me.
- I'm guessing that this issue is too much of a political hotbed....

# Amendments to the AMT?

- *Ensure those earning over \$210k pay at least 15% each year* (may be unfair if they are unable to get deductions & credits lower income Canadians get)...Canada already has an alternative minimum tax!
- Was this “promise” designed to put high income earners on notice that charitable credits are about to be restricted?

# Some Crystal Ball Predictions

## Introduction of a Wealth Tax?

- Short answer...I doubt it.

# Some Crystal Ball Predictions

## More Focus on “Offshore” / Planning?

- Yes. There are many ideologically driven people that are irrationally obsessed with this issue.
  - Numerous “studies” that “prove” their assertions / conclusions.
- Liberals 2021 election platform promised \$1B to the CRA to focus on aggressive tax avoidance and planning.
- What does that mean? Include offshore? Likely.
- Aggressive tax advisors, however, should be aware of the increased focus on “offshore” and “aggressive tax planning / avoidance”...mandatory disclosure proposals are evidence of that.

# Some Crystal Ball Predictions

## Comprehensive Tax Review / Reform?

- Last major comprehensive tax review / reform occurred by the establishment of the Royal Commission on Taxation headed by Kenneth Carter which commenced its work in 1962 and released its landmark recommendations in 1966 which was the impetus for major tax reform implemented in 1972.
- The Income Tax Act has become a patchwork quilt of amendments since 1972.
- It needs modernization.
- Unfortunately, our current Federal Government does not appear interested in this necessary endeavor.

# More Windfall Taxes Coming?

- 2022 Federal Budget introduced the “Canada Recovery Dividend” and a surtax on bank profits.
  - Horrible marketing slogan.
  - Dangerous slippery slope.
- EU is proposing windfall taxes on energy companies  
<https://markets.businessinsider.com/news/commodities/europe-energy-crisis-windfall-taxes-gas-electricity-eu-markets-2022-9>
- UK introduced windfall tax on oil and gas companies earlier this year.
- This week, the Biden administration is threatening to impose windfall taxes on US oil and gas companies unless they “...invest their profits in *“in lowering costs for American families and increasing production.”*”
- What else could be targeted? Technology companies?
- Will Canada follow suit?
  - I hope not!

# Thank You!





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