C.D. Howe Institute

Backgrounder

www.cdhowe.org

No. 89, March 2005

A Taxing Issue

Enhancing Quebec's Investment Attraction

Pierre-Pascal Gendron

The Backgrounder in Brief

Quebec faces a number of fiscal challenges, with its relatively high public spending, burdensome government debt and a rapidly aging population. Addressing these problems will require policies that stimulate investment and productivity growth. To that end, business tax reform should trump additional personal income tax cuts in the next provincial budget.

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$5.00; ISBN 0-88806-652-X;
ISSN 1499-7983 (print); ISSN 1499-7991 (online)

The province of Quebec faces several short-term fiscal challenges that require attention. For one thing, government spending exceeds the Canadian average and it has grown faster than the average historically. For another, Quebec carries a relatively heavy net debt load — almost 40 percent of gross domestic product (GDP) in 2002, the last year for which figures are available. Not only that, the province has the highest personal income taxes in North America. Quebec also faces two major long-term economic challenges. It has to repay some of its public debt and prepare for the impact of population aging on its ability to deliver future government programs and benefits. According to one independent estimate, Quebec faces an implicit demographic liability of approximately $110 billion over the next 50 years.[1]

With the next provincial budget imminent, the new Quebec finance minister, Michel Audet, faces a challenging task. During the press conference following his swearing in, he addressed questions about his government's promises to reduce taxes.[2] He noted that the Liberals' program is to bring Quebecers' tax burden closer to the Canadian average but refused to elaborate further. He reiterated the tight financial situation the government faces. Recall that the most important tax policy measure to be implemented in early 2005 is personal income tax relief of approximately $1 billion, as announced in last year's budget.

Additional government expenditures are clearly not going to meet any of these challenges. The government's presence in the economy through program spending, taxation and regulation is already significant relative to other provinces, especially to the more populous ones. It is generally accepted that this state of affairs has traditionally been a drag on the Quebec economy and that the government will not be able to spend its way out of the problems. Significant expenditure reductions are not in the cards, either, because the government chose to shield the major spending items — health, education, and solidarity — from spending cuts.

At first glance, immediate debt reduction appears impossible because there is so little room for manoeuvre. Although both the 2003/2004 and 2004/2005 budgets were balanced, the government acknowledges that the balance is precarious and that sustaining it partly depends on factors beyond its control.[3] For the same reasons, tax relief would appear to be ruled out. Yet the government chose to grant about $1 billion in personal income tax relief starting January 1. Quebec's tax burdens on both individuals and businesses are heavy, but the corporate income tax base is much more mobile. In fact, Quebec's weak private investment performance relative to other provinces is a matter of serious concern to the government. As a result, the government should focus on business tax reforms because they are likely to have the largest and most immediate impact on

I wish to thank three referees as well as Richard Bird, Yvan Guillemette, Jack Mintz, and Finn Poschmann for comments on earlier drafts, and the Institute for kindly providing some of the data. I am, of course, responsible for the conclusions and any errors.

1 Figure represents a 2001 estimate; see Robson (2003). Following a similar idea, Fortin and Van Audenrode (2004) strongly convey the urgency for Quebec to act on the debt.

2 See Assemblée Nationale (2005).

3 See Ministère des Finances du Québec (2003, 2004a and 2004e).

productivity and incomes. The relatively rapid appreciation in the Canadian dollar against its U.S. counterpart during the last year adds to the urgency of delivering reforms that improve business competitiveness.

The Slippery Slope of Tax Changes

In framing the 2003/2004 budget, the government recognized that the cost of the many tax measures to assist businesses had increased substantially over time and created problems with respect to neutrality, complexity and costs, benefits, risk and taxpayer dependence. It also acknowledged the high level of business taxes in Quebec relative to other jurisdictions.

In response, in 2003/2004, the government reduced assistance to businesses by a full-year total of $759 million, of which $626 million consisted of tax expenditure reductions. The measures announced, with their cumulative full-year equivalent saving, were:

- Elimination of measures to assist businesses operating in specific sectors and carrying out activities at designated sites, and some measures related to investment, as well as exemptions to financial institutions and investment funds (cumulative saving of $248 million).
- Reduction in tax credits, deductions and tax holidays, limits on tax expenditures for business capitalization and major investment projects, and a reduction in tax benefits to high-income earners (cumulative saving of $378 million).
- Deferral of the capital tax reduction, partly compensated for by an increase in the exemption — the threshold on paid-up capital — to $600,000 from $250,000 (net saving of $133 million).

The resulting decline in targeted assistance to $1.6 billion from approximately $2.1 billion represented a radical departure from Quebec's traditionally popular industrial policy towards businesses and helped the government to balance the budget.

Although the government balanced the 2004/2005 budget, as well, it did not sustain the tax expenditure reduction process of the previous fiscal year. The government reiterated its support for targeted business assistance, mostly through tax credits or enhancements of credits for regions, innovation, culture, and manpower. The new reductions in tax expenditures introduced in the 2004/2005 budget eventually amounted to $187 million.

In addition, the government announced a number of changes that took effect on January 1. It increased the capital tax exemption to $1 million and granted personal income tax relief of $219 million by eliminating the general and simplified tax systems in favor of a single tax system. As well, it implemented two new tax expenditure programs for families — child assistance and a work premium for low- and middle-income workers — at a cost of $547 million and $243 million, respectively. The total cost of personal tax measures is about $1 billion.

With the personal income tax, the government has chosen to remain heavily involved in social policy through the tax system. Even after the adoption of a single tax system, there remain many areas for simplification of the income tax system. The previous finance minister published a study on the simplification of the system in July 2004; however, its conclusions indicated his unwillingness to implement fundamental change.[4] With business taxes, a notable change is that capital tax rate reductions subsequent to January 1, 2003, were repealed.[5]

Despite the announcement in the 2003/2004 budget that "[t]he new government has chosen to give priority to general-application measures in terms of business taxation," no broad-based tax relief is yet in sight.[6] The government appears to be continuing along the *dirigiste* path of its predecessors in spite of a growing body of evidence that broad-based relief, such as a reduction in corporate income tax rates and the elimination of capital taxes, would have a more direct and significant impact on investment.

Such relief would be more effective in increasing the size of the future corporate income tax base than targeted measures. Moreover, the revenue cost of broad-based tax relief on businesses is lower than that of personal income tax cuts because businesses can shift income across provinces or countries using financial transactions and transfer pricing.[7] In contrast, the personal income tax base in Quebec is much less mobile, so personal tax reductions have no similar offsets.[8] In sum, the overall direction of change over the last two budgets is commendable but the government should consider compressing the schedule in the future to avoid unnecessarily delaying the benefits.

A Wider View

After the latest changes, how does Quebec compare to other Canadian provinces? In the next section, I consider three groups of indicators: government sector and investment, statutory tax rates and provisions, and marginal effective tax rates. Quebec's indicators in the tables are ranked from best (1) to worst.

Government and Investment

Table 1 presents indicators on government activity and private investment. The ratio of total government expenditures to GDP is chosen to represent the relative size of the provincial public sector in the economy. The Quebec government is heavily involved in the province's economy. Quebec's ratio of government

4 See Ministère des Finances du Québec (2004c).

5 The repeal is surprising in light of the following passage from the 2004/2005 Budget (2004a) at Section 7: "[T]he harmful effect on investment of the tax on capital has been abundantly documented. It increases the cost of investment, saps productivity and penalizes the manufacturing sector in particular" (35). Recall that capital tax rates were originally scheduled to decrease gradually to 0.6 percent by January 1, 2007, for financial institutions and to 0.3 percent for other corporations.

6 Ministère des Finances du Québec (2003, Section 5, p. 5).

7 On financial transactions, see Mintz and Smart (2004). There is a vast literature on transfer pricing.

8 The lack of mobility of Quebec's personal income tax base is believed to be the outcome of cultural, linguistic and other socio-economic factors. This is an important feature of Quebec's society for the present discussion.

expenditures to GDP of 27.2 percent is the fourth highest of all provinces in fiscal year 2003, the latest year for which these figures are available.

The ratio of net debt to GDP shows the cumulative impact of past government operations through deficits and provides an indication of the government's future financial commitments, as well as its flexibility in implementing policies such as tax relief. Quebec's ratio of 38.7 percent is the third worst of all provinces in fiscal year 2002.

Net debt per capita gives a different picture of relative indebtness that relates to population growth rather than economic growth. Quebec has the second highest net debt per capita at $12,744 in fiscal year 2002.

The ratio of debt service charges to total government expenditures shows the proportion of total government spending that is eaten up by interest payments. Quebec's ratio in fiscal year 2003 was 8.2 percent, the third lowest among all provinces. That seemingly odd result is due to the relatively large absolute size of Quebec's government expenditures.

The rate of private capital formation — or fixed investment — is a critically important indicator of competitiveness. Capital formation today will affect future economic prospects and the standard of living through higher productivity, incomes and jobs. Quebec's private investment in fixed non-residential capital as a share of GDP was 9.2 percent on average between 2001 and 2003, dead-last among provinces. As noted in the introduction, this is a matter of serious concern for the government.

Quebec's performance relative to other provinces does not stand out according to this list of indicators. The province can and should do better, especially on the business investment front. Even though several factors not considered here may help explain the poor investment performance, it is relevant and illuminating to consider taxes.

Statutory Tax Rates and Provisions

Table 2 shows provincial and combined federal-provincial personal income tax rates and related information, such as the surtax rate, basic amount, and other measures that affect individuals, including retail sales levies and payroll taxes.[9] Again, Quebec's entries in the table are ranked from best to worst. Quebec has the highest provincial personal income tax and payroll tax rates, as well as the highest combined federal-provincial rates on ordinary and interest income and capital gains.

Table 3 presents details of the provincial and federal business tax system. Major business taxes include the corporate income tax, capital taxes and provincial retail sales taxes on business components. The data include provincial and combined federal-provincial corporate income tax rates and capital tax rates, as

9 Tables 2 and 3 are meant to provide a snapshot of tax rates and tax provisions that are applicable at the time of writing. Space limitations prevent a description of important features of the corporate tax system such as tax credits, tax holidays, tax depreciation provisions, and on-going federal-provincial harmonization initiatives. See notes to tables for important information; for further details, one should consult the relevant provincial and federal legislation or KPMG (2004) and Price WaterhouseCoopers (2004) for summaries.

Table 1: *Provincial Economic and Fiscal Indicators, 2003 or 2002*

	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Total Government Expenditures to GDP, 2003 (%)	22.8	14.6	24.4	25.7	17.5	27.2 (7)	28.0	25.1	31.2	27.8
Net Debt to GDP, 2002 (%)	13.9	-6.8	28.5	27.6	21.4	38.7 (8)	28.1	43.1	30.2	56.6
Net Debt per Capita, 2002 ($)	4,856	-3,359	9,929	8,807	8,398	12,744 (9)	7,887	12,704	8,382	18,338
Debt Charges to Total Government Expenditures, 2003 (%)	7.7	2.7	10.4	15.1	10.5	8.2 (3)	13.6	15.7	9.3	11.4
Private Investment in Fixed Non-Residential Capital as a share of GDP, 2001-2003 Average (%)	9.8	21.1	15.1	11.1	9.6	9.2 (9)	10.0	13.3	10.0	14.7

Notes: Figures are based on the most recent information available. For example, government data for the fiscal year ended March 31, 2004 are shown above as for 2003. Numbers within parentheses indicate Quebec's rank, from best (1) to worst.

Source: Statistics Canada and author's calculations.

Table 2: *Key Non-Business Statutory Provincial Tax Rates and Provisions, 2004*

	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
Personal Income Tax Rate Range										
Lowest Rate	6.05	10.00	11.00	10.90	6.05	16.00[a(9)]	9.68	8.79	9.80	10.57
Highest Rate	14.70	10.00	15.00	17.40	11.16	24.00[a(10)]	17.84	17.50	16.70	18.02
Surtax[b]	n/a	n/a	n/a	n/a	20.0/36.0	n/a	n/a	10.0	10.0	9.0
Basic Amount ($)	8,523	14,337	8,264	7,634	8,044	6,275[(10)]	7,756	7,231	7,412	7,410
Relief for low income	No	No	No	Yes	Yes	Yes	Yes	Yes	Yes	No
Personal Income Tax, Combined Top Marginal Rates[c]										
Ordinary Income & Interest	43.7	39.0	44.0	46.4	46.4	48.2[(9)]	46.8	48.2	47.4	48.6
Capital Gains	21.8	19.5	22.0	23.2	23.2	24.1[(7)]	23.4	24.1	23.7	24.3
Canadian Dividends	31.6	24.1	28.3	35.1	31.3	32.8[(6)]	37.3	33.1	32.0	37.3
Retail Sales Tax										
Rate	7.5	n/a	7.0	7.0	8.0	7.5[d(3)]	8.0[d]	8.0[d]	10.0	8.0[d]
Combined rate	14.5	7.0	14.0	14.0	15.0	15.025[(5)]	15.0	15.0	17.7	15.0
PST on GST	No	n/a	No	No	No	Yes	No	No	Yes	No
Payroll Tax										
Lowest Rate	n/a	n/a	n/a	Nil[e]	Nil[e]	2.70[e(2)]	n/a	n/a	n/a	Nil[e]
Highest Rate	n/a	n/a	n/a	4.30[e]	1.95[e]	4.26[e(4)]	n/a	n/a	n/a	4.00[e]

Notes: Figures are current to July 31, 2004 and take into account the proposals in all 2004 federal and provincial budgets. Tax rates have been calculated under the assumption that all budgets and their proposals will be passed into law. All figures are percentages except otherwise indicated. Numbers within parentheses indicates Quebec's rank, from best (1) to worst.

[a] Care should be exercised in comparing Quebec's personal income tax provisions with those of other provinces based on the table. Not shown in the table are tax brackets, the treatment of low incomes, or other credits. Also, marginal rates for the federal component of personal tax are reduced by the 16.5% "Quebec abatement"; this measure reflects the province's opting out of the programs under the Federal-Provincial Fiscal Arrangements Act.

[b] Threshold for the Ontario 20% surtax is $3,856 while the threshold for the additional 36% is $4,864. The thresholds in Nova Scotia, Prince Edward Island and Newfoundland are $10,000, $5,200, and $7,032.

[c] Combined federal-provincial top marginal tax rates.

[d] Sales taxes in these provinces are harmonized with the federal Goods and Services Tax. Except for Quebec, which has its own arrangement, the system is called the Harmonized Sales Tax.

[e] Payroll taxes are known as: Manitoba and Newfoundland, Health and Post-Secondary Education Tax; Ontario, Employer Health Tax; and Quebec, Health Services Fund.

Sources: KPMG (2004) and Price WaterhouseCoopers (2004).

well as information on dual rates, reduced rates and thresholds. Quebec's general corporate tax rate is the lowest of any province. This, however, does not make the province necessarily more tax competitive because its corporate rate on investment income is the third highest and its general capital tax rate is the highest. Moreover, it has the least generous regime towards Canadian-Controlled Private Corporations (CCPCs) with low incomes.

On the bright side, the Quebec Sales Tax (QST) rate is somewhere in the middle compared to other provinces, and that tax is relatively efficient, with compliance and administrative advantages over the retail sales taxes in other provinces.[10] The most important advantage of the QST for business competitiveness is that it allows credits for taxes paid on purchases of business components, even though some restrictions still apply to certain goods and services.[11]

Overall, Quebec's tax burden on individuals is the heaviest in Canada and its corporate income rates are not competitive when considering factors beyond the general rate.

Marginal Effective Tax Rates on Capital

Statutory tax rate comparisons suffer from one important limitation: They fail to take into account the complexity of the tax system, including the interactions between various tax provisions, rules and rates. In order to overcome this problem, effective tax rates on capital are examined. Marginal effective tax rates capture the impact of taxes on capital investment by measuring the amount of tax paid as a percentage of the return earned by a marginal investment project. That project is the one that earns an after-tax return on investment that is high enough to cover the cost of financing. The effective tax rate on capital is a summary measure that brings in corporate income taxes — including the treatment of depreciation, inventory and financing expenses — as well as capital taxes and sales taxes on capital components.

Table 4 presents effective tax rates on capital investment for medium- and large-sized corporations by province, industry, asset type and country. The estimates include provincial variations in corporate income taxes, sales taxes on business capital inputs, investment tax credits and other special write-offs, as well as the federal Atlantic investment tax credit.[12]

10 See Bird and Gendron (1998) for further discussion of the desirable features of the QST, and its strong relationship and similarities with the GST.

11 Large businesses — enterprises with taxable Canadian sales over $10 million — and banks, trust companies, credit unions, insurers, segregated funds of insurers, the Régie de l'assurance-dépôts du Québec, the Canada Deposit Insurance Corporation, and investment plans are not entitled to input tax refunds under the QST for certain road vehicles and property and fuel associated with those vehicles, electricity, telephone and other telecommunications services, and food and beverages. See Revenu Québec (2003).

12 A limitation of the current data available to calculate effective tax rates is that they do not capture all the information necessary to account for the numerous corporate tax preferences contained in the Quebec tax code, for example tax credits for processing activities in resource regions. This does not affect the comparisons that follow in a significant way.

Table 3: *Key Business Statutory Provincial Tax Rates and Provisions, Effective January 1, 2005*

	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland
General Provincial Corporate Income Tax Rate[a]	13.5	11.5	17.0	15.0	14.0	8.9[b] (1)	13.0	16.0	16.0[b]	14.0[b]
Manufacturing & Processing Provincial Tax Rate	13.5	11.5	10.0	15.0	12.0	8.9[b] (3)	13.0	16.0	7.5[b]	5.0[b]
Investment Income	13.5	11.5	17.0	15.0	14.0	16.2 (7)	13.0	16.0	16.0	14.0
General Combined Tax Rate[c]	35.6	33.6	39.1	37.1	36.1	31.0 (1)	35.1	38.1	38.1	36.1
M&P Combined Tax Rate	35.6	33.6	32.1	37.1	34.1	31.0 (3)	35.1	38.1	29.6	27.1
Investment Income Combined Tax Rate	35.6	33.6	39.1	37.1	36.1	38.3 (7)	35.1	38.1	38.1	36.1
CCPC Provincial Tax Rates										
Income Up to $300K	4.5	3.0	5.0	5.0	5.5	8.9[b] (7)	2.5	5.0[b]	7.5[b]	5.0[b]
Investment Income	13.5	11.5	17.0	15.0	14.0	16.2 (7)	13.0	16.0	16.0[b,d]	14.0[b,d]
CCPC Combined Tax Rates										
Income Up to $300K	17.6	16.1	18.1	18.1	18.6	22.0 (7)	15.6	18.1	20.6	18.1
Investment Income	49.3	47.3	52.8	50.8	49.8	52.0 (7)	48.8	51.8	51.8	49.8
Provincial Capital Tax[e]										
Lowest Rate	n/a	n/a	0.6	0.3	0.3	0.6 (3)	0.3	0.3	n/a	n/a
Highest Rate	n/a	n/a	0.6	0.5	0.3	0.6 (4)	0.3	0.6	n/a	n/a
Exemption ($)	n/a	n/a	10/20M	5M	7.5M	1M (5)	5M	5/0M	n/a	n/a
Provincial Capital Tax on Financial Institutions[f]										
Lowest Rate	1.0	n/a	0.7	3.0	0.6	1.2 (5)	3.0	3.0	3.0	4.0
Highest Rate	3.0	n/a	3.25	3.0	0.9	1.2 (3)	3.0	4.0	5.0	4.0
Exemption ($)	10M	n/a	10/20M	5M	7.5M	500/0M (1)	10M	0.5/10M	2M	5M/0

Notes: Figures are current to July 31, 2004 and take into account the proposals in all 2004 federal and provincial budgets. Tax rates have been calculated under the assumption that all budgets and their proposals will be passed into law. All figures are percentages, unless except otherwise indicate. Numbers within parentheses indicates Quebec's rank, from best (1) to worst.

[a] Non-manufacturing & processing (non-M&P) rate.

[b] Tax holidays are available to certain corporations.

[c] Combined federal-provincial tax rates.

[d] The rate for investment income applies only to non-M&P income.

[e] The federal capital tax, also known as the Large Corporations Tax (LCT), applies at a rate of 0.2 percent and the exemption amount is $50 million. The rate decreased to 0.175% on January 1, 2005.

[f] The LCT applies at a rate of 0.175% (as of January 1, 2005) to financial institutions and insurance companies. The Part VI Financial Institutions Capital Tax applies to financial institutions and life insurance companies at rates of 1% or 1.25% depending on the amount of capital. The exemption applies to financial institutions only and ranges from nil to $200 million. Capital tax rates shown for financial institutions are blended rates.

Sources: KPMG (2004), and Price WaterhouseCoopers (2004).

Quebec's aggregate effective tax rate on capital investment for medium- and large-sized corporations operating in the sectors listed in Table 4 is 30.2 percent. The rate is the fourth highest among the provinces. Ontario is the only populous province — and large economy — with a higher rate; Alberta and British Columbia are the other two populous provinces and both have lower rates, with Alberta by far the lowest.

It is interesting to note that although it has the lowest general corporate income tax rate, Quebec has a relatively high effective rate on capital. Quebec's rates vary by industry, ranging from a low of 26.2 percent in electrical power to a high of 35.3 percent in retail trade. Rates vary by asset type, as well, ranging from a low of 21.8 percent on land to 38 percent on inventories. Quebec's rates by industry or asset type usually are around the middle of the pack. In comparison, the aggregate U.S. effective tax rate on capital is near the very low end of provincial rates. Only New Brunswick, Newfoundland and Alberta have lower rates.

Table 4 also compares the rankings of provincial effective tax rates and private capital investment rates shown in Table 1. Quebec ranks last among provinces in private investment while it has the fourth highest tax rate. The rankings show a broadly consistent pattern where provinces with higher effective tax rates feature lower investment rates. The results are magnified by recent evidence that shows that Quebec's share of investment in North America has been declining since 1989.[13] Relative to most other provinces and to the U.S., Quebec's current effective tax rates do not make it an attractive jurisdiction to invest private capital.

Considering the Options

The overriding objective of the government of Quebec should be the adoption of growth-friendly economic policies to generate higher productivity and incomes and allow for repayment of the provincial debt. The benefits of repaying the debt will be two-fold. They will reduce the proportion of debt service in total government expenditures and increase the room for program spending. More importantly, they will enable sorely needed public infrastructure investments. At the same time, they will place Quebec in a far better position to deal with future increases in social spending required by an aging population and potential emigration of people of working age. What policy options are most suited to reap those benefits? Clearly not spending; what about tax relief?

Personal income tax cuts would yield a direct loss of revenue without a compensating effect on future economic performance. For a significant proportion of the population, such reductions would increase current consumption rather than savings. In addition, personal tax cuts now would mainly benefit baby-boomers while future generations would foot the bill. This would be unfair, as well as failing completely to address the challenges identified earlier.[14]

13 See Robson and Goldfarb (2004).

14 Fortin and Van Audenrode (2004) forcefully make this point.

Table 4: *Effective Tax Rates on Capital Investment for Medium- and Large-Sized Corporations, by Province, Industry, Asset Type and Country, 2004*

	British Columbia	Alberta	Saskatchewan	Manitoba	Ontario	Quebec	New Brunswick	Nova Scotia	Prince Edward Island	Newfoundland	United States
Forestry	26.8	22.9	36.7	34.9	32.0	29.3 (5)	27.9	30.0	30.5	24.5	22.7
Manufacturing	26.1	23.5	26.6	27.0	29.8	29.7 (9)	17.8	20.5	13.9	5.9	26.7
Construction	30.6	26.8	36.2	38.0	35.3	32.1 (7)	24.6	27.2	27.6	17.5	25.7
Transportation	27.3	22.2	37.1	35.4	33.1	28.5 (5)	27.1	29.1	32.0	23.8	24.4
Communications	24.2	20.8	33.7	31.8	29.1	27.0 (5)	25.6	27.5	27.6	22.5	15.7
Electrical Power	22.9	20.1	32.2	30.4	27.6	26.2 (6)	24.7	26.6	25.9	21.6	14.4
Wholesale Trade	33.8	29.4	40.9	41.3	38.4	34.5 (6)	32.3	34.9	32.8	26.3	27.8
Retail Trade	36.3	30.4	45.3	43.8	41.7	35.3 (4)	34.8	37.3	41.3	32.2	30.8
Services, Total	30.0	25.2	39.0	37.5	35.1	30.5 (5)	29.7	31.9	34.5	26.9	27.6
Buildings	21.6	20.3	27.7	28.7	25.3	26.2 (7)	21.6	23.6	18.7	16.6	19.0
Machinery & Equip.	29.9	22.0	33.9	31.1	36.4	28.7 (6)	14.9	17.6	25.8	6.6	36.3
Land	17.8	16.7	24.9	23.8	21.0	21.8 (7)	20.7	22.2	18.6	17.1	18.3
Inventory	35.0	33.1	41.7	42.0	38.0	38.0 (6)	37.9	40.4	34.6	31.5	18.7
Aggregate Rates Canada 31.7	29.0	24.2	37.2	35.3	32.8	30.2 (7)	23.8	27.9	26.1	20.1	25.8
Aggreg. Rate Rank[a]	6	3	10	9	8	7	2	5	4	1	
Investment Rank[b]	7	1	2	5	8	9	6	4	6	3	

Notes All figures are percentages. Numbers within parentheses indicates Quebec's rank, from best (1) to worst.

[a] Quebec's ranking of rates is against the other nine provinces. The U.S. is excluded from the ranking.

[b] Ranks private capital investment rates from Table 1.

Sources: International Tax Program, Institute for International Business, Joseph L. Rotman School of Management, University of Toronto, August-November 2004, and Chen and Mintz (2004).

To grow and meet the challenges, Quebec requires increased investment and saving, not consumption. As such, the government should not commit itself to further personal income tax cuts or increased tax expenditures at this time.

Instead, business tax relief would stimulate private capital expenditures, contribute to productivity and income growth and to the expansion of the corporate tax base and government revenue. To achieve these as quickly as possible, the government should focus on broad-based corporate tax rate cuts and on the complete elimination of the capital tax. It should also rethink and scale down tax incentives targeted to investments in remote regions and similar situations. In and of themselves, they are likely to be ineffective; one of the problems with the regions is that they are unable to attract or retain resources and grow because they lack infrastructure, among other things. In fact, most Quebec regions have been experiencing emigration, especially of young people.[15]

Targeted tax assistance should be replaced by broad-based rate cuts and perhaps supplemented with public infrastructure investments and accelerated tax depreciation. Added benefits of broad-based measures include predictability and lower taxpayer compliance costs and small potential reductions in Revenu Québec's administrative costs. Finally, granting broad-based business tax relief, while keeping personal income tax rates constant, will make the reinvestment of profits more fiscally appealing than distributions to shareholders, thus enhancing the overall impact of the relief.

Failure to act will have immediate and lasting consequences. While Quebec's general economic performance is comparable to other provinces, its investment performance is weakening relative to North America as a whole. For one thing, as other jurisdictions reduce business taxes, some tax base will be lost as a result of the emigration of existing businesses and decisions by others not to locate in the province. Effective tax rates on capital have been falling in other provinces, as well as in the U.S., and that trend will continue.

There will also be a loss of future government revenue because of the erosion of the business tax base due to financial base-shifting transactions and transfer pricing. As well, the rise in the value of the Canadian dollar has been hurting the competitiveness of Canadian businesses relative to those located in other jurisdictions. For all these reasons, Quebec must act now to implement tax and regulatory reforms that will enable its business sector to make durable gains in productivity and incomes — and increase the well-being of all Quebecers.

15 See Fortin (2004).

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