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The 2009 Tax Competitiveness Scorecard: An "Eye-popping" Divergence in Approach across Canada: C.D. Howe Institute

Toronto, Sept. 3 – The 2009 scorecard of tax competitiveness for Canada and the provinces, reveals an "eye-popping" divergence in approach to tax policy among governments, according to respected tax scholars Duanjie Chen and Jack M. Mintz. In their newly released study, *The Path to Prosperity: Internationally Competitive Rates and a Level Playing Field*, authors Chen and Mintz identify governments following the path to prosperity through competitive corporate tax relief aimed at achieving a more neutral tax system versus governments following a murky path characterized by attempts to pick supposedly "winning" industries, in many cases shoring up low-growth industries through targeted tax cuts. "Both lower rates and a more neutral tax system contribute to better growth, as taxes interfere less with business decisions on how to allocate resources to their best economic use," commented Dr. Mintz, who is the Palmer Chair of Public Policy at the University of Calgary and a member of the Tax Competitiveness Council at the C.D. Howe Institute.

Although Canada, overall, has made progress by reducing the tax bite on capital investment from 28.9 percent in 2008 to 28.0 percent in 2009, the authors identify a troubling divergence in approach across governments. A leader on the path to prosperity, they note, is New Brunswick, which is pursuing broad structural reforms to its personal and business tax structures to improve simplicity and efficiency. As well, Ontario and British Columbia will adopt a more efficient and fair sales tax structure by harmonizing their individual sales tax regimes with the federal GST. Ontario will also eliminate its dual corporate income tax rate for large companies (12 percent for manufacturing and resource income and 14 percent for other companies) to a single rate of 10 percent.

On the other end of the spectrum, several provinces have failed to improve their tax structures. Prince Edward Island retains the most outdated structure, with high tax rates on corporate income and retail sales. Quebec, while moving to abolish its capital tax, is raising its corporation income tax rate from 11.4 to 11.9 percent rather than moving to a more neutral tax base by reducing its complex regime of targeted incentives.

The METR Scorecard: Mintz and Chen calculate the marginal effective tax rate (METR) on capital investment in each jurisdiction, (a measure which includes the annualized value of corporate income tax, capital tax and sales tax paid on capital purchases). This allows them to calculate how much of a bite taxes take out of return on investment.

The good news is that Canada's METR has fallen to 28.0 percent in 2009 and is set to fall further. With the tax changes planned in the current and previous federal and provincial budgets for later years, the marginal effective tax rate will fall to 18.9 percent by 2013. If no offsetting tax changes occur abroad by 2013, these tax changes will place Canada's rate for capital investment close to the average level of marginal effective tax rates among 80 countries worldwide. In a changing world, however, it is unrealistic to assume other countries will not reform their corporate taxes.

The bad news, they note, is that the variation in marginal effective tax rates on capital across business activities has been increasing since 2006, resulting in an inefficient allocation of resources. Large and medium-size companies in certain sectors, such as communications, wholesale trade and construction, are disadvantaged by the current tax system.

Provincially, the study finds clear leaders in terms of investment climate. In 2009, the Atlantic Provinces, except for Prince Edward Island, taxed capital investment the least, followed by Quebec and Alberta. Among this group of provinces, Alberta's low marginal effective tax rate is directly associated with its low statutory income tax rate and the absence of capital and sales taxes; the other provinces achieve their apparent overall tax competitiveness by favouring slow-growth industries: manufacturing and forestry.

The highest-taxed province in 2009 is still Ontario, but this is rapidly changing. Prince Edward Island will become the highest-taxed province in 2013 at 29.2 percent, after Ontario and British Columbia implement their sales tax harmonization and Ontario reduces its corporate income tax rate to 10 percent. Manitoba will be second-highest taxed at 27.0 percent, followed by Saskatchewan at 24.9 percent. These provinces have one thing in common – an antiquated sales tax regime that applies high taxes on intermediate and capital inputs.

The study concludes with tax policy recommendations that would enhance Canada's competitiveness and stimulate economic growth and job creation as the country climbs out of recession.

The Path to Prosperity: Internationally Competitive Rates and a Level Playing Field, is available at www.cdhowe.org.

For more information contact:

Jack M. Mintz,
Palmer Chair in Public Policy, University of Calgary;
Finn Poschmann,
Vice President of Research,
C.D. Howe Institute,
416-865-1904.

The Path to Prosperity: Internationally Competitive Rates and a Level Playing Field, C.D. Howe Institute Commentary No. 295, by Duanjie Chen and Jack Mintz (September 2009). 17 pp; $12.00 (prepaid, plus postage & handling and GST – please contact the Institute for details).
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