2015 FEDERAL BUDGET RECOMMENDATIONS

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By

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Executive Summary

Budget 2015 must set the framework for sustaining economic growth through innovation, productivity and attraction of international investments. To that end, it must adopt specific measures that will leverage private sector investments in productive assets and human resources, thereby creating more jobs, and increasing manufacturing outputs and exports.

In recent years, the federal government has introduced a number of important fiscal measures that are already making a significant positive contribution to business investment, innovation, and job growth. Reductions in the business tax rate, the extension of the two-year write-off for investments in manufacturing and processing machinery and equipment, the elimination of import duties on materials and equipment used in manufacturing, and the signing of key international trade agreements will set the framework for growth in the future.

However, further improvements in the tax system aimed at boosting productivity and innovation can still be made. Canada's innovation and productivity landscape has changed significantly in recent years, and now is the time to compare with other international jurisdictions and find ways to improve our capacity to attract major investments, especially in the manufacturing and other high-tech sectors.

Canadian Manufacturers & Exporters' (CME) Recommendations:

1. CME strongly recommends the current 50% straight-line depreciation rate for manufacturing and processing machinery and equipment is made permanent.
2. CME recommends the creation of a *swap* program to repurpose SR&ED tax credits for companies seeking to invest in their capital assets used for R&D purposes.
3. CME recommends the adoption of the patent box model to increase the commercialization of innovation in Canada.
4. CME recommends the creation of a Capital Investment Fund to support the development, expanding, or upgrading of manufacturing facilities.
5. CME believes that significant improvements can and should be made to the existing LMDA program structure. We recommend adoption of a program similar to the former *On–Site* program, which could be combined with an incentive for Canadians to participate.
6. CME urges the federal government to adopt a strategic procurement policy for its infrastructure projects; emphasizing the need to maximize domestic economic benefits, creating jobs and enabling economic growth.
7. CME recommends the elimination of withholding requirements related to services performed and employment functions carried on in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty.

The Importance of Manufacturing and Exporting

Manufacturing and exporting represent the two largest business sectors of the Canadian economy. Manufacturing alone accounts for 11% of Canada's GDP and offers high-paying, stable employment to more than 1.7 million Canadians.

The direct and indirect contributions manufacturers and exporters make to the Canadian economy are critical to Canada's economic wellbeing. Every dollar in value-added output by manufacturers generates an estimated $3.05 in total economic activity – the largest economic multiplier of any business sector. One in every three jobs in Canada depends on our export success. Manufacturing is the source of almost two-thirds of Canada's goods and services exports and more than half of all private sector R&D activity in Canada.

Manufacturers and exporters in Canada are currently facing a number of challenges that are fundamentally changing the nature of their business. It is imperative that the federal budget considers and addresses these issues. Doing so will create ripple effects throughout the economy and could help usher in a new era of prosperity in Canada. Failure to do so could result in a lower standard of living for Canadians.

Proposed Measures to Increase Innovation, Productivity and Economic Growth

Accelerated Capital Cost Allowance (ACCA) for the Acquisition of Machinery and Equipment

Set to expire in 2015, ACCA for machinery and equipment for manufacturing and processing has been in place since 2007.

ACCA has been a key driver of labour productivity in the manufacturing sector since its introduction in 2007, and particularly since the last recession. Targeted tax measures such as the ACCA can be a powerful tool to encourage Canadian manufacturers to invest in productive assets such as new machinery.

Recommendation 1:
Recognizing the importance of capital expenditures for the future of our sector and for increased productivity in the Canadian economy, CME strongly recommends that the depreciation rate for manufacturing and processing machinery and equipment continue at a level that keeps investment in Canada at least as competitive as that in the US. To that end, we encourage the Government to make the current 50% straight-line depreciation rate permanent. The Capital Consumption Allowance should, in any case, not fall below an effective rate of 50% on a declining balance basis. This will ensure that Canadian manufacturers are operating on a level playing field with their US counterparts. This will also assist in closing Canada's productivity gap with the US.

Offset SR&ED Cuts by Easier Access to Unused SR&ED Credits

While we understand that the Government has no intention of repealing the SR&ED cuts it introduced in past budgets, CME recommends that the Government investigate easier means for large companies to access their unused credits when required. The SR&ED program offers large manufacturing firms non-refundable tax credits that can be carried forward until profitable years when their use would reduce a company's overall tax burden. These provisions in the SR&ED program, in conjunction with the difficult economic period of the last decade, have culminated in larger firms carrying more than $10 billion in unused tax credits since 2001 (as of 2012), waiting for a profitable year to redeem them. CME recommends that SR&ED tax credits should be exchanged for direct funding at a percentage of their value, and then put to work on R&D projects.

Recommendation 2:
CME recommends the creation of a *swap* program to repurpose tax credits for companies seeking to invest in their capital assets used for R&D purposes, therefore providing an alternative to the elimination of capital expenditures under the traditional SR&ED program. Included as a program requirement, any funds received through the swap of tax credits could then be used towards company R&D related projects, including capital assets, either through the upgrading of research and development facilities, the building of entirely new R&D facilities, or the acquisition of machinery and equipment used mostly for R&D purposes.

Commercialization of Innovation: CME Recommends the Adoption of the Patent Box Model in Canada

A “patent box” is a tax incentive that provides relief from corporate tax on income generated from certain types of qualifying intellectual property (IP), particularly patents. Patent boxes are distinct from other tax incentives such as R&D tax credits. Patent box regimes provide tax relief at a later stage of the innovation lifecycle, in the years when income is generated from exploiting IP. Relief can be given either as a reduced tax rate or a deduction for a portion of the patent box income. Patent boxes therefore generally target the commercial or manufacturing activities that follow development rather than R&D activities themselves. A patent box tax incentive would support companies at a critical point in their product development and financing cycle and encourage them to commercialize new products in Canada.

Recommendation 3:
CME recommends the adoption of the patent box model in order to increase the commercialization of innovation in Canada. We recommend extending the application of the patent box to innovative products not patented, similar to the model used in the Netherlands (innovation box model).

Maximizing the Number and Types of Jobs for Canadians

Creating Jobs and Incentivizing Large-Scale Capital Investment Attraction

Recommendation 4:
CME is recommending the establishment of a Capital Investment Fund (CIF), which will directly support the development, expansion, or upgrading of manufacturing facilities that will result in jobs, economic activity and/or improvements to manufacturing productivity.

This CIF would be a targeted investment fund, considering only those projects that would demonstrate an ability to increase manufacturing and processing output in Canada. The sorts of projects that could be eligible for such direct contributions would include the building of new production facilities, the expansion of current facilities, revamping existing operations, or the upgrading of machinery and equipment. In all of these preceding examples, the goal of increasing production in Canada would remain paramount, and would be a prerequisite to any direct funding.

Supporting Families and Helping Vulnerable Canadians by Focusing on Health, Education and Training

CME believes that Labour Market Development Agreements (LMDA) training funds should be leveraged and focused on the specific needs of industry and on closing the most pressing skills gaps to help businesses compete, grow, and employ Canadians. Specifically, LMDA funds should be invested into areas that are employer-driven and have specific economic outcomes.

Manufacturers and their employees pay roughly $2.1 billion in EI premiums annually with only $1.2 billion paid back in benefits, the majority of which are parental leave and other social supports. This leaves a gap of roughly $900 million in the manufacturing sector alone, which we believe should be available for training in the manufacturing sector through LMDAs or similar tools.

As an example, the former *On-Site* program placed EI recipients at manufacturing facilities for up to 26 weeks. While on placement, the recipients continued to receive their EI benefits, and also gained valuable work experience in the process. This program was cancelled in the early 2000s with the switch to the LMDA. To us, this is a great example of using the funds that are focused on employer needs, and producing real and demonstrable results for the economy.

> ***Recommendation 5:***
> CME supports elements of the existing LMDA program, where investments are economically measurable and beneficial to the individuals and companies involved, however, we believe that significant improvements can and should be made to the existing LMDA program structure. We recommend the adoption of a program similar to *On–Site*, which could be combined with an incentive for Canadians to participate in the program. This incentive could for example take the form of extended EI benefits for program users.

Ensuring Prosperous and Secure Communities, Including Through Support for Infrastructure

The federal government has committed more than $50 billion for infrastructure projects over the next 10 years through the Building Canada Plan. CME urges the federal government to use this large investment in public infrastructure to leverage the capabilities of Canada's manufacturing sector and to ensure that Canadian companies can compete on a fair and reciprocal basis against international competitors when it comes to supplying goods, services, and new technologies to infrastructure projects in Canada and in export markets.

> ***Recommendation 6:***

CME urges the federal government to adopt a strategic procurement policy for all its infrastructure projects, which will emphasize the need to maximize domestic economic benefits, creating jobs and enabling economic growth, while respecting its current international trade obligations.

Improving Canada's Taxation and Regulatory Regimes

Sections 102 and 105 of Canada's Income Tax Regulations impose withholding requirements on payments in respect of services rendered in Canada by non-residents. Regulation 105 covers situations where a fee is paid to a non-resident for services in Canada while 102 covers compensation paid to an employee who is working in Canada (even if the non-resident employee is a legal employee of the non-resident company and is not a resident of Canada).

In a competitive global environment, Canadian companies are often required to strengthen the level of expertise on their Canadian project teams by accessing a global talent pool. Businesses can ill afford to look solely to resources and know-how available in their home country. Access to foreign workers with skills and expertise, either on a temporary or project basis, is critical to the competitiveness of Canadian industry, especially when those skills are unavailable in the Canadian market. Administrative practices and unnecessary costs that hamper the ability of Canadian companies in this regard should be eliminated.

Recommendation 7:
CME recommends the elimination of withholding requirements related to services performed and employment functions carried on in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty.