Cost Estimate of Election Campaign Proposal

Publication Date:	September 2021
Short Title:	Deny deduction for transactions with foreign subsidiaries without economic substance
Description:	Corporations will be required to demonstrate that a foreign subsidiary is carrying out economic activity to be able to deduct payments made to this subsidiary from their taxable income. The proposal would be effective starting September 21, 2021.

Cost of Proposed Measure:

$ millions	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026	Total
Total cost	-1,499	-2,777	-2,704	-2,631	-2,557	-12,167

Notes:

· Estimates are presented on an accrual basis as would appear in the budget and public accounts.
· A positive number implies a reduction in the budgetary balance (lower revenues or higher spending). A negative number implies an increase in the budgetary balance (higher revenues or lower spending).
· "-" = PBO does not expect a financial cost.

Estimation and projection method:

The cost estimate was based on historical corporate income tax (CIT) administrative microdata. Foreign affiliates were assumed to have no economic substance if they reported fewer than 5 employees. PBO summed the expenditures made by Canadian corporations to foreign affiliates deemed as not having any economic substance. Corporations exempt from CIT were excluded from the calculation. The revenue estimate was calculated based on the general CIT rate of 18% (consistent with a related proposal). Behavioral effects and avoidance were accounted for using basic attrition guidelines from HM Revenue and Customs.

Source of Uncertainty:

The main sources of uncertainty relate to the projected tax base and the magnitude of behavioural and avoidance effects.

Data Sources:

Variable	Source
Expenditures to foreign affiliates	T106 - T2-LEAP, Statistics Canada, CRA
Number of full-time employees	T1134 - T2-LEAP, Statistics Canada, CRA
Taxable income	T2-LEAP, Statistics Canada, CRA