OFFICE OF THE PARLIAMENTARY BUDGET OFFICER
BUREAU DU DIRECTEUR PARLEMENTAIRE DU BUDGET

Legislative Costing Note

This is an independent cost estimate of a budgetary measure contained in the federal government's Budget 2021. A list of the PBO's cost estimates of components of the Budget can be viewed on its website.

Publication Date:	2021-07-21
Short Title:	Immediate expensing for Canadian-Controlled Private Corporations (CCPC)
Description:	Introducing immediate expensing for eligible property (most capital property except generally long-lived assets) acquired by a CCPC on or after Budget Day and that becomes available for use before January 1, 2024, up to a maximum amount of $1.5 million per taxation year. The availability of other enhanced deductions under existing rules – such as the full expensing for manufacturing and processing machinery and equipment and for clean energy equipment, introduced in the 2018 Fall Economic Statement – would not reduce the maximum amount available under this new measure.

Data Sources:

Variable	Source
Cost of acquisitions during the year, capital cost allowance (CCA), non-capital losses, net income, taxable income, total credits and deductions, Part I tax, total federal tax	T2 corporation tax return administrative data (from schedules 1, 4, 8 and 200)
Gross fixed capital formation (investment in non-residential construction, machinery and equipment, and intellectual property products	Statistics Canada Table 36-10-0108-01 (up to 2020) and PBO's economic projection (for 2021 and onwards)
New motor vehicle registrations	Statistics Canada Table 20-10-0021-01

Estimation and Projection Method:

Using administrative data from T2 corporation tax returns for reference year 2017, the PBO performed a microsimulation of the federal tax payable by all CCPCs under the tax legislation in force just before Budget Day, which serves as the baseline for the cost estimate. Another microsimulation was then performed on the same data which included the immediate expensing measure introduced in the Budget. The difference between this simulation and the baseline estimates the impact of the Budget measure. Note that the 2018 Fall Economic Statement introduced immediate expensing for zero emission vehicles (ZEV). However, since there were few ZEV purchased in the 2017 data, the PBO assumed in its microsimulations that five per cent of new acquisitions in CCA classes 10 and 10.1 would be ZEV eligible for immediate expensing. This percentage is based on a projection of the share of ZEV in 2022 according to historical data on the share of ZEV in new motor vehicle registrations.

The estimate obtained through the microsimulation model was then scaled to 2022 (the first full calendar year of the measure, since it was introduced on April 19, 2021) based on PBO's projection of gross fixed capital formation excluding construction (since long-lived assets are excluded from the measure). To project the costs over the 2021-22 to 2025-26 fiscal year horizon, the PBO created a multiperiod depreciation model based on its forecast of investment in non-residential construction, machinery and equipment, and intellectual property products and the average share between 2016 and 2020 of each subcomponent in these aggregates. The difference in CCA in this model between the baseline tax system and the changes introduced in the Budget was set to 100 for 2022 (the reference year) and an index was computed for each other year relative to 2022. The results from the microsimulations which had been scaled to 2022 were then extended to the other years of the costing horizon by multiplying them with each year's index.

Lastly, the increase in the deduction for CCA introduced in the Budget will reduce CCPCs net income (or loss) for tax purposes. This implies that some less profitable or not profitable CCPCs will incur a non-capital loss, which can be carried back to the three previous years or carried forward for the next 20 years. The PBO made assumptions about the percentage of new non-capital losses generated by the increase in CCA that would be used in subsequent years and therefore increase the cost of the measure (by reducing the federal government's tax revenue when these losses are applied against future or past taxable income).

Sources of Uncertainty: The breakdown by CCA classes of capital assets purchased by CCPCs in 2017 might not be reflective of their current investments. To project the costs forward, the PBO relied on its projections of gross fixed capital formation, which represent investments by all corporations and not just CCPCs. It is therefore possible that the investment profile of CCPCs is different than that of all corporations. The estimate is also highly dependant on the economic outlook, for which there is still uncertainty given that new variants of COVID-19 could bring further lockdowns which are likely to affect small businesses more than non-CCPCs. If CCPCs are more profitable than anticipated, the cost of the measure could increase in the short term and decrease in the longer term. Indeed, the total value of all capital assets will be depreciated over time, thus providing immediate expensing reduces tax revenue in the year of the purchase but increases revenue in the following years compared to the baseline since there is no more depreciation left to claim. Finally, behavioural impacts have not been included in this cost estimate. While there is some evidence in the literature that immediate expensing increases the level of investment, it is not clear if it is net new investment resulting from the tax incentive or if it is simply bringing forward investment that was already planned in the next few years. If investment increases above the currently forecasted levels, then the cost in terms of foregone tax revenue could be higher. However, an increase in investment could potentially increase GDP growth and in turn result in higher tax revenues received in future years.

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Cost of proposed measure

$ millions	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Total cost	916	1,091	687	-199	-51

Supplementary information

$ millions	2021-2022	2022-2023	2023-2024	2024-2025	2025-2026
Direct cost	916	1,091	588	-594	-442
Use of new non-capital losses	-	-	99	394	390
Total cost	**916**	**1,091**	**687**	**-199**	**-51**

Notes

· Estimates are presented on an accruals basis as would appear in the budget and public accounts.

· Positive numbers subtract from the budgetary balance, negative numbers contribute to the budget balance.

· "-" = PBO does not expect a financial cost.