CRA: Canadians Will Pay Higher Taxes To Cover COVID Expenses

Description

It's no secret that Canada's coronavirus response was fuelled by government debt. The government has now borrowed so much that investors and taxpayers should start preparing for higher taxes to pay it off soon. Here are some of the ways the Canada Revenue Agency (CRA) could mitigate the debt and what it means for your portfolio.

GST hike

The goods and services tax (GST) was set at 7% when it was originally introduced in the early 90s. Later, the government reduced the rate to 5%, which is where the tax is today.

Raising this tax back up is popular with some economists. A consumption tax is viewed as more fair since its impact is on non-essential goods. As wealthier households spend a larger portion of their income on non-essentials, this tax impacts them more.

A hike in GST could impact high margin retailers such as **Canada Goose**. Even a few percentage points of higher taxes on the company's expensive coats could impact their sales. Investors should keep an eye on this.

Raise income or corporate taxes

Simply hiking the taxes on ordinary businesses and individual taxpayers would be a practical way to mitigate the debt burden we now face. In 2018, Canada had a tax-to- GDP ratio of 33.0% compared with the OECD average of 34.3%. This year, raising taxes on wealthy individuals and businesses could be politically popular.

A higher corporate tax rate could impact the bottom line for several high margin businesses. Canada Goose, for example, paid an effective tax rate of 12.8% in the second quarter of 2020. A higher tax burden would leave less cash for the company to fuel its expansion overseas and could ultimately squeeze the stock price.

Reduce tax shields

Another potential way for the CRA to boost tax collection is to reduce or restrict popular tax shields. The most popular, of course, would be the tax-free savings account (TFSA). As of 2017, Canadians collectively held $276.7 billion in their TFSAs. While taxing this amount would be unpopular, investors should brace for a potential freeze on contribution amounts for the next few years.

This means investors can deploy less cash to invest in stocks, which will ultimately squeeze stock valuations.

Other ways of reducing tax shields could include raising the inclusion rate for capital gains, which means investors would book a higher portion of their investment profits as personal income for tax purposes. The CRA could potentially also eliminate the principal residence exemption, which would have an impact on residential real estate investment trusts.

Bottom line

The CRA and federal government have borrowed relentlessly over the past few months. Their spending programs have kept millions of families and businesses afloat. However, the debt burden will eventually have to be mitigated with higher taxes from those who are still employed after the crisis is over.

No matter how the government chooses to mitigate the tax burden, investors should prepare their portfolios for any eventuality.

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