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COMMENTARY

TAX COMPETITIVENESS PROGRAM

The Path to Prosperity:
Internationally Competitive Rates and a Level Playing Field

The 2009 Federal-Provincial Tax Competitiveness Report

Duanjie Chen
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In this issue...

Canadian governments took divergent approaches to tax policy in the 2009 budget season, one path leading to prosperity and the other to disappointment and diminished prospects.

The Study in Brief

While Canadian federal and provincial governments have made progress in reducing the tax burden on business investment in recent years, the 2009 budget season also saw more counterproductive tax policies that favour certain industries and disadvantage others. In this *Commentary*, the authors assess the implications of these trends for Canada's competitiveness as they update their annual survey of marginal effective tax rates in Canada and individual provinces.

The good news is that Canada's marginal effective tax rate on capital has fallen from 28.9 percent in 2008 to 28.0 percent in 2009. With the tax changes planned in the current and previous federal and provincial budgets for later years, the marginal effective tax rate will fall further, 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 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.

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