Canada proposes new Productivity Mega Deduction

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On Sept. 15, 2026, the federal government announced a proposed **Productivity Mega Deduction** (PMD) that would significantly expand immediate expensing for capital investments by Canadian businesses. Draft legislative proposals released with the announcement provide important details regarding eligible taxpayers, qualifying property and applicable limits. Providing further context on these rules, BLG partner Steve Suarez authored the article "Ottawa gets it on tax policy, gamechanger 'mega deduction' shows" in *The Globe and Mail*.

If enacted as proposed, the PMD allows taxpayers to deduct the full undepreciated capital cost of eligible property in the taxation year it becomes available for use, rather than deducting the cost over time under the capital cost allowance (CCA) system. The PMD is therefore a timing measure: it does not increase the total deduction available over the life of an asset, but it accelerates tax relief.

Beyond timing, the PMD serves as a crucial competitiveness measure. The federal government states that accelerated CCA measures announced in Budget 2025 reduced Canada's marginal effective tax rate on new business investment from 15.4 per cent to 13 per cent and that the PMD further reduces that rate to 6.4 per cent. The same release compares the proposed Canadian rate with a 2026 U.S. rate of 16.9 per cent and an OECD average of 19 per cent.

For multinational groups deciding where to locate new projects, a lower marginal effective tax rate may improve the relative attractiveness of Canadian investment, particularly for capital-intensive sectors such as manufacturing, infrastructure, technology, transportation, energy and resource development.

The broader policy rationale is straightforward. Canada faces persistent concerns about weak productivity growth and underinvestment in productivity-enhancing assets. For businesses with significant upfront capital costs, earlier deductions can improve cash flow, reduce the after-tax cost of capital and help support investment decisions that might otherwise be deferred or made outside Canada.

The proposed permanent nature of the PMD is a distinct structural advantage. Temporary incentives may accelerate investment already planned; a permanent rule can be built into longer-term capital allocation, project modelling and investment location decisions. The federal government has described the earlier Productivity Super-Deduction as covering about 15 per cent of capital asset investments, while the PMD extends immediate expensing to approximately two-thirds of such investments.

Which taxpayers and property qualify?

The proposed rules apply to eligible depreciable property acquired on or after Sept. 15, 2026. Corporations and partnerships may qualify. For individuals, trusts and partnerships with non-corporate members, the deduction is limited to income from the business or property where the asset is used. Therefore, these taxpayers cannot use it to create or increase a loss from that source.

Most prescribed CCA classes qualify, subject to specific exclusions. Excluded property generally includes:

- Certain Class 1 and Class 3 buildings: most buildings and structural improvements, although manufacturing and processing buildings may still benefit from separate temporary immediate expensing measures;
- Property in Classes 14 and 14.1: certain intangible property, including limited-period licences, franchises, concessions, goodwill and similar property;
- Property in Class 51: certain natural gas distribution pipeline property;
- Certain passenger vehicles and other specified vehicles, unless they satisfy the proposed Canadian assembly and new-use conditions;
- Qualified Liquefied Natural Gas (LNG) liquefaction equipment; and
- Industrial mineral mines and certain timber limits.

Property that does not qualify for immediate expensing may still be eligible for the Accelerated Investment Incentive.

Rules for used property

Used property may qualify, but generally not if the taxpayer or a non-arm's-length person previously owned it, or if the property was acquired in a transaction that preserves prior CCA history. These conditions target the incentive toward new third-party investments rather than internal transfers among related groups.

Special rules apply to vehicles. Certain used or foreign-assembled passenger vehicles and other specified Class 10 or 10.1 vehicles are excluded. Taxpayers may also elect to exclude a Class 10.1 vehicle from immediate expensing in their timely filed return for the acquisition year.

Immediate deduction for Canadian development expenses

The proposals also permit an immediate deduction for qualifying Canadian development expenses incurred on or after Sept. 15, 2026. The new rules exclude successored expenses and the cost of Canadian resource property acquired from a non-arm's-length person or partnership. Flow-through share expenses may qualify only when taxpayers renounce them under an agreement entered on or after that date.

What businesses need to consider

Businesses contemplating significant capital expenditures should assess whether planned investments qualify, when the property will become available for use and whether any taxpayer-specific limitations apply. Taxpayers must pay particular attention to used property, related-party acquisitions, tax-deferred transfers, vehicles, partnerships, LNG facilities, Canadian development expenses and flow-through share arrangements.

From a planning perspective, taxpayers should revisit current and proposed capital budgets to identify assets expected to become available for use on or after Sept. 15, 2026. They must also confirm whether any exclusions or limitations could affect the timing or amount of the deduction. For resource issuers and investors, the treatment of Canadian development expenses renounced under flow-through share agreements will be particularly important.

BLG's Tax Group will continue to monitor the proposals as they proceed through the legislative process.

By

Siwei Chen

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BLG Offices

Calgary

Centennial Place, East Tower
520 3rd Avenue S.W.
Calgary, AB, Canada
T2P 0R3

T 403.232.9500
F 403.266.1395

Ottawa

World Exchange Plaza
100 Queen Street
Ottawa, ON, Canada
K1P 1J9

T 613.237.5160
F 613.230.8842

Vancouver

1200 Waterfront Centre
200 Burrard Street
Vancouver, BC, Canada
V7X 1T2

T 604.687.5744
F 604.687.1415

Montréal

1000 De La Gauchetière Street West
Suite 900
Montréal, QC, Canada
H3B 5H4

T 514.954.2555
F 514.879.9015

Toronto

Bay Adelaide Centre, East Tower
22 Adelaide Street West
Toronto, ON, Canada
M5H 4E3

T 416.367.6000
F 416.367.6749

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