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The 2014 C.D. Howe Institute Business Tax Burden Ranking

by
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- Before a business decides to start up or expand operations in a given locality, it must take into account the total tax burden on the investment, and how it affects the potential return. Heavy tax burdens can drive away investment to other locales and with it, the associated economic benefits.
- Comparing tax burdens is thus important for businesses and the governments that seek to attract them. Yet there are gaps in the way Canadian governments measure the tax burden on business investment. They ignore provincial and municipal property taxes and land transfer taxes. In this study, we find this to be a large oversight: total business property and land transfer taxes represent about two-thirds of the total tax wedge on investment in Canada, mainly because of provincial and municipal property taxes.
- Using this more complete measure, we estimate the tax burdens of the largest cities in each province. We find that Saint John, Charlottetown, and Montreal have the highest total tax rates. Calgary and Saskatoon lead the pack with the most competitive all-inclusive taxes.

Many governments across Canada have made reducing the marginal effective tax rate (METR) on new business investment a policy priority. The METR, after all, can make or break a decision to invest since it measures the tax burden on each new dollar of investment. The federal government and many provinces have been reducing the taxes – such as corporate income, retail sales and capital taxes – they include in this key yardstick of the tax-related barrier to investment.

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However, the METR estimates cited by governments are incomplete because they exclude two types of capital taxes: (i) provincial and municipal business property taxes (BPTs); and (ii) land transfer taxes (LTTs). BPTs and LTTs are not only salient from the investor's perspective, they have an appreciable effect on the return an investment must yield to be economically viable. We estimate that BPTs and LTTs together represent about two-thirds of the total METR wedge on investment in Canada, a large share for governments to continue ignoring.

Comparing the largest city in each province, we find in this edition of our tax burden estimate that Saint John, Charlottetown, and Montreal have the highest overall tax burden, followed by Winnipeg and Halifax. On the other end of the spectrum, Calgary and Saskatoon lead the pack with the lowest overall METRs in Canada. The significant share of BPTs in the tax burden shows that governments should include provincial and municipal BPTs in their METR estimates. Doing so would showcase the large potential benefits of lower BPT rates for new investment.

Business Property Taxes in Canada

Most existing measures of the tax burden on investment include only federal and provincial corporate income taxes and, where they exist, provincial retail sales taxes. On top of these, we layer business property taxes and land transfer taxes, both at the provincial and municipal levels.

Land Transfer Taxes

Many Canadian provinces, and some Canadian cities, apply a land transfer tax (LTT), which is calculated as a percentage of the value of real estate when ownership is transferred. As a transaction tax, LTTs have the same effect on business investment decisions as retail sales taxes that make structure purchases more expensive. Like retail sales taxes on capital purchases, LTTs can apply multiple times during the life of a structure, resulting in a cascading effect. By contrast, the Harmonized Sales Tax avoids this problem through input tax credits, but there is no such input tax credit for LTT paid on business real estate.[1] (See Dachis 2012 and Dachis, Duranton and Turner 2008 for more details).

Provincial Business Property Taxes

Provincially controlled property taxes – on both residential and business properties – were historically used to finance local schools. Today, however, the fiscal role of a provincial BPT is the same whether provinces call it an education tax or – as in New Brunswick and Prince Edward Island – a provincial property tax.

Regardless of labels, the relationship between school spending and provincial BPT revenue is the same as the relationship between school spending and, for example, corporate income tax revenue. Regardless of its source, a marginal dollar of general revenue is spent on the optimal expenditure line from the government's perspective. While businesses may see a return in better services for paying higher provincial corporate income taxes, existing METR studies do not attempt to quantify any such return. We apply the same logic to conclude that provincial BPTs affect businesses in the same way. The fact that some provincially controlled BPTs are still collected by

1 This cascading could occur if, for example, a developer buys a vacant lot, constructs a building and then sells it to an end user. We do not estimate such cascading in our analysis, assuming instead that LTT applies once on the value of land and structures. We also assume that both municipal and provincial LTTs, like RSTs, are CIT-deductible only through capital cost allowance (CCA) deductions.

municipalities is irrelevant to their economic role. Even where municipalities transfer revenues directly to school boards, as in Ontario, the province controls total school board revenues independently of their property tax component.

Municipal Business Property Taxes

We also incorporate municipal BPTs in the METR. The level and mix of municipal services differ across cities, just as they do across provinces. For example, transit services or social assistance may be predominantly a municipal service in some provinces, but a provincial responsibility in others. Likewise, the distribution of services, revenue sources and intergovernmental grants between a province and its municipalities differs by province. For instance, municipalities in a province with a generous provincial grant system may be able to rely less on property taxes compared to municipalities in another province. METRs are more complete and comparable across jurisdictions when all relevant levels of government are included, which is the approach we have adopted for this series and encourage other METR analysts and governments to adopt.

With this edition, we reflected further upon how we should incorporate municipal taxes into the METR, recognizing particularly the need to compare the same jurisdiction over time. Traditionally, analysts have restricted METR analysis to the tax-related side of the investment decision, ignoring the value of government services to investors. While it would be ideal to quantify the benefit to businesses of all government services financed by taxation, and then incorporate the result into the METR to arrive at a net-of-benefits measure of fiscal competitiveness, such quantification would be extremely difficult. Hence, it is no surprise the METR has traditionally been strictly a tax-competitiveness indicator. No doubt there are benefits that businesses get from the municipal property taxes they pay, thus lowering their cost of investing in a city. In our previous edition, we attempted to roughly estimate service benefits at the municipal level. However, given the difficulty we encountered when doing this estimation, and given the absence of provincial and federal benefit estimates, we now treat municipalities identically to senior levels of government by using gross-of-benefit tax rates (see the online Appendix for details).

Provincial and Municipal Effective BPT Rates

Provincial and municipal BPTs have varying tax bases and assessment regimes that often make effective BPT rates different from their statutory counterparts. Although each provincial and municipal property tax system is unique, we have adopted a standardized, assessment-class-weighted method of calculating effective BPT rates for each jurisdiction (Tables 1 and 2). We analyse the property tax system for each province and the largest municipality in that province.[2] We include all property taxes, including business occupancy taxes (BOTs) regardless of whether the legal incidence is on the building owner or on the renter.[3]

2 For more details on the provincial property tax regimes in British Columbia, Alberta and Ontario, see Found and Tomlinson (2012) and Found (2013a); for details on Saskatchewan, see Reiter (2009); for details on Manitoba, see Henley and Young (2008). Information from other provinces is available in Kitchen and Slack (2012). We do not include the most recent provincial residential rates or total revenues provinces collected from property taxes, which Found, Dachis and Tomlinson (2013) calculate to be approximately $14 billion annually across Canada.

3 In contrast, a recent study by KPMG (2014) that examined tax burdens only included commercial property taxes paid by renters, such as business occupancy taxes, and did not include property taxes paid by building owners, which is a significant omission.

Table 1: Provincial Business Property and Land Transfer Tax Rates, 2014

Province	Provincial Business Property Tax Rate		Land Transfer Tax Rate
	statutory rate (as a percent of assessed value)	*effective rate (as a percent of market value)*	*top provincial (added municipal) marginal rate as a percent of arms-length transaction value*
British Columbia	0.611	0.611	2.0
Alberta	0.372	0.344	0.02
Saskatchewan	0.943	0.737	0.3
Manitoba	1.149	0.605	2.0
Ontario	1.174	1.007	2.0 (+Toronto: 2.0)
Quebec	0.239	0.218	1.5 (+Montreal: 0.5)
New Brunswick	2.040	1.888	0.5
Nova Scotia	0.314	0.301	0 (+Halifax: 1.5)
Prince Edward Island	1.500	1.500	1.0
Newfoundland and Labrador	No provincial property tax		0.4

Sources: Authors' interpretation and calculations from provincial documents for 2014 rates. See online **appendix** for details on our calculation of assessment-weighted statutory and effective provincial BPT rates.

British Columbia (Vancouver): British Columbia has a province-wide property tax with rates varying by property class. Since 2005, the province has adjusted the rates each year so that total revenues have increased by only the rate of inflation plus the tax revenues from new construction. In 2014, the assessment-weighted provincial average effective tax rate for businesses is 0.611 percent. Using the same business property classes, Vancouver has an effective average business rate of 0.995 percent. British Columbia imposes an LTT at a top marginal rate of 2 percent.

Alberta (Calgary): The province levies a province-wide property tax on residential and non-residential property. In 2014, we calculate the effective provincial BPT rate as 0.344 percent once we account for the

Table 2: Municipal Business Property Tax Rates, Largest Municipality in Province

Municipality	Municipal Business Property Tax Rate	
	statutory rate (as a percent of assessed value)	*effective rate (as a percent of market value)*
Vancouver, British Columbia	0.995	0.995
Calgary, Alberta*	1.363	1.363
Saskatoon, Saskatchewan	0.799	0.605
Winnipeg, Manitoba*	3.102	2.035
Toronto, Ontario	1.559	1.285
Montreal, Quebec	3.771	3.320
Saint John, New Brunswick	2.678	2.678
Halifax, Nova Scotia	3.088	2.962
Charlottetown, Prince Edward Island	2.360	2.360
St. John's, Newfoundland	2.620	2.368

Note: * Local school boards in Manitoba levy supplemental property taxes, which we do not include in our provincial tax burden estimates, but estimate for Winnipeg-area school boards and include them in the municipal tax. We include business occupancy taxes in our calculation of statutory tax rates for Calgary and Winnipeg. See online Appendix for details on our calculation of assessment-weighted effective municipal BPT rates.

Sources: Authors' interpretation and calculations from municipal documents for 2014 rates.

1.5-year lag between market and equalized assessed values.[4] Calgary levies both a BPT and business occupancy tax (BOT), which is similar to a BPT but is levied directly on the occupants of business premises. The City of Calgary is phasing out its BOT and shifting the corresponding revenue to its BPT. Based on the city's website, BOT

4 The provincial government has started setting property tax rates as required to finance 32 percent of school spending. Thus, school spending determines property tax revenue rather than the other way around. Also, due to the continued unavailability of appropriate assessment data at the provincial level, we continue with our practice of applying Ontario's split of total assessment growth between new construction and appreciation to impute an estimated annual appreciation rate for Alberta to account for the lag between equalized assessment and market value of property engendered by its provincial property tax system. For 2014, the statutory provincial BPT rate is determined by dividing the province's 2014 revenue requisition by 2013 provincial equalized assessment which has a valuation date of July 1, 2012, hence the 1.5-year assessment lag.

revenue is currently 27.5 percent of BPT revenue. We use this fact to calculate a BPT rate equivalent of the BOT and form a single effective BPT rate of 1.363 percent for Calgary. Alberta levies a land title transfer fee, similar to an LTT, with a negligible rate of 0.02 percent that we do not include in our analysis.

Saskatchewan (Saskatoon): The province levies a property tax with tax rates varying by property class. In 2014, the assessment-weighted statutory provincial BPT rate is 0.943 percent. However, because of its assessment regime, the assessment-weighted effective BPT rate is 0.737 once we factor in the three-year assessment lag. Saskatoon manages its own assessment regime independently of the province, but with the same assessment lag, and has an effective BPT rate of 0.605 percent. Saskatchewan levies a land title transfer fee, similar to an LTT, with a rate of 0.3 percent.

Manitoba (Winnipeg): The statutory provincial BPT rate for 2014 is 1.149 percent, which under Manitoba's assessment regime results in an effective rate of 0.605 percent. In Winnipeg, local school boards levy BPTs, which we layer on top of Winnipeg's BPT and BOT regimes. Based on the City's 2014 budget, the current 5.700 percent BOT rate will raise $59.7 million. We divide this revenue by total assessment for the "Other Business" class obtained from the city to arrive at a statutory assessment-weighted BPT rate equivalent of 0.385 percent for all business.[5] Combining this with Winnipeg's 2014 statutory municipal and local education BPT rates of 1.337 percent and 1.380 percent, respectively, yields a total assessment-weighted statutory BPT rate of 3.102 percent. Factoring in assessment discounting and the two-year assessment lag for 2014, we calculate the corresponding effective BPT rate to be 2.035 percent. Manitoba imposes an LTT at a top marginal rate of 2 percent.

Ontario (Toronto): In 2014, the municipality-weighted average statutory provincial BPT rate on new investment is 1.174 percent compared to an effective rate of 1.007 percent once we account for Ontario's four-year phase-in of assessed values. This differs from the provincial BPT rate levied on structures initiated prior to the 2007 Ontario Budget, which does not affect new major investment and differs across the province by municipality as a legacy of the era when school boards levied property taxes directly. Accounting for the same four-year phase-in of assessed values, Toronto's 2014 effective BPT rate is 1.285 percent. Business investment in Toronto faces the highest combined top marginal municipal and provincial LTT rate in Canada, at 4 percent, equally split between the two levels of government.

Quebec (Montreal): Quebec's statutory BPT rate for 2014 is 0.239 percent, which on an effective basis becomes 0.218 percent once we account for Quebec's three-year phase-in of assessed values.[6] To facilitate this calculation, based on assessment data obtained from the province, we impute an average annual business property appreciation rate of 3.19 percent. Among Montreal's many boroughs, we focus on the Borough of Ville Marie, the location of Montreal's central business district, which has an effective BPT rate of 3.320 percent once we account for the three-year phase-in of assessed values using 2013-2014 appreciation data from the city's budget. Quebec requires municipalities to collect LTT, with a top marginal rate of 1.5 percent, but Montreal has an additional LTT that brings the top marginal rate there to 2 percent.

5 We assume pipelines and railways are not contained in the BOT base.

6 While each school board in the province levies its own property tax, this ability is heavily constrained by the province. As such, we label this a provincial tax.

New Brunswick (Saint John): At time of our writing in September 2014, New Brunswick had announced a future reduction in the provincial BPT rate, which means that the 2014 effective rate of 1.888 percent is lower than the statutory rate of 2.040 percent because investors today know that their future tax rates will be lower.[7] Saint John has an effective BPT rate of 2.678 percent. New Brunswick levies a flat-rate LTT of 0.5 percent.

Nova Scotia (Halifax): The province of Nova Scotia requires each municipality to collect tax revenue based on that municipality's share of the provincial assessment. To meet the provincial mandate, cities collect the provincial BPT with a total statutory rate of 0.314 percent in 2014. With an assessment lag of two years, this translates into an effective rate of 0.301 percent given our deemed appreciation rate.[8] The Halifax Regional Municipality collects a variety of its own general and supplementary taxes, which we combine into an effective BPT rate of 2.962 percent after accounting for the two-year assessment lag. Many municipalities in Nova Scotia impose LTTs of varying rates with Halifax tied for the top rate at 1.5 percent.

Prince Edward Island (Charlottetown): Prince Edward Island levies a statutory 1.5 percent BPT, which is also the effective rate based on its assessment regime. Charlottetown's municipal business statutory and effective BPT rates are also the same at 2.360. Prince Edward Island levies a top marginal LTT of 1 percent.

Newfoundland and Labrador (St. John's): The province does not levy a provincial property tax. St. John's levies a BPT with an effective rate of 2.289 percent.[9] Newfoundland and Labrador levies a flat-rate LTT of 0.4 percent.

The METR Effect of Business Property and Land Transfer Taxes

The METR is a measure of the effective tax burden on new corporate investment for a taxable investor. When a business is deciding whether to invest in new a plant or equipment, for example, it must estimate the METR on each dollar invested, which reduces the expected return on investment and its attractiveness. The METR measures the percentage increase in the rate of return an investor would need to cover the cost of taxes. For example, if the prevailing acceptable after-tax rate of return on investment is 4 percent, and if investors in a specific city need a before-tax rate of return of 6 percent in order to pay their taxes and leave their shareholders with the acceptable after-tax return, the METR would be 50 percent.[10] As Canadian provinces are small in the

7 See Found (2013a) for the formula used to transform the statutory rate into an effective rate. In this edition of our analysis, and in order to be consistent with our calculations with other provinces that directly include an assessment fee on taxpayers, we include a provincial fee that the province imposes for assessments services, which we did not know of when we completed our previous edition.

8 Like in our previous edition, having been unable to obtain full assessment data for Nova Scotia, we have deemed province-wide and Halifax business property appreciation to be equal to that cited for residential property in the Halifax budget.

9 Having obtained the total annual business assessment over 2010-2014 from municipal budgets, we apply St. John's assessment regime to estimate real assessment growth during non-reassessment years and total assessment growth during reassessment years. We find the difference between these estimates to impute the estimated appreciation rate. The effective rate is based on the 2014 assessment lag of three years and on our 3.43 percent imputed annual business property appreciation rate.

10 We use the net-of-tax rate of return as the baseline in calculating the METRs. In our example, we therefore calculate the METR as (6-4)/4 = 50 percent.

worldwide market for capital, a higher cost of investing in a Canadian province compared to a lower cost of investing elsewhere will likely cause the province's stock of capital to be smaller at each point in time.[11]

We quantify the extent of this tax wedge for all Canadian provinces, as well as the largest city in each, focusing on the following taxes: federal and provincial corporate income tax (CIT), retail sales tax (RST), municipal and provincial LTTs, provincial BPT and municipal BPT.[12] The METR excludes taxes not directly related to capital investment costs.[13] But tax breaks such as investment tax credits (ITCs) and capital cost allowance (CCA) deductions from corporate income do directly impact investment decisions, so we include them. Working with the general modelling framework applied in Found (2013a), our METR reflects the tax wedge on a hypothetical investment that would have the same value regardless of the municipality in which it is located.

The Results

Traditional METR estimates comparing provinces, such as those presented by the Federal Department of Finance (most recently in the 2012 federal budget), imply that investors in Saint John, New Brunswick, for example, would face the lowest METR among the 10 cities we consider. Our results are not consistent with this claim, primarily because we take property taxes into account. Indeed, our results indicate that investors in Saint John would actually face the highest METR among our 10 cities.[14]

We find as well that Charlottetown, Halifax, Montreal and Winnipeg have METRs well above the 10-city average, whereas METRs in Saskatoon and Calgary are lowest in the group. Toronto and Vancouver are in the middle of the pack, with Toronto above the 10-city average and Vancouver below. St. John's is right at the 10-city average. (See Figure 1, which for each city shows overall METRs and METR contributions of individual taxes.)

So far as RSTs and LTTs are concerned, METR contributions of RSTs exceed METR contributions of LTTs. The highest RST contribution is in Manitoba, where the RST impact on Winnipeg's METR is 11.1 percentage points. Manitoba now has the highest RST rate among provinces that still have not harmonized sales taxes – having increased its rate from 7 to 8 percent in 2013. The highest LTT impact on the METR is in Toronto: 4.2 percentage points (combined provincial / municipal impact).

Looking only at provincial and federal taxes (i.e., with municipal taxes excluded but provincial BPTs and LTTs still in) New Brunswick, Nova Scotia, Manitoba and British Columbia have the highest METRs. In all these provinces, provincial business property taxes are among the major tax costs imposed on new investment.

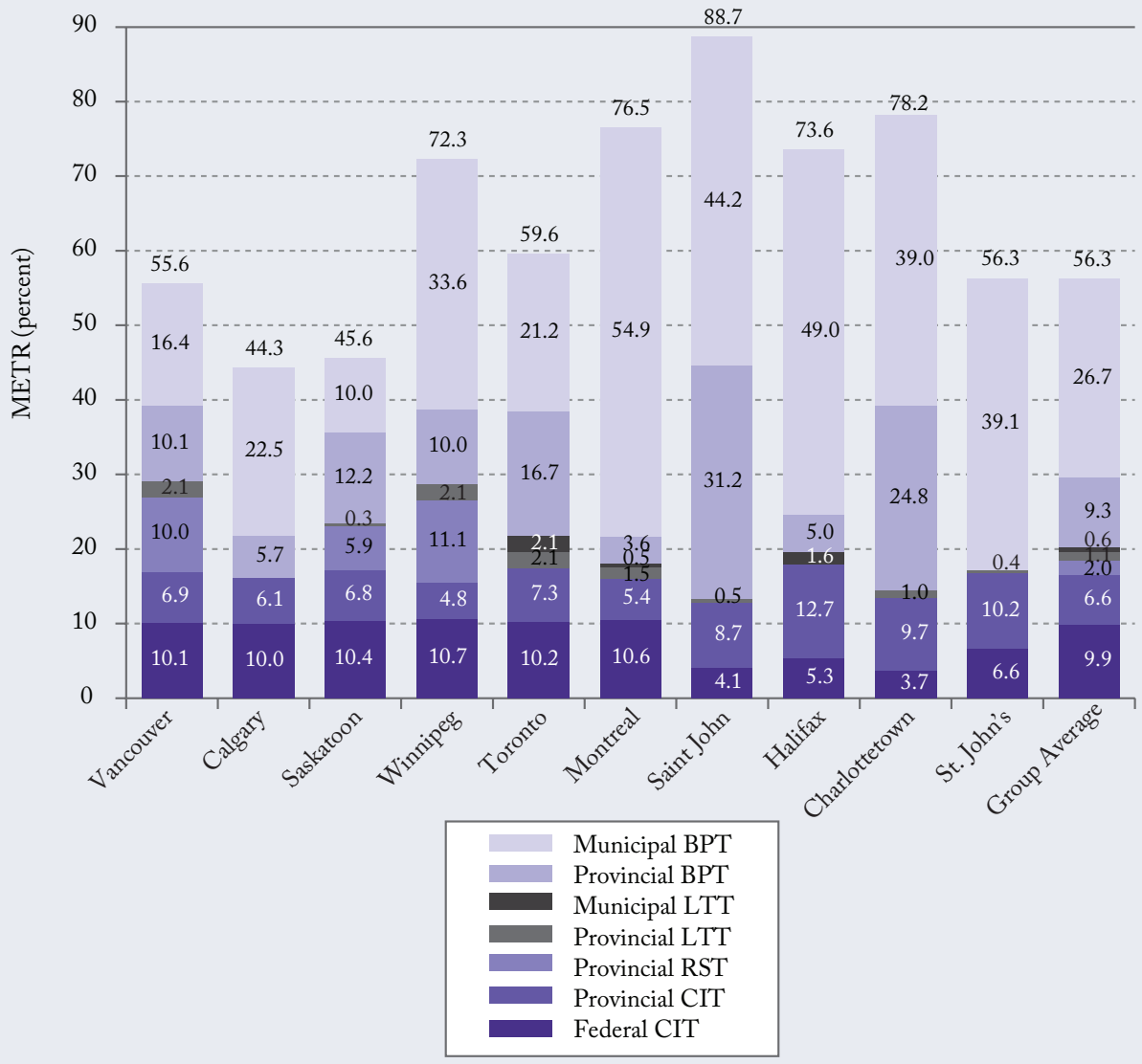
11 For a discussion that shows how investors respond to higher business property taxes through lower investment, see Found (2013b). That study finds that, relative to a city that had no business property taxes, the average commercial property tax burden in Ontario municipalities increases the marginal cost of structure capital by 26-46 percent and depresses the commercial tax base by 59-66 percent.

12 Unless provinces have announced future years' rates in advance – as, for example, New Brunswick has done for 2014 onward – we assume that the current effective rate will hold constant in future years.

13 For example, general payroll taxes, pension contributions, Employment Insurance premiums and municipal user fees do not directly affect capital investment costs.

14 Apart from exclusion or inclusion of property taxes, other differences between our model inputs and federal model inputs would affect METR estimates only to a minor degree. The 2012 federal budget's METR estimates were projections to 2014, but would differ from actual 2014 results had they appeared in the 2014 budget. For example, the 2012 projections did not take PEI's subsequent HST adoption into account.

Figure 1: Composition of 2014 METR on Capital Investment for Largest Municipality in Each Province



Source: See online **Appendix.**

Recommendations

Our first recommendation is for the Federal Department of Finance – which provides the provinces with METR estimates – to include BPTs in its interprovincial comparison of METRs.[15] Once governments better understand the effect BPTs are having on the cost of investing in their province, it will become clear that they should act to reduce the burden that these taxes impose. To the extent possible, governments should also include municipal business taxes in METR comparisons, on domestic and international bases.

To facilitate inclusion of BPTs in METR estimates, provincial governments should make data needed to determine effective BPT rates readily and freely available, both for provincial and municipal property taxes. Also, as we have argued (Found, Dachis and Tomlinson 2013), provinces should not call their BPTs education taxes because in no province does provincial property tax revenue determine school spending.

Further, provinces and municipalities should reduce investor uncertainty by announcing a time-path of tax rates for future years. At this point, most provinces and municipal governments announce BPT rates for a given year only when that year has commenced, having waited for new assessment numbers and a determination of revenue requirements.

Conclusion

Despite years of concerted provincial and federal efforts to reduce the tax cost of investment – by lowering corporate income, capital, and retail sales taxes – Canadian governments need to address a gap in their METR monitoring. A major tax on business – the business property tax – has been missing from prevailing tax-burden estimates. It is time that governments include these taxes in their METR measures, which will prompt a closer examination of their potential detrimental impact on business investment.

15 This may also require Statistics Canada to allocate more resources to collecting property tax data than it currently does.

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