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FISCAL AND TAX POLICY

Business Tax Burdens in Canada's Major Cities: The 2016 Report Card

by
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- Before a business decides to locate or expand in a given jurisdiction, it must consider the total expected tax burden the prospective investment will face. Heavy business tax burdens reduce potential returns, driving investment away to other jurisdictions and, with it, the associated economic benefits. Interjurisdictional comparisons of tax burdens are thus important for businesses and the governments that seek to attract and retain them.
- Yet there are gaps in the way Canadian governments measure the overall tax burden on business investment, primarily because they ignore business property taxes and land transfer taxes. As in previous editions in this series, we find this to be a large oversight: business property taxes and land transfer taxes still represent about two-thirds of the total tax wedge on investment in Canada.
- Bringing these taxes into the mix, we estimate the burdens of various business taxes for the largest city in each province, taking into consideration federal, provincial and local tax regimes. We again find the overall highest tax burdens to be in Saint John, Charlottetown and Montreal. As for the most competitive overall business tax environments, Saskatoon and Calgary still lead the way, but Calgary increasingly lags behind Saskatoon as Alberta's business tax environment deteriorates.

Many governments across Canada have made it a policy priority to reduce the marginal effective tax rate (METR) on new business investment. The METR, after all, can make or break a decision to

The authors thank Benjamin Dachis and reviewers of this and previous editions of this series. Any remaining errors are our own. As this is an update of our 2015 edition, we have repeated some text from that edition that did not require updating.

invest, since it measures the tax burden on each new dollar of investment.[1] Provincial capital markets are small relative to the worldwide market, so if the cost of investing in a particular Canadian jurisdiction is higher than the cost of investing elsewhere, that jurisdiction's stock of capital will be smaller than it otherwise would be.[2]

In this E-Brief, we build on our 2013–15 work by quantifying the 2016 METR for the largest city in each province, focusing on corporate income taxes, retail sales taxes, land transfer taxes and business property taxes. As with similar analyses, our calculation of the METR excludes taxes not directly related to capital investment costs.[3] Working with the general modelling framework developed in Found (2014a), our METR reflects the tax burden on a hypothetical investment that has the same pre-tax value regardless of where in Canada it is located.

The federal government and many provinces have reduced business taxes – such as those on corporate income, retail sales and machinery and equipment – included in their METR estimates. However, these estimates are incomplete because they exclude business property taxes and land transfer taxes, which are not only salient to investors but also have an appreciable effect on the gross-of-tax return an investment must yield to be economically viable. As in earlier editions in this series, we find that business property taxes and land transfer taxes represent about two-thirds of the total METR on corporate investment in Canada, a share much too large for governments to continue ignoring.

Having examined the largest municipality in each province, we find that Saint John and Charlottetown have the highest overall tax burdens in 2016, followed by Montreal, Halifax and Winnipeg. At the other end of the spectrum, given Alberta's corporate income tax rate increase in 2015 and repeated increases in the provincial business property tax burden, second-place Calgary now lags further behind first-place Saskatoon. Vancouver, Toronto and St. John's remain in the vicinity of the national average. As in previous editions, our results demonstrate the potential investment benefits of reducing the burden of business taxation, especially business property taxation.

Unfortunately, many governments have business property tax regimes that are complex and opaque, making them difficult for investors and other taxpayers to understand. This edition represents the second time we have included a report card that evaluates business property tax regimes in respect of simplicity and transparency, given the relative importance of business property taxes in the METR.

1 The METR measures the percentage increase in the rate of return an investor needs 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 to pay their taxes and leave shareholders with the acceptable after-tax return, the METR, using the net-of-tax rate as the baseline, would be 50 percent – that is, (6 – 4) / 4.

2 For a discussion of how investors respond to higher business property taxes through, for example, lower investment, see Found (2014b), who finds that, relative to a city with no such tax, the average commercial property tax burden in Ontario municipalities increases the marginal cost of structure capital by between 26 and 46 percent and depresses the commercial tax base by between 59 and 66 percent.

3 For example, general payroll taxes, pension contributions, employment insurance premiums and municipal user fees do not directly affect capital investment costs. However, we include tax breaks such as investment tax credits and capital cost allowance deductions from corporate income, since they form part of the corporate taxation system and thus directly affect investment decisions.

Business Property and Land Transfer Taxes

The level and mix of public services differ across provinces and, by extension, their municipalities. For example, transit or social assistance might 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. Municipalities in a province with a generous provincial grant system, for instance, might rely less on property taxes than do municipalities in another province. METRs are more complete and comparable across jurisdictions when they include all relevant levels of government. This is the approach we have adopted for this series, and one we continue to encourage governments and other METR analysts to adopt.

Typically, governments structure their business property tax regimes such that effective tax rates differ from their statutory counterparts.[4] Although each provincial and local property tax system is unique, we have developed a standardized methodology to transform statutory business property tax rates into estimated effective rates (Tables 1 and 2).[5] Depending on the availability and quality of relevant data, however, we need to support our methodology with certain assumptions on a case-by-case basis, as detailed in the online appendix and/or in our previous editions. Given the time series presentation of our results, we continue to restate historical METRs to account for updated data and methodologies relevant to bringing business property taxes into the METR.[6]

We continue to include business occupancy taxes in the METR as a component of business property taxes, as they are simply a variant of business property taxation. The negative investment effect of a business occupancy tax is equivalent to that of a business property tax; whether the legal incidence falls on property owners or on tenants

4 The difference between the statutory and the effective tax rate is illustrated by the following example. Suppose an investor owns real property that willing buyers would pay $100 million to purchase. Due to lagged assessment, the property is assessed at $80 million. The statutory tax rate – the rate applied to the property's assessed value – is 2 percent, resulting in a tax burden of $1.6 million per year. However, the effective tax rate – the tax as a percentage of the current value of the property – is only 1.6 percent ($1.6 million divided by $100 million).

5 As is done to calculate national average METRs, national average tax rates are calculated by weighting individual rates by corresponding provincial capital stock shares. For this edition, we considered reflecting Toronto's Imagination, Manufacturing, Innovation and Technology (IMIT) Financial Incentive Program in the METR analysis. Introduced in 2008, the program provides municipal property tax relief for eligible development, redevelopment or major renovation of business property in sectors such as office, information technology, manufacturing, biomedical, creative industry and food processing (Toronto 2016). The relief is provided in the form of tax increment equivalent grants (TIEGs), which are structured such that the incremental municipal business property tax liability associated with the eligible investment is phased in over the first decade following the time of investment. We estimate that a business property investment eligible for this program would face a METR of about 5.4 percentage points lower than that shown in Figure 2 for Toronto. Unfortunately, however, we do not yet have sufficient data to estimate the actual share of total business property investment in Toronto that receives tax relief under the IMIT program. Until such time, we leave Toronto's IMIT program out of the METR analysis.

6 For 2016, one methodological update is worth noting. We now account for the difference between market and assessed value for non-residential property in Calgary. Previously, we had assumed the local assessment regime in Calgary resulted in property assessments not appreciably different than their market value counterparts as determined by Alberta's equalized assessment regime. Upon closer inspection of Calgary's assessment regime, however, we have concluded that the assessed-to-market value difference is sufficient to warrant reflection in our METR calculations.

Table 1: Statutory Business Property and Land Transfer Tax Rates – 2016						
	Business Property Tax			Land Transfer Tax		
Municipality	Provincial	Municipal	Total	Provincial	Municipal	Total
			Percent			
Vancouver	0.544	0.838	1.382	3.000		3.000
Calgary	0.378	1.399	1.777			
Saskatoon	0.828	0.872	1.700	0.300		0.300
Winnipeg	1.089	3.218	4.307			
Toronto	1.180	1.416	2.596	1.500	1.000	2.500
Montreal		3.775	3.775	1.500	1.000	2.500
Saint John	2.205	2.678	4.883	1.000		1.000
Halifax	0.336	2.967	3.303		1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000		1.000
St. John's		2.520	2.520	0.400		0.400
National Average	**0.602**	**1.764**	**2.366**	**0.985**	**0.399**	**1.384**

Source: Authors' calculations from government websites.

Table 2: Effective Business Property and Land Transfer Tax Rates – 2016						
	Business Property Tax			Land Transfer Tax		
Municipality	Provincial	Municipal	Total	Provincial	Municipal	Total
			Percent			
Vancouver	0.544	0.838	1.382	3.000		3.000
Calgary	0.387	1.347	1.734			
Saskatoon	0.452	0.556	1.008	0.300		0.300
Winnipeg	0.635	1.881	2.516			
Toronto	0.972	1.166	2.138	1.500	1.000	2.500
Montreal		3.324	3.324	1.500	1.000	2.500
Saint John	2.205	2.678	4.883	1.000		1.000
Halifax	0.308	2.721	3.029		1.500	1.500
Charlottetown	1.500	2.360	3.860	1.000		1.000
St. John's		2.368	2.368	0.400		0.400
National Average	**0.517**	**1.554**	**2.070**	**0.985**	**0.399**	**1.384**

Source: Authors' calculations from government websites.

Table 3: Business Property Tax Report Card Summary – 2016

Province	Provincial BPT Regime		Municipal BPT Regime		Overall Grade
	Simplicity	Transparency	Simplicity	Transparency	
British Columbia	B	A	B	A	A
Alberta	B	D	C	B	C
Saskatchewan	C	D	C	B	C
Manitoba	C	D	F	C	D
Ontario	F	F	C	B	D
Quebec	D	D	D	B	D
New Brunswick	B	A	A	A	A
Nova Scotia	C	F	D	B	C
Prince Edward Island	A	A	A	B	A
Newfoundland and Labrador	-	-	B	B	B
National Average	**C**	**D**	**C**	**B**	**C**

Source: Authors' assessments.

is irrelevant. By contrast, we continue to exclude business improvement area levies from the analysis, since spending financed by such levies is allocated not by governments, but by boards directly accountable to member businesses.

Many provinces and municipalities levy a land transfer tax, which appropriates a percentage of the value of real estate (land and buildings) when property changes ownership (see Table 1 and Table 2 for rates).[7] As a transaction tax, a land transfer tax's impact on business investment decisions is similar to that of a retail sales tax. As in previous editions, we have modelled land transfer taxes as applied to an intercorporate property transaction. Like a retail sales tax on capital purchases, a land transfer tax can apply multiple times during the

7 Alberta levies a land transfer tax rate of 0.02 percent, which we continue to treat as negligible and therefore omit from the analysis. We have updated the analysis to reflect 2016 increases in the highest marginal rate in British Columbia (from 2 to 3 percent) and New Brunswick (from 0.5 to 1 percent). We have also corrected rates we had been using in error in previous editions for the following jurisdictions: Manitoba (from 2 to 0 percent given the retail sales tax-related refund), Ontario (from 2 to 1.5 percent given the top tax bracket applies to residential property only), Toronto (from 2 to 1 percent) and Montreal (from 0.5 to 1.0 percent). Furthermore, we exclude from the analysis British Columbia's new 15 percent land transfer surtax on foreign purchases of property in Metro Vancouver (formerly the Greater Vancouver Regional District) as it applies to residential property only.

life of a property, resulting in a cascading effect.[8] By contrast, a harmonized sales tax avoids this problem through input tax credits, but in none of our jurisdictions is there such a credit for the land transfer tax.

Business Property Tax Report Card: The Ease of Estimating Effective Tax Rates

In our previous edition, we introduced a Business Property Tax Report Card to assess the ease with which investors can determine the effective business property tax rates they face on a given investment in real property in a particular jurisdiction (see Table 3). This determination can be easy – or almost impossible – depending on (i) structural features of jurisdictions' assessment and tax policies; and (ii) information that jurisdictions make available.

We rate structural features based on their simplicity. Ideally, property assessments would be based on a market valuation date no more than a year before January 1 of the current taxation year, while a uniform tax rate would apply to all business property. In this ideal state, the jurisdiction would levy just one effective tax rate, and this is the rate that would be shown on tax bills. Typically, however, provincial governments introduce elements of complexity – such as multiple business classes with differential tax rates, discounts applying to specified assessment categories and valuation dates several years back in time – needlessly undermining simplicity.

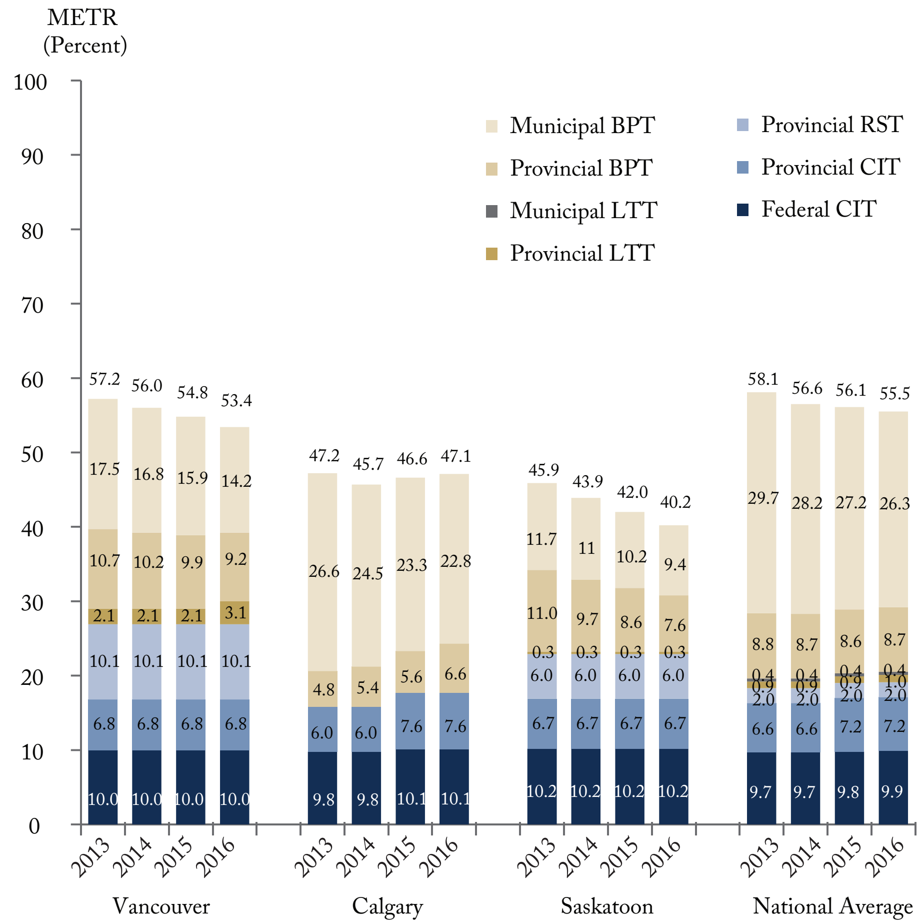
As for the information governments make available, we rate it based on transparency. If relevant information is difficult to find on websites or if it is presented in obscure terms, investors will have difficulty estimating effective tax rates – even in jurisdictions with relatively simple assessment and tax policies. Conversely, if a government makes information easy to find online, and if it includes as much information as possible relevant to an effective tax rate estimation, then it can mitigate the effect of even complex structural features. Unfortunately, however, provincial governments – along with the assessment agencies and municipalities they control – often place a cloak of secrecy over information needed to estimate effective business property tax rates, needlessly undermining transparency.

As stated in our previous edition, the report card evaluates provincial performance only, even though it has separate provincial and municipal sections of assessment. The two sections apply to the provincial and municipal components of the business property tax regime, both of which are controllable by provincial governments. It would be difficult to rank municipalities in different provinces equitably, given the different constraints imposed by their provincial governments.

Using the methodology we developed in 2015, we evaluate simplicity and transparency separately by assigning numerical scores based on a qualitative assessment of the provincial-municipal business property tax regime, and then translate these scores into letter grades. With the exception of Alberta, our qualitative assessments remain as they were for 2015, so we do not repeat them in this edition. Having re-examined Alberta's business property tax regime, however, we have updated our assessment to better reflect the complexity and opaqueness associated with the taxation of the linear (e.g., pipelines, electricity transmission lines etc.), railway, and

8 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 a land transfer tax applies once on the value of land and structures. Moreover, land transfer taxes, like retail sales taxes, form part of the initial cost of capital, so they are deductible from corporate income tax only through capital cost allowance deductions for capital depreciation over time. For more details on land transfer taxes, see Dachis (2012) and Dachis, Duranton, and Turner (2008).

Figure 1: Composition of 2013 to 2016 METR on Capital Investment for Largest Municipality – Western Provinces



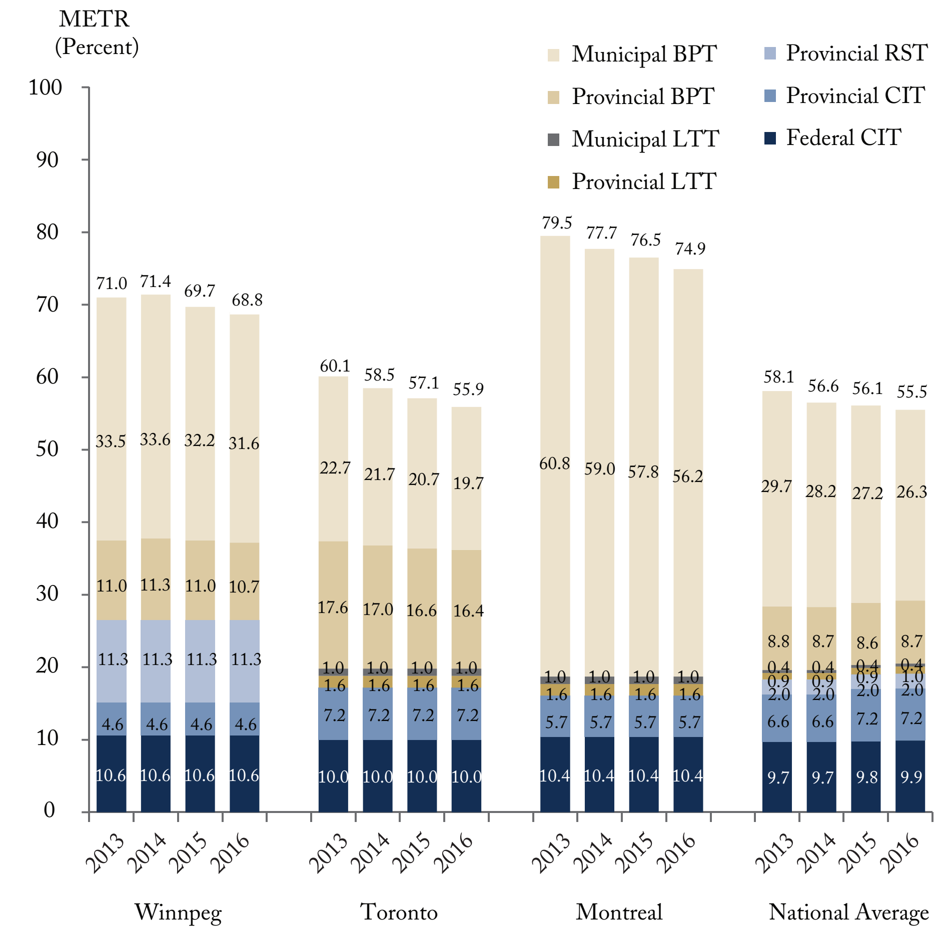
Source: See online appendix.

machinery and equipment property classes in Alberta. The overall assessment of a province is the simple average across the four simplicity and transparency scores, whereas national scores are weighted averages with provincial capital stock shares applied as weights as done in Table 1 and Table 2.[9]

We evaluate each jurisdiction against the ideal that the effective business property tax rate applicable to a property investment is readily ascertainable from a government website. None of our 20 jurisdictions (10 provinces and the largest city in each province) currently meets this ideal. Our results suggest, moreover, that Canadian governments have much to improve upon in respect of simplicity and transparency of their business

9 Jurisdictions without a provincial or municipal business property tax, as the case may be, are excluded from the corresponding component of the report card and, by extension, from the calculation of average scores.

Figure 2: Composition of 2013 to 2016 METR on Capital Investment for Largest Municipality – Central Provinces



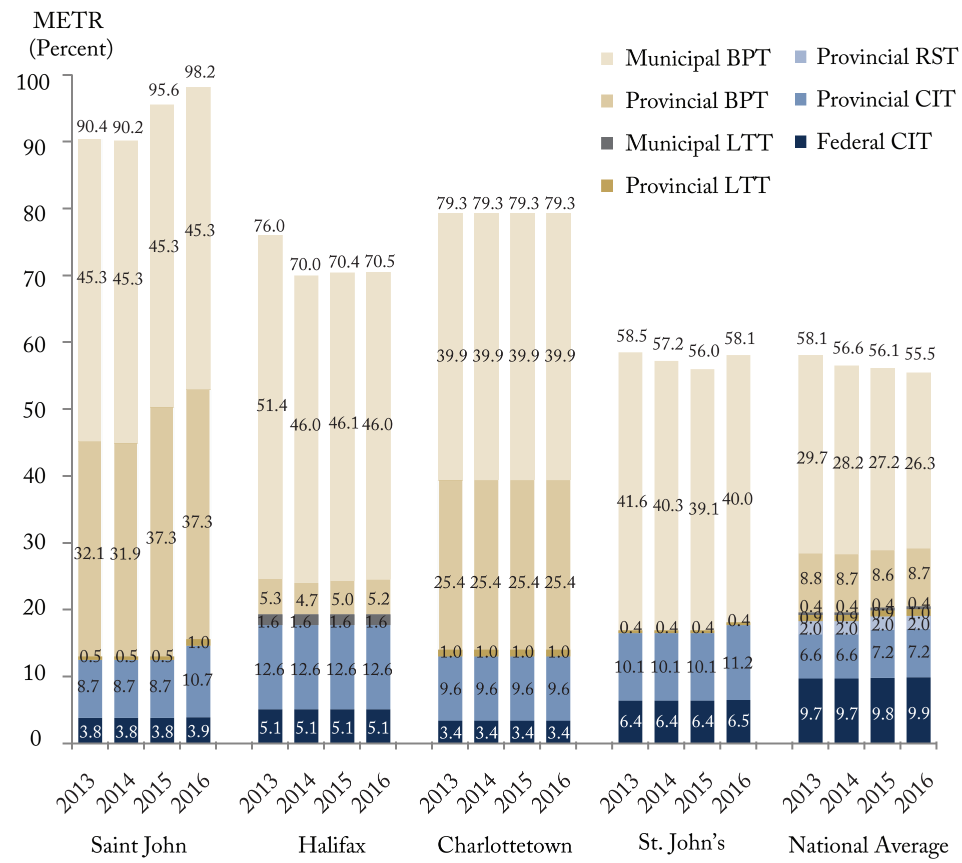
Source: See online appendix.

property tax systems (see Table 3). When simplicity and transparency are jointly considered, the top-scoring provinces are New Brunswick, Prince Edward Island and British Columbia, whereas Manitoba, Ontario and Quebec are the lowest performers.

The Effect of Business Property and Land Transfer Taxes on the METR

Traditional METR estimates, such as those presented by the federal Department of Finance, indicate that the four Atlantic provinces have the lowest METRs. By taking business property taxes into account, our results are inconsistent with this conclusion. We find that the largest cities in the Atlantic provinces, along with those in Quebec and Manitoba, have the highest tax burdens on investment. Calgary and Saskatoon have the lowest tax burdens, while Toronto and Vancouver are in the middle of the pack. (See Figures 1 through 3, which show overall METRs by municipality for the 2013–16 period, and the component contributions of individual taxes.)

Figure 3: Composition of 2013 to 2016 METR on Capital Investment for Largest Municipality – Atlantic Provinces



Source: See online appendix.

Looking only at provincial and federal taxes, the highest tax burdens are in New Brunswick, Nova Scotia, Manitoba and British Columbia. In all these provinces, provincial business property taxes are one of the leading barriers to new business investment. In British Columbia, Saskatchewan and Manitoba, retail sales taxes still represent a sizable burden, and in all provinces, federal and provincial corporate income taxes remain considerable barriers to new business investment.

Which provinces have done the most to reduce tax burdens since 2013? Through revenue-neutral approaches to provincial business property taxation, Ontario, British Columbia and Saskatchewan have shaved their METR contributions in Toronto, Vancouver and Saskatoon by 1.1, 1.5 and 3.4 points, respectively. In contrast, Newfoundland and Labrador's 2016 corporate income tax hike increased its portion of St. John's METR by 1.1 points. Alberta's 2015 corporate income tax hike and repeated increases in the provincial business property tax burden have increased its share of Calgary's METR by 4.2 points. Worse still, New Brunswick's 2015 cancellation of planned cuts to business property taxes combined with its 2016 hikes in corporate income and land transfer taxes have jumped its contribution to Saint John's METR by a whopping 7.8 points.

Turning to municipal taxes, Montreal continues to have the largest local METR (sitting at 57.2 percent including LTT), followed by the four Atlantic municipalities and Winnipeg. In Toronto and Vancouver, local business property tax burdens remain below that of the group average and even below that of Calgary. Saskatoon continues to showcase the most competitive business property (and overall) tax environment in our group and to improve upon its position as property appreciation outpaces municipal levy increases.

Which municipal governments have taken the lead in reducing local tax barriers to business investment? Since 2013, local METR contributions have dropped in Halifax (by 5.4 points), Montreal (4.6 points), Calgary (3.8 points), Vancouver (3.3 points), Toronto (3.0 points), Saskatoon (2.3 points) and Winnipeg (1.7 points). These improvements are largely the result of business property appreciation outpacing municipal levy increases on business property classes.

Recommendations

As the federal Department of Finance provides the provinces' METR estimates, our first recommendation is for the department to include business property taxes in these METRs.[10] Once governments better understand the effect of business property taxes on the cost of investing, they are more likely to act to reduce the burden these taxes impose. To facilitate the inclusion of business property taxes in METR estimates, provincial governments should simplify their property tax systems, and make the data needed to determine effective business property tax rates readily and freely available, for both provincial and local levels.

Also, as we have argued previously (Found, Dachis, and Tomlinson 2013, 2014, 2015), provinces should not call their provincial property taxes "education taxes," since that label is misleading. All provincial property taxes function as general revenue taxes, but only New Brunswick and Prince Edward Island label them appropriately. Governments elsewhere might hope the misleading education label will make taxpayers feel better about paying the tax; however, that objective, insofar as it is achieved, undermines accountability.

Conclusion

Despite years of concerted provincial and federal efforts to reduce the tax cost of business investment, Canadian governments need to address a gap in their METR monitoring. A major tax on business investment, the business property tax, has been missing from prevailing tax burden estimates. It is time that governments included this tax in their METR estimates, which would prompt a more balanced and informed examination of the level and mix of business taxation they impose.

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

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